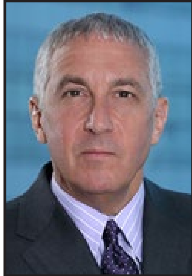
New Eleventh Circuit opinion may warrant a second look at Florida as a venue for chapter 11 bankruptcy filings

by Paul Steven Singerman, Paul A. Avron and Ilyse M. Homer



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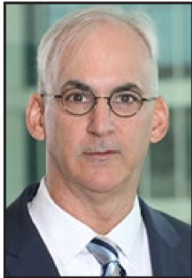

P. AVRON

I. HOMER

Once the threshold decision is made to file a corporate chapter 11 bankruptcy case, the second question is where that case should be filed. It is almost always the case that businesses have multiple options, i.e., the state of incorporation or the state in which their principal place of business is located, if different than the state of incorporation. When the venue analysis is being conducted, lawyers and other advisors should take into account the applicable law in circuits with respect to issues that may be material to the success of the case, including issuance of third-party releases and non-consensual releases, whether in a litigation or chapter 11 plan context. This may well be an important consideration for individuals who have guaranteed repayment to a corporate debtor's lenders, and possibly private equity sponsors concerned about the assertion of tort claims against them. In the Eleventh Circuit, that means taking into account the law enunciated in that court's case law, most recently *In re Fundamental Long Term Care*, No. 16-16462, 2017 WL 46826791 (11th Cir. Oct. 19, 2017).

In *In re Fundamental Long Term Care*, the Eleventh Circuit addressed the jurisdiction of a bankruptcy court to issue a non-consensual release of state law causes of action in favor of non-debtor third parties. These releases go by other names, including "injunctions" or "litigation bar orders." The principal issue faced by bankruptcy courts is whether they possess subject matter jurisdiction (i.e., the legal ability) to enter bar orders that favor non-debtor third parties. The primary authority on that issue in the Eleventh Circuit has been a two-decades-old decision, *In re Munford*, 97 F.3d 449 (11th Cir. 1996). In *Munford*, the Eleventh Circuit restated the familiar *Pacor* test that it (and virtually every other U.S. Court of Appeals) adopted six years earlier in *In re Lemco Gypsum*, 910 F.2d 784 (11th Cir. 1990) for "related to" jurisdiction pursuant to 28 U.S.C. § 1334(b) (in relevant part, "the district courts shall have original but not exclusive jurisdiction of all civil proceedings … related to a case under [the Bankruptcy Code]."). As the *Lemco Gypsum* court stated:

> In order for the bankruptcy court to exercise subject matter jurisdiction over a dispute … some nexus between the civil proceeding and the title 11 [bankruptcy] case must exist. The test for determining whether a civil proceeding is related to bankruptcy is whether the outcome of the proceeding could conceivably have an effect on the estate being administered in bankruptcy. In other words, an action is sufficiently related to bankruptcy if the outcome could alter the debtor's rights, liabilities, options or freedom of action (either positively or negatively) and which in any way impacts upon the handling and administration of the bankruptcy estate. 910 F.2d at 453.

The bankruptcy court in *Munford* approved a settlement between the debtor and some but not all of the defendants in an adversary proceeding that included entry of a bar order that would forever prevent all of the non-settling defendants from being able to seek contribution or indemnification from the settling defendants related to the claims covered by the bar order. *Id*. at 452-53. The Eleventh Circuit held "that the non-settling defendants' contribution and indemnity claims affect the debtor's estate because [the settling defendant] would not settle the [debtor]'s claims against it without the bankruptcy court entering a bar order." *Id*. at 454. Thus, under *Munford*, where a settlement is made expressly contingent upon entry of a bar order in return for monetary consideration from the person or entity who or which will benefit from the proposed bar order, a bankruptcy court in the Eleventh Circuit will almost certainly possess "related to" subject matter jurisdiction to enter such an order.

The fact that the matter in *Munford* concerned the settlement of an adversary proceeding (essentially a lawsuit filed in connection with a pending bankruptcy case) does not limit entry of litigation bar orders to the litigation context. This is because there is no meaningful difference when an injunction or a bar order is

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proposed through a plan of reorganization filed in a chapter 11 bankruptcy case, whether the plan contemplates continued post-bankruptcy operations or is a liquidating plan, as opposed to resolution of an adversary proceeding, when entered in return for plan funding by a principal of a chapter 11 corporate debtor. In the plan context, the beneficiaries of litigation bar orders can be officers and directors against whom negligence or breach of fiduciary duty claims have been asserted. Other beneficiaries of litigation bar orders can be, under the appropriate circumstances, officers and/or directors of corporate debtors, i.e., when, like guarantors, they are pivotal to a successful reorganization and cannot have their time and attention diverted to defending lawsuits in other courts.

In *Fundamental*, the Eleventh Circuit addressed the issue of the jurisdiction of a bankruptcy court to issue a non-consensual release in favor of a third party in the context of a settlement of claims asserted by a trustee in a chapter 7 bankruptcy case. The Eleventh Circuit appears to have gone a full step beyond *Munford's* straightforward application of the *Pacor* test. Specifically, the court in *Fundamental* concluded that if the plaintiff-appellants succeeded on their state court claims, the "potential existed to deconstruct the bankruptcy court's resolution of the dispute." 2017 WL 46826791, *8. In its analysis, the Eleventh Circuit explained that the plaintiff-appellants had "identified no scenario in which a claim to recover on [the plaintiff-appellants' state court claims against a non-debtor] would not impact the size and administration of the bankruptcy estate, as well as the debtor's potential claims with respect of the [transaction]." *Id.*, *9. By using this language, the Eleventh Circuit suggested, but did not outright hold, that it had shifted the burden of proof to the party opposing entry of a bar order to demonstrate that the action it seeks to continue prosecuting will not affect the bankruptcy estate.

In *Fundamental*, the Eleventh Circuit offers the clearest and broadest formulation of the jurisdiction of bankruptcy courts to issue bar orders of any circuit court to date. For example, bankruptcy and district courts within the Second Circuit (which covers New York, Connecticut and Vermont) appear to apply a more restrictive standard to determine whether a bankruptcy court possesses subject matter jurisdiction to enjoin non-bankruptcy, state law claims against non-debtor third parties, i.e., guaranty claims against a principal of the corporate debtor. Beyond the traditional "any conceivable effect" requirement under the *Pacor* test, a bankruptcy court in the Second Circuit "has jurisdiction to enjoin third-party, nondebtor claims that directly affect the res of the estate." *In re Sabine Oil & Gas Corp.*, 555 B.R. 180, 289 (Bankr. S.D.N.Y. 2016) (citing *In re Johns-Manville*, 517 F.3d 52, 66 (2d Cir. 2008)); *see also In re FairPoint Communications, Inc.*, 452 B.R. 21, 29 (S.D.N.Y 2011) ("a bankruptcy court has jurisdiction to enjoin third party non-debtor claims, but only to the extent those claims 'directly affect' the res of the bankruptcy estate.") (emphasis added). And, in the *Fundamental* case, the Eleventh Circuit offered the All Writs Act as a secondary basis upon which the bankruptcy court properly issued its bar order.

With the decision in *Fundamental*, the benefits of filing chapter 11 bankruptcies in the Eleventh Circuit may have increased. Time will tell.

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