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Litigating in **Bankruptcy Court:** Do You Know Where You Are?

BY DANIEL L. BROWN

Bankruptcy court proceedings are often characterized by the extensive negotiations that occur among counsel for the bankruptcy constituents, particularly the debtor and its creditors. It is also commonly understood that, once a bankruptcy proceeding is commenced, the automatic stay bars litigation against the debtor or its property or "estate." However, the nature of bankruptcy proceedings and the automatic stay does not in any way mean that litigation is foreign to bankruptcy proceedings. In fact, within the "main bankruptcy case," litigation is varied and frequent.

When litigation occurs in bankruptcy court, it can be a dream come true for litigators familiar with bankruptcy litigation—because of the fast-paced nature in which high-stakes and complex matters can proceed through discovery to a final hearing on an aggressively condensed schedule, sometimes in only a matter of weeks—or, alternatively, it can be a nightmare for litigators adept at federal and state court practice, but unfamiliar with bankruptcy litigation—because of the sometimes startling differences between litigating in bankruptcy court and federal or state court.

DANIEL L. BROWN *is a partner at Sheppard Mullin Richter & Hampton in New York.*

A mastery of the Federal Rules of Civil Procedure (the Federal Rules) is a prerequisite to competently litigating a dispute in bankruptcy court, but it is not enough. Attorneys must also understand the nuances of bankruptcy litigation, including which of the Federal Rules and/or Federal Rules of Bankruptcy Procedure (the Bankruptcy Rules) will apply to the dispute being litigated. Attorneys must also understand and be prepared to litigate within the parameters established by the customs, practices, and other rules that apply to bankruptcy court litigations, including local and individual judges' rules. In particular, litigators must be ready to adapt to the speed at which a case can move in bankruptcy court, which is something that may be entirely foreign to the federal and state court litigator.

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Types of Bankruptcy Litigation

While the "automatic stay" of 11 U.S.C. §362 operates to bar or stay most pre-petition litigation against a debtor in bankruptcy or involving its property or "estate," litigation involving the debtor and its estate occurs with regularity within the main bankruptcy case. The most common types of bankruptcy litigation are "adversary proceedings" and "contested matters."

Adversary Proceedings. The Bankruptcy Rules identify certain types of claims or disputes that must proceed as adversary proceedings. See Bankruptcy Rule 7001 ("[T]he following are adversary proceedings"). Thus, adversary proceedings include proceedings to recover money or property; to determine the validity, priority, or extent of a lien or other interest in property; to obtain approval for the sale of the interest of the estate and of a co-owner in property; to object to or revoke a discharge; to determine the dischargeability of a debt; to obtain an injunction or equitable relief; to subordinate claims or interests; or to obtain a declaratory judgment. See Bankruptcy Rule 7001.

An adversary proceeding is akin to a separate lawsuit arising from or related to the bankruptcy proceeding, and is commenced by the filing of an "adversary complaint" in the main bankruptcy case, which is nearly identical to a complaint filed to commence an action in a federal district court. See *The Section 1120(A)(1) Comm. of Unsecured Creditors v. Interfirst Bank Dallas (In re Wood & Locker)*, 868 F.2d 139, 142 (5th Cir. 1989) ("Adversary proceedings have been correctly described as full blown federal lawsuits within the larger bankruptcy case….") (internal quotation marks omitted). Adversary proceedings are frequently commenced by creditors, appointed committees, debtors, and bankruptcy trustees, both against parties to the bankruptcy proceeding and third parties. For example, an adversary proceeding against a third party might be commenced to recover alleged fraudulent transfers.

Contested Matters. Contested matters are governed by Bankruptcy Rule 9014. While this rule does not explicitly identify the type of disputes that constitute a "contested matter," it is generally understood that all disputes between parties in a bankruptcy proceeding that are not adversary proceedings proceed as contested matters. See Notes of Advisory Committee on Rule 9014 (1983) ("Whenever there is an actual dispute, other than an adversary proceeding, before the bankruptcy court, the litigation to resolve that dispute is a contested matter").

In contrast to the procedures applicable to adversary proceedings, contested matters are commenced by the filing of a motion, and are not viewed as separate cases from the main bankruptcy case, because contested matters are often integral to the resolution of the main bankruptcy proceeding. For example, a debtor's plan of reorganization may rely on the value of property or a disputed claim (or lack thereof), in which case an estimation[1] or valuation hearing will proceed as part of the main bankruptcy case. Other examples of contested matters include requests for relief from the automatic stay, disputes concerning the assumption or rejection of executory contracts, and disputes concerning a debtor's proposed financing.

In **sharp contrast** to cases governed by the Federal Rules Where litigators can successfully block discovery that is tantamount to a "fishing expedition," **bankruptcy courts routinely approve of such fishing expeditions** under Rule 2004.

Federal Rules, Bankruptcy Litigation

The Bankruptcy Rules are sometimes equivalent to, or incorporate by reference, the Federal Rules, but that is not always the case. Further complicating matters is the fact that the applicable rules and procedures can differ depending on whether the dispute is being litigated as an adversary proceeding or contested matter, and can also differ by court and judge.

Adversary proceedings are governed by Part VII of the Bankruptcy Rules. See Bankruptcy Rule 7001, et seq., which in large part adopts the Federal Rules. See, e.g., Bankruptcy Rule 7030, Depositions Upon Oral Examination ("Rule 30 F.R.Civ.P. applies in adversary proceedings"); Rule 7033, Interrogatories to Parties ("Rule 33 F.R.Civ.P. applies in adversary proceedings").

Contested matters, however, are governed by Bankruptcy Rule 9014, which generally provides that "relief shall be requested by motion, and reasonable notice and opportunity for hearing shall be afforded the party against whom relief is sought." Rule 9014 identifies some Bankruptcy Rules (and corresponding Federal Rules) applicable to adversary proceedings that apply in contested matters, and those that do not. See Bankruptcy Rule 9014(a) ("The following subdivisions of Fed. R. Civ. P. 26, as incorporated by Rule 7026, shall not apply in a contested matter unless the court directs otherwise: 26(a)(1) (mandatory disclosure), 26(a)(2) (disclosures regarding expert testimony) and 26(a)(3) (additional pretrial disclosure), and 26(f) (mandatory meeting before scheduling conference/discovery plan)"). Notably, the above Federal Rules provisions do not apply because "[t]he typically short time between the commencement and resolution of most contested matters makes the mandatory disclosure provisions of Rule 26 ineffective." See Notes of Advisory Committee on Rule 9014 (2004 Amendment).

In addition, litigators must also familiarize themselves with the local rules of the particular bankruptcy court and individual practice rules of the assigned judge, which can vary dramatically. See, e.g., Notes of Advisory Committee on Rule 9014 (2002 Amendment) ("Local procedures for hearings and other court appearances in a contested matter vary from district to district"). As a mere example, while the practice is sometimes used by federal district court judges, many bankruptcy judges require that direct testimony be provided by declaration, with the result that almost all live testimony consists of cross-examination. This obviously requires that preparation of the parties' direct case conclude well in advance of the final hearing. While this practice may be unwelcome to many litigators, the opportunity to review direct testimony in advance of cross-examination is something that litigators gladly welcome.

A significant difference between litigation in bankruptcy courts and the federal and state courts derives from Bankruptcy Rule 2004, which permits "any party in interest" to utilize the discovery devices available under the Federal Rules to seek discovery from "any entity" relating "to the acts, conduct or property or to the liabilities and financial condition of the debtor, or to any matter that may affect the administration of the debtor's estate, or to the debtor's right to a discharge."

However, the extremely broad standard for discovery under Rule 2004 is something that is entirely foreign to non-bankruptcy

litigators. Indeed, the "relevance" standard of the Federal Rules and related case law are largely inapplicable to a "2004 Request." The broad scope of Rule 2004 discovery is permitted to assist a party to explore the nature and extent of the bankruptcy estate, including to determine whether wrongdoing has occurred.[2]

As such, Rule 2004 expressly authorizes "prelitigation discovery" that is unavailable under the Federal Rules, except in very narrow circumstances.[3] In fact, in sharp contrast to cases governed by the Federal Rules where litigators can successfully block discovery that is tantamount to a "fishing expedition," bankruptcy courts routinely approve of such fishing expeditions under Rule 2004. See, e.g., *In re Szadkowski*, 198 B.R. 140, 141 (Bankr. D. Md. 1996) ("Discovery under Rule 2004 serves a far different purpose than discovery propounded under the Federal Rules of Civil Procedure. A Rule 2004 examination allows a broad 'fishing expedition' into an entity's affairs for the purpose of obtaining information relevant to the administration of the bankruptcy estate") (citation omitted); *In re Ionosphere Clubs*, 156 BR. 414, 432 (S.D.N.Y. 1993) ("Bankruptcy Rule 2004 is supposed to be a 'fishing expedition,' as exploratory and groping as appears proper") affd 17 F.3d 600 (2d Cir. 1994); *In re Ecam Publ'ns*, 131 BR. 556, 559 (Bankr. S.D.N.Y. 1991) ("Discovery under Rule 2004 is broader than that available under the Federal Rules of Civil Procedure. In fact, the scope of a Rule 2004 examination is so broad that it can be in the nature of a 'fishing expedition'").

In addition to mastering the explicit requirements of the Federal Rules, Bankruptcy Rules, local rules, and judge's individual practice rules, non-bankruptcy litigators must also adapt to the frequent informality that applies in a bankruptcy case. For instance, Bankruptcy Rule 9017 provides that "[t]he Federal Rules of Evidence and Rules 43, 44 and 44.1 F.R.Civ.P. apply in cases under the Code."[4] Thus, a federal court litigator might think that he or she should not expect any surprises in connection with evidentiary issues that arise in a bankruptcy litigation, but that would not be a safe assumption. There certainly are many bankruptcy judges who require strict compliance with the Federal Rules of Evidence and, in fact, will tolerate nothing less.[5] In addition, attorneys who strictly follow the Federal Rules and Federal Rules of Evidence will be appreciated by the bankruptcy judge, and can use that expertise to their great advantage if their adversary is a bankruptcy attorney who is less experienced as a litigator.

Nonetheless, contested matters and even adversary proceedings are often characterized by a relative informality as compared to federal district court cases. Some of the informality as it relates to evidence and other matters arises from the fact that bankruptcy courts are courts of equity and most matters in bankruptcy are tried to the bankruptcy judge, who oftentimes will "let it in" because of his or her ability to consider the quality of the evidence without the concern of unfair prejudice that might apply when a jury is the fact-finder. As such, non-bankruptcy practitioners may be surprised when a meritorious motion in limine to strike evidence or expert testimony in advance of a final hearing is given short shrift. Be prepared—it happens all the time. Given the foregoing, it is critical to understand your judge's individual practices, as well as his or her unwritten rules, such as how he or she handles evidentiary matters, and the submission of testimony. In this regard, spending a day in that judge's courtroom to observe can be an invaluable experience.

Finally, perhaps the most unusual aspect of bankruptcy litigation, and the one that can be the most jarring for the non-bankruptcy litigator, is the pace at which a complex litigation can proceed. The pace of litigation in bankruptcy court is dictated in large part by the fact that a bankruptcy court is a court of equity; the limited assets value of a company in bankruptcy may be declining; and the bankruptcy court's interest in moving the bankruptcy case along to comply with various deadlines imposed by the Bankruptcy Code, by a potential purchaser of a debtor's assets, by a debtor's post-petition lender, or by the circumstances of the case.

As a result, high-stakes litigations, for example, to determine the value of a disputed claim or resolve a cause of action, can proceed from start to finish in a matter of weeks. In order to accomplish a litigation in this shortened time frame, it is not unusual for a bankruptcy judge to set a schedule that contemplates, in a matter of weeks or less, extremely condensed response times to written discovery, including requests for production, double tracking of depositions shortly after documents are produced, expert reports and depositions, and written submissions, including all direct testimony and trial briefs. While this pace of litigation can be exhilarating for those that thrive on litigation practice, it can be startling to litigators unfamiliar with bankruptcy court practice, who must learn to adapt, quickly.

Conclusion

Bankruptcy cases frequently involve complex high-stakes litigation that moves at an extremely high speed relative to federal and state court cases. As a result, and because of the interplay between the Bankruptcy Rules, the Federal Rules, and the customs and practices of the particular bankruptcy court and judge, bankruptcy court can be the ideal place for a litigator to hone (or challenge) his or her skills. Litigators unfamiliar with bankruptcy litigation must master and follow the various rules, and be prepared to be flexible and adapt when the "normal" rules and procedures must give way to the demands of the main bankruptcy case. While it is true that bankruptcy practice includes frequent negotiations in the "hallway," in order to protect clients' interests, counsel needs to be ready to litigate and to adapt to the peculiarities of doing so in a bankruptcy court.

1. Section 502(c) of the Bankruptcy Code permits estimation, "for purposes of allowance," of claims where failure to do so "would unduly delay the administration of the case." Rule 3018 provides for temporary estimation of claims "for the purpose of accepting or rejecting a plan."

2. See, e.g., *In re Recoton*, 307 B.R. 751, 756 (Bankr. S.D.N.Y. 2004).

3. See, e.g., *In re Symington*, 209 B.R. 678, 683 (Bankr. D. Md. 1997) (Rule 2004 permits "examination of any party without the requirement of a pending adversary proceeding or contested matter").

4. See also Federal Rule of Evidence 101 ("These rules govern proceedings…before United States bankruptcy judges…").

5. See, e.g., *In re Roberts*, 210 B.R. 325, 329 (Bankr. N.D. Iowa 1997) (quoting *In re Applin*, 108 B.R. 253, 262 (Bankr. E.D. Cal. 1989)) ("In a routinized area, such as bankruptcy motion practice, one easily loses sight of some of such basics as the need to make out a prima facie case by competent evidence. Bankruptcy litigation is no different than any other federal litigation practice in this respect. Although such evidentiary questions as the use of appraisals arise more frequently in bankruptcy courts than elsewhere because the issue of value of property is pervasive in bankruptcy, that does not excuse compliance with the Federal Rules of Evidence").