

## CHAPTER 11 - 101 THE NUTS AND BOLTS OF CHAPTER 11 PRACTICE: A PRIMER

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### An Overview of Bankruptcy Litigation

**Editors' Note:** *This is the fifth of 22 installments that are being published here, with permission from the American Bankruptcy Institute. The series, read consecutively, will give the reader a broad overview of the chapter 11 bankruptcy process. The installments are chapters from a CD-Rom that is available for purchase for \$20 (\$10 to ABI members) through the ABI. For more information, you can call the ABI at (703) 739-0800 or go to [www.abiworld.org](http://www.abiworld.org). The authors welcome your comments and questions as well, and you may feel free to contact them. Jonathan Friedland is a member of the ABI Board of Directors as well as a member of NACM Oregon.*

Things generally move at a much faster pace in bankruptcy than in nonbankruptcy litigation. This is true for one good, practical reason: the debtor in bankruptcy is sick, and if you fight too long over the patient, you'll have nothing left but a corpse. The upshot is that bankruptcy is in many ways a livelier and more dynamic forum than the nonbankruptcy realm. But for the experienced litigator, practicing in bankruptcy can be like trying to speak Italian when you studied Spanish in school. You keep thinking you speak the language, but every so often you get an unexpected, and often nasty, surprise.

In short, general civil litigation and bankruptcy litigation may appear at first blush to be largely the same, but when you look beneath the surface, there are important differences.

Start with the "case." Litigators try cases. But in bankruptcy, the "case" isn't really a litigation matter. A Chapter 11 "case" is better thought of as a forum in which many smaller pieces take place. Some of those pieces involve contests in court; many more involve negotiation among interested parties.

Although lawyers do not litigate "bankruptcy cases" themselves, there can be plenty of litigation inside the case. First, there may be lawsuits within the bankruptcy case. For example, the trustee may sue nondebtors to collect assets for the estate, or to undo avoidable

transfers. Less frequently, someone may sue the debtor, or even the trustee. These proceedings will look like traditional litigation, but if you spend much time in bankruptcy court, you will see differences. Some of these differences are substantive, while others involve terminology.

#### Adversary Proceedings

The first difference of terminology involves the name of the action. The bankruptcy name for a lawsuit filed in the bankruptcy case is "adversary proceeding." You will see this on the face of the complaint. For example, if Smith is the debtor and Jones is the trustee, suing Brown, the caption will say: In re Smith (the case name) and Jones v. Brown (the adversary proceeding name). The pleading will bear a "case" number (referring to the bankruptcy case) and an "adversary number" referring to the lawsuit-within-the-case.

Aside from adversary proceedings, there are plenty of instances where a bankruptcy case may generate conflict and litigation that does not result in an "adversary proceeding." For example, a creditor might seek relief from the automatic stay to foreclose on its collateral. Or the DIP might want to assume (or reject) an executory contract. Or a Chapter 11 debtor may seek to confirm a plan to which creditors are objecting.

#### Contested Matters

The bankruptcy term for these situations is "contested matters." Again, you can tell the difference from the face of the pleading. Adversary proceedings begin with a "complaint" just like a "case" under the Federal Rules of Civil Procedure. "Contested matters" begin with a motion or, occasionally, an application. They don't get their own number, and they don't get that special two-headed caption.

So if the trustee in Smith's case wants to assume an executory contract, the caption will say "In re Smith," and will bear the title: "Trustee's Motion to Assume

Executory Contract” (or words to that effect). Contested matters tend to proceed more quickly, and somewhat less formally, than adversary proceedings, although they can still result in discovery and in trials before the bankruptcy judge.

Some proceedings go before the court only if an interested party objects. The DIP notifies parties of its intention and if nobody objects, it can go ahead and do what it proposes. For example, the DIP may abandon property of the estate on “negative notice” to parties-in-interest. Similarly, the Code provides that the DIP may sell property of the estate without court order if it has given the right kind of notice and no one objects.

But many lawyers and clients find they can’t live with that uncertainty (what will the title insurance company say?). So in many places, the courts will issue comfort orders (e.g., “Order Approving Sale”) even though there is no contest before it and even though the Code doesn’t seem to require a court order.

### **Notice and a Hearing**

This describes the basic framework. Now, for the law. Where do we find the rules that govern bankruptcy litigation? The answer is—not in the Bankruptcy Code. For the most part, the Code sidesteps questions of mechanics. Instead, it directs, repeatedly, that something or other may be done “after notice and a hearing.”

Bankruptcy Code § 102(1) defines the phrase “after notice and a hearing” to mean after:

“such notice as is appropriate in the particular circumstances, and such opportunity for a hearing as is appropriate in the particular circumstances...”

This doesn’t tell you anything helpful. But the point is that the Code doesn’t pretend to tell you anything specific on the point: rather, matters of procedure are handled outside the Code in the Bankruptcy Rules (of which more *infra*).

But it is a little trickier than that. Note that the rule doesn’t require a hearing. Rather, “hearing” actually means “opportunity for a hearing.” The drafters intended matters to go without hearing if it was “appropriate” to do so. Subsection (1)(B) fleshes out the point. This subsection says that “after notice and a hearing”

- (B) authorizes an act without an actual hearing if such notice is given properly and if—
- (i) such a hearing is not requested timely by a party in interest; or

- (ii) there is insufficient time for a hearing to be commenced before such act must be done, and the court authorizes such act.

As a practical matter, a lot of things in bankruptcy happen just this way: someone gives notice of an intention to do something; no one objects, and so the moving party goes forward without a hearing. (A classic example of this is a trustee’s notice of intention to abandon property, referred to above).

Beyond this somewhat slender principle, we must look outside the Bankruptcy Code for answers to our procedural questions. Your first stop should be the Federal Rules of Bankruptcy Procedure (often referred to as the “Bankruptcy Rules” or the “FRBP”). And here again, we encounter a potential language barrier. The Bankruptcy Rules look like the Federal Rules of Civil Procedure; indeed the Bankruptcy Rules incorporate a good many of the Federal Rules, but not all, as we shall see. And this is where the neophyte can run into trouble if she looks at the rules on a cursory basis and assumes she already speaks the language.

The easiest way to approach the rules is in the framework we sketched out above. Start with “adversary proceeding”—the lawsuit-within-a-case. For an “adversary proceeding,” the governing rules are in Part VII (the “Adversary Rules” or as some say, the “7000 Series”) of the Bankruptcy Rules, starting with Rule 7001. Here, mercifully, litigators are on largely familiar territory: the Bankruptcy Rules bear considerable similarity to the Federal Rules of Civil Procedure. Indeed, Adversary Rules simply “adopt by reference” many of the Federal Rules of Civil Procedure.

Rule 7001 lists forms of relief that parties may only obtain through adversary proceedings. The list includes actions:

- to recover money or property.
- to determine discharge or dischargeability.
- to determine the validity or priority of liens.
- to get an injunction.
- to subordinate a claim.

Some matters “not on the list” have their own rules framework: e.g., the rules governing the process of confirmation for a Chapter 11 plan (Rules 3018 through 3021). Some fall under the more general rubric of “contested matters” governed by the rules in Part IX of the Bankruptcy Rules, particularly Rule 9014.

The distinction can seem arbitrary—why, for

example, is an action to assume or reject an executory contract a mere “contested matter,” while an action to avoid a lien is an “adversary proceeding?” But there may be less here than meets the eye. Rule 9014 specifies a number of Adversary Rules that apply to contested matters as well as adversary proceedings. And it provides that the judge may apply any of the other Adversary Rules if she chooses.

One noteworthy provision in these rules, provided in Bankruptcy Rule 7004, allows nationwide service of process by mail. This provision is a good deal more liberal than the parallel one contained in non-bankruptcy rules. The practical effect of Rule 7004 is that a plaintiff commencing an adversary proceeding can just drop the summons and complaint in the mail to the defendant—any place in the United States—and this will constitute adequate service.

Oddly, the rule governing “service of process” does not extend to the issuance of subpoenas. Rule 9016 governs subpoenas, incorporating by reference Federal Rule of Civil Procedure 45, which is much less expansive. As litigators will recognize, Rule 9016 limits service of subpoenas (in most instances) to the district of issuance or to within 100 miles of the place designated for response to the subpoena.

Another point of familiarity to the general litigator is the matter of evidence. Bankruptcy Rule 9017 provides that the Federal Rules of Evidence apply in bankruptcy cases. And Bankruptcy Rule 9014(d) provides that “testimony of witnesses with respect to disputed material factual issues shall be taken [in contested matters] in the same manner as testimony in an adversary proceeding.”

As a matter of history, bankruptcy has a tradition of laxity about matters of evidence. There is a tradition in bankruptcy wryly nicknamed “testimony from the podium,” describing situations in which the judge bases her decision upon attorney proffer rather than sworn testimony (“Your honor, if called to testify, my client would say...”).

Our observation is that practice has tightened up some in recent years, and that the judge will often compel counsel in bankruptcy proceedings to comply with basic evidentiary rules just as in any other court. In fact, a litigator who has a firm grasp of the rules of evidence will often have a distinct advantage over her bankruptcy counterparts, simply because bankruptcy lawyers tend to be less familiar with the rules of evidence.

Nevertheless, practice remains a bit more fluid and informal in many bankruptcy courts compared to what you would encounter in federal district or state trial courts. One possible reason for this is the general absence of juries; because there is no jury to poison, the judge may simply permit witnesses to tell their stories, confident in his ability to later disregard any inadmissible portions. Another explanation is that bankruptcy judges tend to look for practical business solutions, and may be more concerned about reaching a commercially appropriate result than being bogged down with a “technical” dispute about the admissibility of any particular piece of evidence.

As you might expect, lawyers will encounter substantial variation among judges with regard to the level of formality in their courtrooms and the extent to which they require strict compliance with the rules of evidence or demand complete evidentiary records to support factual findings. An understanding of the courtroom procedures and practices of the judge in your case is essential. Counsel must also consult Local Bankruptcy Rules. In most instances, these are available on the court’s website.

Aside from the Adversary Rules and the rules regarding motions, there are a number of other rules that may apply to particular bankruptcy-related matters. Many of these govern bankruptcy-specific issues—such as filing schedules or filing and objecting to proofs of claim. An indispensable (but by no means exhaustive) set of deadlines is set forth in Rule 2002. Another important rule relating to dates and deadlines that bankruptcy litigators should be aware of is Rule 9006, particularly subsections (b) and (c), which dictate which other deadlines in the Bankruptcy Rules may be modified by the judge, and which may not.

#### **Rule 2004**

One Bankruptcy Rule of particular notoriety is Rule 2004, with the anodyne title of “examinations.” Rule 2004 gives “any party in interest” the right (on court order) to examine “any entity.” The examination “may relate only to the acts, conduct, or property or to the liabilities and financial condition of the debtor, or to any matter which may affect the administration of the debtor’s estate, or to the debtor’s right to a discharge.” The inclusion of the word “only” strikes your authors as somewhat Pickwickian.

The rule prohibits us from asking for a prediction as to the Red Sox’s chances of winning a World Series

(assuming the debtor has no stake in the series), but it is hard to imagine much else that would fall outside the scope of such a broadly worded rule. (In fact, parties seeking broad Rule 2004 examinations are fond of citing language from some published decisions referring to such examinations as “fishing expeditions”).

Rule 2004 might appear unnecessary given that the Bankruptcy Rules already incorporate the discovery rules that have been transplanted in their entirety from the Federal Rules of Civil Procedure. Why do we need both? Well, Rule 2004 appears to authorize examination outside the context of an adversary proceeding or contested matter.

Indeed, when there is a pending adversary proceeding, the judge may deny a Rule 2004 order relating to the subject of the adversary proceeding, telling the parties to use ordinary litigation discovery procedures instead. Sometimes a party will use Rule 2004 to obtain information necessary to decide whether to bring an adversary proceeding. This sort of pre-complaint discovery is rarely available in non-bankruptcy litigation.

One Bankruptcy Rule that is central to Chapter 11 practice is Rule 4001, dealing with three matters that are common sources of contention in chapter 11 cases:

- relief from the automatic stay.
- use of cash collateral.
- obtaining credit.

Of these, perhaps the most interesting portions of the rule are those governing use of cash collateral. Imagine this scenario: 24 hours after the Chapter 11 case begins, the debtor appears before the judge, arm in arm with the secured creditor. The debtor says he needs instant authorization to use cash collateral in order to stay in business. The secured creditor says he will consent, but only if the judge signs an order granting broad protections for his priority position, as to both pre- and post-bankruptcy claims.

The judge is necessarily in something of a bind: she can believe the sincerity of both presentations, but she is likely to worry that the debtor and secured party are acting together at the expense of unsecured creditors. Seen in this light, it is not surprising that Rule 4001 sets criteria for notice to other parties, for time limits, and (perhaps not least important) for ex parte relief under limited circumstances.

Perhaps the most common point of unfamiliarity for non-bankruptcy litigators appearing in bankruptcy court

is the disposition of claims. For the moment, consider the case of the plaintiff whose defendant files for bankruptcy in the middle of the lawsuit. What happens next? The plaintiff’s first impulse will be to continue the lawsuit. But he can’t—he is barred by the automatic stay which prohibits a creditor from taking action against a debtor to collect claims. He might seek relief from the stay to continue the lawsuit, but if the debtor is deeply insolvent and will ultimately get a discharge, then continuing the lawsuit may just be throwing good money after bad.

The Bankruptcy Code and Rules contemplate something more stripped-down and simple. The creditor (plaintiff) may file a “proof of claim,” as set forth in § 501 and Bankruptcy Rules 3002 and 3003, after which time the trustee or DIP may object to the claim as provided by Rule 3007. At this point, “the court, after notice and a hearing, shall determine the amount of such claim...” § 502(b). But note that this brings about a contested matter, and not “adversary proceeding,” because such a proceeding is not one of those enumerated in Rule 7001.

But suppose the claim involves some more elaborate matter, such as a suit alleging patent infringement, with a prayer for damages sufficiently large that in itself it would be enough to put the debtor out of business. How will a bankruptcy forum go about resolving such a complicated matter?

One answer will shock a good many litigators, especially patent litigators. The bankruptcy judge may have the power to adjudicate the matter right there in the bankruptcy court. This assertion is bound to generate a good deal of sputtering about the role of the specialized court. But from at least one perspective, the assertion of jurisdiction is perfectly straightforward—the point of bankruptcy is to get all the issues relating to the debtor into one forum, where one judge can effect a global resolution.

Practically speaking, this result isn’t likely. Most bankruptcy judges have plenty to do without trying patent cases. A more conventional strategy would go something like this: the claimant will move for relief from the stay to continue with the lawsuit in a non-bankruptcy forum on the question of liability and damages, while stipulating that the bankruptcy court retains control over the amount ultimately distributed on account of the damage claim, and the priority of the claim in bankruptcy. Another option for a claimant who finds himself in this situation is to seek “withdrawal of

the reference,” under 28 U.S.C. § 157(d), which would allow the patent case to be tried by the district court in the district where the bankruptcy case is pending.

Bankruptcy litigation is a complicated topic and we have just begun in this chapter to outline some of the important issues. The next few chapters will continue our discussion of the litigator in the bankruptcy forum. But we leave you with this thought: bankruptcy litigation is important and it is difficult to be a good bankruptcy lawyer if you are not a competent litigator. But Chapter 11 is mostly about negotiation, rather than litigation. And many more successful reorganizations are the product of skilled negotiation than hotly contested litigation. In other words, you should know how to protect your client’s interests in the courtroom, but you may do your most important work in the hallway or the conference room.

It is the unique blend of litigation and transactional practice that makes Chapter 11 practice so interesting. Some would claim that this specialized field is the last home of the generalist practitioner, as just about every industry and social issue related to business has landed in bankruptcy court, from airlines to windfarms. Potentially every non-bankruptcy law issue can arise in Chapter 11. It is where all the problems that could not be solved elsewhere come to reside. And there they are litigated, negotiated, documented, and put to rest.

*Watch for next month’s issue—“Overview of Avoidance Actions”*