

# Getting Your Business Torts Case out of Bankruptcy Court: Abstention

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**Y**ou have agreed to represent a small business that is evidently the victim of a tort. The tortfeasor could be any number of entities: your client's bank, your client's auditors, its competitors, its vendors, even its customers.

Whoever it is, and no matter what the cause of action is, the damages suffered by your small business client have likely rendered it insolvent as a result of the tortfeasor's conduct, and your client has no option but to sue. As your client requires protection from its creditors immediately, it must now petition for bankruptcy protection.

In the realm of personal injury practice, a party to litigation who seeks bankruptcy court protection from its creditors is familiar to practitioners. The common scenario is that a tortfeasor defendant files for bankruptcy, and the plaintiff's counsel moves the bankruptcy court to lift the automatic stay on the basis that the debtor carried casualty liability insurance so there is no need to burden the bankruptcy estate with the plaintiff's claims. The bankruptcy judge typically grants the motion to lift the stay. The matter then proceeds to resolution in usual fashion and without further interference from the bankruptcy court.

However, where your client must move for bankruptcy, the matter is entirely different.

Two important things occur because of the filing of this bankruptcy petition. First, the ownership and control of this small company have changed, so that the decision to hire counsel and prosecute the business torts case has been transferred from the business owner to a fiduciary for the bankruptcy estate. If your relationship to the case was through the business owner, you may have just lost the case to other counsel.

The second development is that jurisdiction over the business torts case is transferred to the bankruptcy



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court. Under Section 1334 of the federal Judiciary Code,<sup>1</sup> exclusive jurisdiction over all bankruptcy-related matters rests with the federal district courts. All pending state court actions involving the debtor company are automatically stayed.

## STRATEGIC CONCERNS ABOUT BANKRUPTCY COURT

When a third-party lawsuit becomes an asset of a debtor's bankruptcy estate, by default, it becomes an adversarial proceeding to be litigated in the bankruptcy court itself. Several strategic concerns are at play here. All of them stem from the fact that the playing field is different in bankruptcy court.

First, adversarial actions in bankruptcy court are all subject to the Federal Rules of Civil Procedure and the Federal Rules of Evidence. The discovery allowed in your local federal court rules may be much more curtailed than that allowed by your local county court judges. The proof in your case may have a feature that is much more vulnerable to a Federal Rule 56 motion than it would be to a state court motion for summary judgment.

Second, you should consider where

the jury pool is being drawn from for your case in bankruptcy court. Typically, a federal jury pool is drawn from a much broader geographic spectrum than one in state court, which can mean a much more conservative jury, depending upon your state court alternative.

Next, the question of jury unanimity is important. If you are in a state where the jury in a civil case does not need to be unanimous, the plaintiff is generally in a better position.<sup>2</sup>

This is because juries can usually be depended on to have one or two nay-sayers, regardless of the strength of the plaintiff's case. If unanimity is not required, the minority of nay-sayers can be disregarded.

Where unanimity is required, these defense-oriented jurors can and do force the amount of the verdict far below just amounts for the sole reason that they have the power to do so. Because the Federal Rules of Civil Procedure require unanimity in verdicts unless the parties stipulate otherwise, that alone can be a strong reason for the plaintiff to want to be in state court.<sup>3</sup>

In addition to the traditional reasons for wanting to be out of federal court and into state court, there is the plain fact of the matter that trial lawyers are usually unfamiliar with bankruptcy practice, the bankruptcy judges, and the Bankruptcy Rules themselves.

As uncomfortable as the trial lawyer may be in bankruptcy court, the bankruptcy judges may be even more uncomfortable handling full-blown liability trials in their courtrooms. Accustomed to moving quickly and efficiently through daily hearing dockets, these judges can be ill-suited for the often cumbersome and protracted processes called trials.

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#### **BANKRUPTCY COURT ABSTENTION**

Probably the most important option that trial lawyers should consider in this situation is the motion for abstention which is available for adversary proceedings in the bankruptcy courts. Section 1334(c) of the federal Judiciary Code provides as follows:

(c)(1) Except with respect to a case under chapter 15 of title 11, nothing in this section prevents a district court in the interest of justice, or in the interest of comity with State courts or respect for State law, from abstaining from hearing a particular proceeding arising under title 11 or arising in or related to a case under title 11.<sup>4</sup>

Under the 1991 amendments to the Bankruptcy Rules, bankruptcy judges are empowered to make final orders on motions to abstain.<sup>5</sup>

Relevant considerations that are appropriately raised in motions for abstention include: the extent to which the case you are prosecuting relies on state law, as opposed to federal law, especially where there have been recent changes in state law;<sup>6</sup> whether your case was already filed in state court at the time of the bankruptcy petition;<sup>7</sup> whether you have demanded a jury trial in the action and the parties do not consent to a jury trial in the

bankruptcy court; the likelihood that the bankruptcy petition has been the product of forum-shopping;<sup>8</sup> how burdened the bankruptcy court's docket is at the current time; and other factors.<sup>9</sup>

The bankruptcy courts consider all of these factors, no one factor being considered determinative of whether abstention should occur, and the relevance and importance of each factor varying depending on the particular circumstances of the case.<sup>10</sup>

Brushes with bankruptcy court are much more common in business torts cases simply because of the nature of the cases, and the amount of harm tortious conduct can inflict on a business. Accordingly, it makes sense for trial lawyers handling these cases to be familiar with the implications of their clients' possible or impending bankruptcies.

In that situation, we should decide if bankruptcy court is a more or less advantageous forum for our client. If we conclude that it is less advantageous, we should be prepared to file a motion for abstention with the bankruptcy court soon after the petition is filed. In line with that decision, if we want a third-party business tort case to proceed through discovery and trial in state court, it should be filed in state court before the filing of a bankruptcy petition and, to the extent practicable, plead distinctly state-law causes of action, so as to increase the chances of

winning the abstention motion. In addition, we should be prepared to marshal our arguments concerning all of the other applicable factors routinely considered in such motions.

When bankruptcy looms on our client's horizon, we will do ourselves credit as resourceful trial lawyers to recognize the choices and opportunities that are available to us, and plan accordingly.

#### **Notes**

1. 28 U.S.C. §1334 (West 2006).
2. E.g., *Utah Const.*, Art. I, §10 ("In civil cases three-fourths of the jurors may find a verdict"); N.J. Const., Art. I, ¶ 9 (five-sixths).
3. Fed.R.Civ.P. 48 (West 2006).
4. 28 U.S.C. §1334(c)(1)(West 2006).
5. Bankruptcy Rule 5011(b)(West 2006).
6. E.g., *In re Matlock*, 154 B.R. 721, 723 (E.D. Ark. 1993).
7. Previously-filed state actions militate in favor of abstention. Compare *In re J&J Towne Pharmacy, Inc.*, 2000 WL 568355 at \*12 (E.D. Pa. 2000) and *Matter of Continental Airlines, Inc.*, 156 B.R. 441, 444 (D.Del. 1993) with *In re Curran*, 157 B.R. 500, 506 (D. Mass. 1993).
8. *In re J&J Towne Pharmacy, Inc.*, supra at \*12.
9. See *Collier on Bankruptcy*, ¶5011.02 (Bender & Co. 15th Ed., 2006).
10. *Cassidy v. Wyeth-Ayerst Laboratories Division of American Home Products Corp.*, 42 F.Supp.2d 1260 (M.D. Ala. 1999).

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