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# The Biggest Bankruptcy Decisions Of 2014: Midyear Report

By **Maria Chutchian**

Law360, New York (July 10, 2014, 7:22 PM ET) -- The year is half over and while commercial bankruptcy filings continue to decline, courts have kept the restructuring and insolvency community on its toes as they've churned out decisions that have left lasting imprints on jurisdiction, credit bidding and law firm liquidations.

Not all of the year's major decisions have come from bankruptcy courts. One was issued by New York's highest court, while another came from the U.S. Supreme Court. Each has played a role in shaping various aspects of bankruptcy law, even when they stem from otherwise small cases.

**Bankruptcy Judges Hold On to Powers in Executive Benefits**

When the Supreme Court ruled on June 9 that bankruptcy judges have the authority to tentatively rule on fraudulent transfer claims in Executive Benefits Insurance Agency v. Arkison, many felt the court **brushed aside** other pressing questions by electing not to issue a decision on the full scope of bankruptcy judges' power.

The case evolved from a fraudulent transfer claim that Peter Arkison, as Chapter 7 trustee for the Bellingham Insurance Agency Inc., brought against Executive Benefits Insurance Agency. A bankruptcy judge granted summary judgment in favor of Arkison, which EBIA appealed to a federal district court.

The district court upheld the bankruptcy judge's ruling, and EBIA appealed to the Ninth Circuit. The Ninth Circuit held that the bankruptcy court did not overstep its authority by awarding summary judgment to Arkison on the fraudulent transfer claim — a matter the Constitution says can only be decided by Article III courts — in part because EBIA had, by not objecting to a bankruptcy judge deciding the matter, implied that it had no problem with a non-Article III judge making the ruling. EBIA petitioned the Supreme Court to take up the matter last year.

The justices largely upheld the Ninth Circuit's finding, relying on their 2011 Stern v. Marshall ruling. The result is that bankruptcy judges have maintained their ability to rule on disputes that the Constitution says must be decided by Article III judges as long as those decisions are affirmed by a federal district judge, which will keep business running as usual. They did not, however, make a decision as to whether the parties can consent to having a bankruptcy judge make a final ruling on a so-called Stern claim.

"This makes sense on one level, because parties can't really consent to a court acting outside the Constitution. Reasonable people may and, in my experience, do, disagree with the Supreme Court on whether bankruptcy courts should have the authority to hear these claims in the first place," Ted Gavin of Gavin Solmonese LLC said.

Some professionals believe that if the court had ruled the other way, it would have had had a disastrous effect on the court system, as matters that have been traditionally handled by bankruptcy courts would start clogging up the federal district courts.

"I think what the decision really does is it stops the gridlock that we've experienced because jurisdiction was unclear. So whether a case is core or noncore, bankruptcy courts can have a bit more comfort that they can act. That is really good for the system," Barry Chatz of Arnstein & Lehr LLP said.

EBIA is represented by Douglas Hallward-Driemeier of Ropes & Gray LLP.

Bellingham's Chapter 7 trustee, Peter H. Arkison, is represented by John A.E. Pottow of the University of Michigan Law School.

The case is Executive Benefits Insurance Agency v. Peter H. Arkison, case number 12-1200, in the U.S. Supreme Court.

**Fisker, Free Lance-Star Throw Credit Bidding Up in the Air**

Judges in the Fisker Automotive Holdings Inc. and Free Lance-Star Publishing Co. bankruptcies issued decisions this year that came as unwelcome surprises to secured lenders by limiting the amount that could be credit bid in a bankruptcy sale.

At the very start of the year, U.S. Bankruptcy Judge Kevin Gross threw a curveball at Hybrid Tech Holdings LLC, which had been prepared to acquire Fisker out of bankruptcy in exchange for wiping out the $168.5 million that Fisker owed on a loan Hybrid purchased at a substantial discount from the federal government.

The judge, at the urging of the official committee of unsecured creditors, held that the privately planned sale was not fair to creditors and that a **competitive auction** had to be held instead. He also imposed a $25 million credit bid cap, which allowed China's Wanxiang Group Corp. to swoop in with a better offer.

The takeaway from that ruling has been that judges are concerned with transparency and a competitive process in bankruptcy sales, to the chagrin of hedge funds and other debt buyers who prefer to make deals outside of court before bringing them in for a quick prepackaged or prearranged bankruptcy. Though Judge Gross insisted that his ruling was limited to the facts of the Fisker case, restructuring professionals believe it will have a lasting impact on Chapter 11 sales.

"The Fisker decision is troubling for debt purchasers," Chatz said.

A few months later, U.S. Bankruptcy Judge Kevin Huennekens capped the credit bid for the sale of The Free Lance-Star Publishing Co. at $13.9 million instead of the full $38 million that secured creditor and interested buyer DSP Acquisition LLC was hoping for.

DSP ultimately prevailed at the auction, but the judge's decision in limiting credit bidding based partly on his finding that DSP engaged in inequitable conduct was still unsettling to debt buyers. The Bankruptcy Code allows credit bidding up to the full amount of a creditor's debt "unless the court for cause orders otherwise," but the Fisker and Free Lance-Star cases have thrown that once-certain right into question by applying a broad interpretation of what constitutes "cause."

"Free Lance-Star picked up the credit bidding football from Judge Gross in Fisker and carried it down the field. Recognizing that a secured lender that had acted solely in its own interests, and acted badly at that, should be limited in its right to credit bid is acting to

preserve the integrity of the process," Gavin said.

Fisker is represented by James H.M. Sprayregen, Anup Sathy and Ryan Preston Dahl of Kirkland & Ellis LLP and Laura Davis Jones, James E. O'Neill and Peter J. Keane of Pachulski Stang Ziehl & Jones LLP.

Fisker's committee is represented by Mark Minuti and Lucian B. Murley of Saul Ewing LLP and William R. Baldiga, Sunni P. Beville and Nicolas M. Dunn of Brown Rudnick LLP.

Wanxiang is represented by Andrew F. O'Neill, Bojan Guzina and John R. Box of Sidley Austin LLP and Edmon L. Morton of Young Conaway Stargatt & Taylor LLP.

The case is In re: Fisker Automotive Holdings Inc., case number 1:13-bk-13087, in the U.S. Bankruptcy Court for the District of Delaware.

Free Lance-Star is represented by Lynn L. Tavenner and Paula S. Beran of Tavenner & Beran PLC with Kaufman & Canoles PC serving as special corporate counsel.

DSP is represented by Dion Hayes of McGuireWoods LLP.

The case is In re: The Free Lance-Star Publishing Co. of Fredericksburg Va., case number 14-bk-30315, in the U.S. Bankruptcy Court for the Eastern District of Virginia.

**Unfinished-Business Litigation Gets Hammered in Thelen, Coudert and Heller Ehrman**

The New York Court of Appeals' **July 1 decision** in the Thelen LLP and Coudert Brothers LLP cases doesn't affect the bankruptcy world outside of law firm insolvencies, but for those in the legal industry who have been targeted by a defunct firm's bankruptcy trustee for unfinished-business claims, the ruling came as a giant sigh of relief.

The judges found that the estates of dissolved firms are not entitled to the hourly fees made by former partners at new firms from the dissolved firms' former client matters. Some attorneys believe the ruling will be the end of unfinished-business litigation brought by liquidating trustees and administrators of those defunct firms as they try to collect as much money as possible to distribute to creditors.

"A client can always replace its lawyer, and the new firm has no right to fees for services billed by the replacement firm, so why should there be a different rule where a firm goes bankrupt and the client has no choice but to go elsewhere?" Alan Halperin of Halperin Battaglia Raicht LLP said. "It simply made no sense that the debtor was able to reach into the new firm's pocket for fees it billed and earned. The client isn't property of the old firm."

The ruling was decided on a state level, but since so many of the country's biggest law firms are based in New York and the New York Partnership Law is based on the Uniform Partnership Act, as are many states' partnership laws, the decision is expected to change the game for law firm bankruptcies across the board.

In California, a federal judge issued a **similar ruling** less than a month earlier. In the Heller Ehrman LLP decision, U.S. District Judge Charles R. Breyer prohibited the firm's administrator from proceeding with its unfinished business litigation.

Both decisions found that firms have no property interest in the hourly matters pending at the time of its dissolution despite a California appeals court's 1984 ruling in Jewel v. Boxer, which trustees argued entitled dissolved law firms to a share of the profit stream for work performed on unfinished hourly rate cases.

With the two decisions, trustees and administrators of law firm liquidations will have a tough

time building up the estate by going after law firms who assumed their former attorneys and clients, a tactic that has become common in the past several years.

Thelen's trustee Yann Geron was represented by Howard P. Magaliff of Rich Michaelson Magaliff Moser LLP. Coudert's administrator Development Specialists Inc. was represented by David J. Adler of McCarter & English LLP.

Seyfarth Shaw LLP, which was sued by Geron, was represented by its own Michael R. Levinson. The firms sued by DSI were represented by Joel Miller of Miller & Wrubel PC.

The New York cases are Development Specialists Inc. v. K&L Gates et al., case number 2013-00010, and Yann Geron, as Chapter 7 Trustee of the Estate of Thelen LLP v. Seyfarth Shaw LLP, case number 2013-00009, both in the New York State Court of Appeals.

Heller Ehrman was represented by Diamond McCarthy LLP and Schnader Harrison Segal & Lewis LLP.

The California cases are Heller Ehrman LLP v. Davis Wright Tremaine LLP, case number 3:14-cv-01236; Heller Ehrman LLP v. Jones Day, case number 3:14-cv-01237; Heller Ehrman LLP v. Foley & Lardner LLP, case number 3:14-cv-01238; and Heller Ehrman LLP v. Orrick Herrington & Sutcliffe LLP, case number 3:14-cv-01239; all in the U.S. District Court for the Northern District of California.

--Editing by Katherine Rautenberg and Sarah Golin.