THE YEAR IN BANKRUPTCY: 2006

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In light of the continued favorable business climate and ample liquidity in the U.S., the fall-off in business bankruptcy filings in 2006 should come as no big surprise. Unlike 2005, which added three new stars to the all-time hit parade of chapter 11 “mega” cases, 2006 saw no new additions to the top ten list for public company chapter 11 filings. Overall, the number of business bankruptcy filings dropped twenty-percent in fiscal year 2006, the fifth straight year a decline was reported, according to statistics released by the Administrative Office of the U.S. Courts in October of 2006. Only 27,333 businesses sought bankruptcy protection for the fiscal year ending September 30, 2006, compared with 34,222 in fiscal year 2005. Of those, the number of chapter 11 cases fell from 6,637 to 6,003. Public business bankruptcy filings fell to a 25-year low in 2006. Sixty-six public companies filed for bankruptcy protection in 2006, the lowest number of filings since 1980, when 62 public companies filed for bankruptcy.

Even so, 2006 saw a handful of notable billion dollar chapter 11 cases. Two of the Top 10 chapter 11 filings in 2006 involved automobile part suppliers, adding another grim chapter to the continuing saga of an industry that has been slammed by declining market share, overcapacity and high labor costs. Toledo, Ohio-based Dana Corp., a key supplier of axles, brakes and truck frames to Detroit auto makers, filed for chapter 11 protection in March of 2006, citing its customers’ shrinking market share (a quarter of Dana’s revenue comes from Ford) and higher costs of raw materials and energy. Listing over $9 billion in assets, Dana’s chapter 11 case was the largest bankruptcy filing of 2006.

Components supplier Dura Automotive Systems Inc., together with its U.S. and Canadian subsidiaries, filed for chapter 11 protection at the end of October of 2006, blaming an accelerating deterioration of the North American automotive industry, including escalating raw materials costs, for the decision. Dura's filing was the third largest in 2006, the company listing over $2 billion in assets. Bankruptcy filings by Dana and Dura follow those of, among others, Tower Automotive, Collins & Aikman Corp. and Delphi Corp., the last of which is the largest U.S. auto-parts supplier. Six of the 20 largest North America-based auto-parts suppliers are trying to reorganize their finances in bankruptcy. At least 36 U.S. auto-parts suppliers have filed for bankruptcy since 1999, including eight in 2006.

Coming in at No. 2 on the Top 10 ten public chapter 11 filing hit parade for 2006 was Sea Containers Ltd., the London and Bermuda-based shipping and railroad company. Blaming higher fuel prices and fallout from the July 2005 London terrorist bombings, the company filed for chapter 11 protection on October 15, 2006, after failing to make a scheduled $115 million debt payment. Sea Containers listed nearly $2.75 billion in assets at the time of its bankruptcy filing.

The fourth largest public chapter 11 case of 2006 was filed by Satelites Mexicanos, S.A. de C.V. The Mexican satellite services company filed a chapter 11 petition on August 11, 2006, after finalizing the terms of a pre-negotiated chapter 11 plan with noteholders who had filed an involuntary bankruptcy case against the company in 2005 that was subsequently dismissed in favor of a Mexican insolvency proceeding and a companion U.S. ancillary proceeding under section 304 of the Bankruptcy Code. Plagued by financial woes dating as far back as 2001, when it was battered by an economic downturn in Mexico and the U.S. that severely cut into demand for its telecommunications services, Satelites Mexicanos listed approximately $925 million in assets at the time of its bankruptcy filing.

Spot No. 5 on the Top 10 list for 2006 went to Pliant Corporation. The Schaumberg, Illinois-based packaging company filed for chapter 11 on January 3, 2006, citing severe increases in resin prices and tightening of trade terms with key suppliers as the reason for the filing. Pliant listed total assets of $777 million and total debts of nearly $1.2 billion.

Orthodontic Centers for America Inc., a Metairie, Louisiana-based provider of business services to orthodontic and dental practices worldwide, filed a chapter 11 petition on March 14, 2006. OCA cited the need to protect its contractual relationship with its affiliated practices and to provide necessary “breathing room” to restructure its balance sheet and operations as the reason for seeking chapter 11 protection. At the time of the filing, the company listed over $660 million in assets. The case was the sixth largest public chapter 11 case filed in 2006.

The seventh largest chapter 11 case in 2006 was filed by Silicon Graphics, Inc., which sought bankruptcy protection on May 8, 2006, after pre-negotiating a plan of reorganization with its bondholders under which they agreed to swap their debt for a stake in the reorganized company. Silicon Graphics does high-end computer design and engineering work and manufactures supercomputers for clients such as NASA. Employing more than 1,800 people worldwide, the company listed assets of over $450 million at the time of its bankruptcy filing.

Houston, Texas-based electrical contractor Integrated Electrical Services, Inc. and its subsidiaries filed for chapter 11 protection on February 14, 2006. Listing over $416 million in assets, the companies' filings were the eighth largest of 2006. Rounding out the Top 10 public chapter 11 filings on 2006 were cases filed by Granite Broadcasting Corp., an operator of 23 television stations throughout the U.S., which filed for chapter 11 protection on December 12, 2006, listing over $405 million in assets, and Tulsa, Oklahoma-based designer and manufacturer of natural gas turbine equipment Global Power Equipment Group, Inc., which filed a chapter 11 petition on September 28, 2006, listing over $381 million in assets.

2006 was notable for the absence of any new airline chapter 11 cases, suggesting that the industry may at last be headed for better times, as the nation's troubled air carriers struggle to reinvent themselves through rounds of consolidation and cost cutting. In fact, the resurgent airline industry in 2006 experienced its first profitable year since before the 2001 terrorist attacks, and analysts expect even healthier earnings in 2007. Higher fares, continued seat-demand and lower operating costs have helped to revive an industry that saw little reason for optimism in 2005, as major carriers Delta and Northwest scrambled for cover in chapter 11 in an effort to sort out their financial and operational problems. Provisions in sweeping pension reforms enacted in 2006 designed to give air carriers more time to fund shortfalls in their pension plans may also help the ailing industry to get back on its feet. It remains to be seen what impact the consolidation frenzy sparked in late 2006 by US Air's hostile buyout bid for Delta will have on the industry in 2007 and beyond.

Largest Public Company Bankruptcy Filings in 2006

Company	***Filing Date***	***Assets***
Dana Corporation	3/3/2006	$9,047,000,000
Sea Containers Ltd.	10/15/2006	$2,736,100,000
Dura Automotive Systems, Inc.	10/30/2006	$2,075,209,000
Satelites Mexicanos, S.A. de C.V.	8/11/2006	$925,271,000
Pliant Corporation	1/3/2006	$777,092,000
OCA Inc.	3/14/2006	$660,303,000
Silicon Graphics, Inc.	5/8/2006	$452,145,000
Integrated Electrical Services, Inc.	2/14/2006	$416,372,000
Granite Broadcasting Corp.	12/11/2006	$405,836,710
Global Power Equipment Group, Inc.	9/28/2006	$381,131,000
J.L. French Automotive Castings, Inc.	2/10/2006	$366,681,000
Radnor Holdings Corp.	8/21/2006	$361,454,000
Oneida Ltd.	3/19/2006	$328,812,000
Curative Health Services, Inc.	3/27/2006	$283,784,000
Premier Entertainment Biloxi LLC	9/19/2006	$240,896,996
AMTROL Inc.	12/18/2006	$222,451,000
G+G Retail, Inc.	1/25/2006	$202,868,000
Werner Holding Co. (DE), Inc.	6/12/2006	$201,042,000
Vesta Insurance Group, Inc.	8/8/2006	$195,325,000
Home Products International, Inc.	12/20/2006	$192,488,000

Notable Decisions of 2006

Bankruptcy Court Authority/Jurisdiction

A New York district court fired the latest salvo in a battle concerning the prerogative of a bankruptcy court to authorize the modification or termination of contracts regulated by the Federal Energy Regulatory Commission ("FERC") under the Federal Power Act. In *In re Calpine Corp.*, 337 B.R. 27 (S.D.N.Y. 2006), the court ruled that a bankruptcy court did not have the power to authorize rejection of a FERC-regulated power contract because the debtor's justification for rejection involved the rate in the contract. In doing so, the court adopted an even more restrictive approach than that applied by the Fifth Circuit Court of Appeals in its controversial 2004 ruling in *In re Mirant Corp.*, 337 B.R. 511 (5th Cir. 2004), where the Court of Appeals held that a debtor could reject a FERC-regulated contract, but only because the rationale for rejection had nothing to do with the rates under the contract, but was based upon the fact that the debtor simply did not need the power covered by the agreement.

Conflicts between the Bankruptcy Code and another federal statute — the Federal Arbitration Act — were the subject of rulings handed down by the Second and Third Circuits Courts of Appeal in 2006, both of which suggest that the scope of a bankruptcy court's retained discretion to deny arbitration may be even less broad than is generally understood. In *MBNA America Bank, N.A. v. Hill*, 436 F.3d 104 (2d Cir. 2006), the Second Circuit reversed an order denying arbitration of a dispute between the debtor and a bank involving allegations of willful violation of the automatic stay because the governing credit agreement contained a valid arbitration clause, the litigation was styled as a class action and even a "core" stay-violation proceeding may be subject to arbitration. Claims asserted by a chapter 13 debtor against a lender under the Truth in Lending Act as well as various federal and state consumer protection laws were also subject to arbitration according to the Third Circuit, which ruled in *Mintze v. American General Financial Services Inc. (In re Mintze)*, 434 F.3d 222 (3d Cir. 2006), that the party opposing arbitration of a dispute covered by an arbitration clause is obligated to prove that there is "an inherent conflict between arbitration and the Bankruptcy Code" that manifests Congress's intent to preclude a waiver of judicial remedies for the statutory rights at issue.

A bankruptcy court's authority to order the substantive consolidation of two or more related entities was the subject of a ruling handed down in 2006 by the Fifth Circuit Court of Appeals.

In *Wells Fargo Bank of Texas N.A. v. Sommers (In re Amco Insurance)*, 444 F.3d 690 (5th Cir. 2006), the Court held that the bankruptcy court abused its discretion in *nunc pro tunc* substantively consolidating a debtor corporation with its non-debtor sole shareholder, because the court had previously authorized a secured creditor to pursue its remedies against the shareholder in state court.

Good Faith Requirements

A ruling handed down by the Ninth Circuit Court of Appeals in 2006 examined whether the motive of non-consumer chapter 7 debtors bears on their ability to file for bankruptcy protection. In *Sherman v. SEC (In re Sherman)*, 441 F.3d 794 (9th Cir. 2006), the Ninth Circuit ruled that misconduct by a debtor cannot constitute "cause" for dismissal under section 707(a) of the Bankruptcy Code if it can be remedied by applying other provisions of the Bankruptcy Code.

A debtor's motives in connection with a bankruptcy filing were also addressed in 2006 by a Michigan district court, albeit in a slightly different context. In *Monroe Bank & Trust v. Pinnock*, 349 B.R. 493 (E.D. Mich. 2006), the court ruled that a chapter 11 debtor does not have the absolute right to convert its chapter 11 case to a chapter 7 liquidation even though section 1112(a) expressly provides that the debtor "may" do so, because the statute does not state that the court "shall" honor the debtor's request. Concluding that dismissal would better serve the interests of the estate and creditors, the court denied the debtor's conversion request and instead granted a creditor's motion to dismiss the chapter 11 case.

Enforcement, Allowance and Priority of Claims

A controversial decision rendered in 2005 by the New York bankruptcy court overseeing the chapter 11 cases of Enron Corp. and its affiliates sent traders in the multi-billion dollar distressed claims market scrambling to devise better ways to minimize exposure and maximize profit in connection with acquired claims against bankrupt entities. In *Enron Corp. v. Avenue Special Situations Fund II, LP (In re Enron Corp.)*, 333 B.R. 205 (Bankr. S.D.N.Y. 2005), the court ruled that a claim can be equitably subordinated even if it is transferred to an entity that did not engage in any misconduct.

This "caveat emptor" cautionary tale continued in 2006, with yet another controversial ruling by the same court in the same chapter 11 case. In *In re Enron Corp.*, 340 B.R. 180 (Bankr. S.D.N.Y. 2006), the court held that a transferred claim should be disallowed altogether under section 502(d) of the Bankruptcy Code unless and until the transferor returns payments to the estate that are allegedly preferential. The practical ramifications of caveat emptor as the prevailing rule of law have already spurred traders to build greater protections into loan/claim transfer agreements and to focus far more attention on the indemnities commonly given in distressed trades.

The Fourth Circuit Court of Appeals examined the consequences of a creditor neglecting to seek temporary allowance of its claim for the purpose of voting on a chapter 11 plan in *Jacksonville Airport, Inc. v. Michkeldel, Inc.*, 434 F.3d 729 (4th Cir. 2006). In that case, the Court held that if the debtor objects to a claim, it is incumbent upon the creditor to seek temporary allowance of the claim for voting purposes pending resolution of the objection on the merits, failing which the creditor does not have the right to vote.

A bankruptcy court's authority as a court of equity to recharacterize debt as equity in appropriate circumstances was the subject of a ruling in 2006 by the Fourth Circuit Court of Appeals. In *Fairchild Dornier GMBH v. Official Committee of Unsecured Creditors (In re Official Committee Of Unsecured Creditors for Dornier Aviation (North America), Inc.)*, 453 F.3d 225 (4th Cir. 2006), the Court held that a bankruptcy court has the power to order that obligations denominated as debts be treated as equity interests, and affirmed a bankruptcy court's ruling recharacterizing a parent corporation's claim arising from the sale of spare parts to its chapter 11 debtor-subsidiary as an equity contribution.

Courts have wrestled for 20 years over the priority of claims asserted by workers if a chapter 11 debtor fails to comply with its obligations under a collective bargaining agreement. Some courts, reasoning that such claims do not meet the traditional standards for administrative priority, relegate them to the pool of general unsecured claims. Other courts focus on the special protections afforded workers covered by a bargaining agreement under section 1113 of the Bankruptcy Code as grounds for granting such claims priority. The Tenth Circuit Court of Appeals injected its voice into the debate in 2006, staking out a middle-ground position in a widening rift regarding this controversial issue among the circuit courts of appeal. In *Peters v. Pikes Peak Musicians Association*, 462 F.3d 1265 (10th Cir. 2006), the Court ruled that the debtor's obligation under a collective bargaining agreement for payments to employees that became due between the chapter 11 petition date and the date that the debtor rejected the agreement was payable as a priority administrative expense.

In an issue of first impression in the federal circuit courts of appeal, the Third Circuit ruled in *Cohen v. KB Mezzanine Fund II, LP (In re SubMicron Systems Corporation)*, 432 F.3d 448 (3d Cir. 2006), that creditors whose claims are only partially secured because of inadequate collateral value are entitled to credit bid their claims at full face value rather than the economic value of the claims (*i.e.*, the value of the collateral) in any sale of the collateral proposed during the bankruptcy case.

Compensation of Professionals

A pair of court rulings handed down in 2006 dealt with the allowance of professional fees incurred by an official committee as an expense of administration even though the committee's constituency was "out of the money." In *In re Veltri Metal Products, Inc.*, 2006 WL 1716732 (6th Cir. June 22, 2006), the Sixth Circuit Court of Appeals reversed a bankruptcy court's order denying compensation to counsel for a creditors' committee because no distribution was likely to unsecured creditors. Benefit to the estate, the Court emphasized, need not be quantified monetarily to qualify a claim for administrative status.

In *In re Gadzooks, Inc.*, 352 B.R. 796 (Bankr. N.D. Tex. 2006), the bankruptcy court ruled that counsel for a committee of equity security holders could receive a professional fee award for services provided prior to the date on which it became clear that the committee's proposed plan would not be confirmed, regardless of whether the committee could show any "identifiable, tangible, and material benefit" to the estate. According to the court, the services were reasonable and necessary when rendered, the work was beneficial to the estate when performed, and, based upon its complexity, the work was performed in a timely manner at rates customarily charged by comparably skilled practitioners.

Rejection of Collective Bargaining Agreements

Employers' reliance on chapter 11 as a way to revise, restructure or eliminate obligations under collective bargaining agreements figured prominently in both the headlines and court rulings of 2006, particularly in connection with the continuing efforts of troubled U.S. air carriers to regain profitability. In *In re Delta Air Lines*, 342 B.R. 685 (Bankr. S.D.N.Y. 2006), the bankruptcy court denied a request by Delta Air Lines subsidiary Comair to reject its bargaining agreement with flight attendants under section 1113 of the Bankruptcy Code, finding that the debtor did not comply with the requirement that it "confer in good faith in attempting to reach mutually satisfying modifications" to the agreement prior to seeking to reject it. In a subsequent decision, *In re Delta Air Lines*, 351 B.R. 67 (Bankr. S.D.N.Y. 2006), the court granted Comair's renewed motion to reject the collective bargaining agreement, ruling that the modifications proposed by Comair to the agreement were necessary to the airline's reorganization, given the fact that Comair's flight attendant costs significantly exceeded those of all other regional carriers with which it was in direct competition, and that it had to bring these costs in line with those of its competitors to obtain contracts with other airlines to provide regional service. Finally, in *In re Delta Air Lines, Inc.*, 2006 WL 3771049 (Bankr. S.D.N.Y. Dec. 21, 2006), the bankruptcy court authorized Comair to reject the collective bargaining agreement with its unionized pilots.

Regional carrier and chapter 11 debtor Mesaba Aviation also encountered a rocky road in seeking to terminate its collective bargaining agreements with pilots, mechanics and flight attendants. After denying the carrier's initial request to reject the agreements in *In re Mesaba Aviation, Inc.*, 341 B.R. 693 (Bankr. D. Minn. 2006), based on the debtor's refusal to provide adequate information to the unions' bargaining representative, the bankruptcy court subsequently authorized rejection of the agreements in *In re Mesaba Aviation, Inc.*, 2006 WL 2739047 (Bankr. D. Minn. Jul. 14, 2006), finding that the debtor had remedied its earlier indiscretions and that the proposed cost reductions were necessary to Mesaba's reorganization. That ruling, however, was reversed in part on appeal. In *Association of Flight Attendants-CWA, AFL-CIO v. Mesaba Aviation, Inc.*, 350 B.R. 435 (D. Minn. 2006), the district court held that the debtor demonstrated bad faith by wholly refusing to negotiate regarding "snap-backs" restoring employee wages in the future. Upon remand of the case for additional consideration of the issue, the bankruptcy court ultimately authorized Mesaba to reject the agreements and to impose new work rules and conditions on its union employees.

The bankruptcy court overseeing the chapter 11 cases of Northwest Airlines and its affiliates authorized rejection of the air carrier's collective bargaining agreement with its flight attendants in *In re Northwest Airlines Corp.*, 346 B.R. 307 (Bankr. S.D.N.Y. 2006). The bankruptcy court concluded that rejection was necessary to the debtors' reorganization, given the fact that they had lost approximately $4 billion in the four years prior to seeking bankruptcy protection and were currently losing approximately $4 to $5 million per day, their borrowing capacity was limited by the absence of unencumbered assets, and $195 million in flight attendant concessions was both a necessary and integral part of their business plan.

Northwest's subsequent unilateral imposition of new labor terms and conditions on employees covered by the rejected bargaining agreement led to calls for a strike by the flight attendants' union. Northwest responded by seeking to enjoin any strike. In *Northwest Airlines Corp. v. Assoc. of Flight Attendants-CWA (In re Northwest Airlines Corp.)*, 346 B.R. 333 (Bankr.

S.D.N.Y. 2006), the bankruptcy court ruled that the Norris-LaGuardia Act deprived it of jurisdiction to enjoin the strike. The district court reversed that determination on appeal. In *Northwest Airlines Corp. v. Assoc. of Flight Attendants-CWA (In re Northwest Airlines Corp.)*, 349 B.R. 338 (S.D.N.Y. 2006), the court ruled that Northwest's rejection of the bargaining agreement did not constitute an act of bad faith that would relieve the union of its obligation under the Railway Labor Act to bargain in good faith, and that a preliminary injunction was warranted to prevent the strike.

Chapter 11 Plan Issues

The continued vitality of what has become a common practice in chapter 11 cases — senior class "gifting" to junior classes of creditors as a way to achieve a consensus on the terms of a consensual chapter 11 plan — was called into doubt in 2005 by the Third Circuit Court of Appeals, which ruled in *In re Armstrong World Indus., Inc.*, 432 F.3d 507 (3d Cir. 2005), that senior class give-ups violate the "absolute priority rule" if an intervening objecting class of creditors is not paid in full. In 2006, a Delaware bankruptcy court examined the legacy of *Armstrong*, ruling in *In re World Health Alternatives, Inc.*, 344 B.R. 291 (Bankr. D. Del. 2006), that a "carve-out" from a senior secured creditor's recovery to be distributed to unsecured creditors as part of a settlement agreement outside of a chapter 11 plan violated neither the dictates of *Armstrong* nor the absolute priority rule, where the funds in question were not estate property because the senior creditor was fully secured and the only intervening class of creditors did not object to the settlement.

A pair of rulings handed down in 2006 addressed the circumstances under which an order confirming a chapter 11 plan can be revoked in the face of allegations of fraud. In *Haskell v.*

Goldman, Sachs & Co. (In re Genesis Health Ventures, Inc.), 340 B.R. 729 (D. Del. 2006), the Delaware district court upheld an order dismissing a lawsuit seeking revocation in which it was alleged that the debtor and its senior lenders fraudulently misrepresented the debtor's enterprise value in connection with confirmation of a chapter 11 plan, because the complaint was filed after the 180-day period specified in section 1144 of the Bankruptcy Code. The inability to restore the status quo ante and protect innocent third parties prompted a New York bankruptcy judge to deny a request to revoke an order confirming a plan in *Salsberg v. Trico Marine Services, Inc. (In re Trico Marine Services, Inc.)*, 337 B.R. 811 (Bankr. S.D.N.Y.), *disposition unaltered on reargument*, 343 B.R. 68 (Bankr. S.D.N.Y. 2006). According to the court, because the plan of reorganization, which contemplated the issuance of new stock that had already been widely traded, was substantially consummated at the time of the revocation request, a far less disruptive and potentially damaging remedy would be to allow the parties seeking revocation to sue for damages arising from the alleged misrepresentations concerning projected revenues made by the debtor during the plan confirmation hearing.

Pension Plan Termination

Termination of one or more defined benefit pension plans has increasingly become a significant aspect of a debtor-employer's reorganization strategy under chapter 11 of the Bankruptcy Code, providing a way to contain spiraling labor costs and facilitate the transition from defined benefit-based programs to defined contribution programs such as 401(k) plans. Although the Employee Retirement Income Security Act ("ERISA"), rather than the Bankruptcy Code, establishes the rules and procedures governing an employer's obligations under a defined benefit pension plan, a bankruptcy filing can provide a vehicle for an employer to effectuate a "distress termination" of its pension plan.

A landmark ruling handed down by the Third Circuit Court of Appeals in 2006 examined a matter of first impression in the federal circuit courts of appeal — how ERISA's "reorganization test" for distressed pension plan terminations should be applied in cases where a chapter 11 debtor-employer seeks to terminate multiple pension plans. In *In re Kaiser Aluminum Corp.*, 456 F.3d 328 (3d Cir. 2006), the Court held that a chapter 11 debtor's pension plans should be considered in the aggregate rather than separately when applying the "reorganization test."

Cross-Border Bankruptcies

October 17, 2006 marked the one-year anniversary of new chapter 15 of the Bankruptcy Code. As the volume of chapter 15 filings steadily increases, the bankruptcy courts are being called upon to iron out the details of an as yet largely untested legislative framework. One issue that is unclear based upon the provisions of chapter 15 — whether a bankruptcy court can recognize and provide assistance to a foreign bankruptcy case as a secondary ("nonmain") proceeding when no primary ("main") proceeding is pending — was the subject of a ruling handed down in 2006 by a New York bankruptcy court. In *In re SPhinX, Ltd.*, 351 B.R. 103 (Bankr. S.D.N.Y. 2006), the court denied a petition seeking recognition of liquidation proceedings in the Cayman Islands as foreign "main" proceedings under chapter 15, because the evidence did not support a finding that the "center of main interest" of the companies involved was in the Cayman Islands and it appeared that the liquidators' motive for seeking recognition was to gain a tactical advantage in pending litigation involving the debtors. Even so, the court recognized the Cayman Islands liquidation proceedings as foreign "nonmain" proceedings.

Deepening Insolvency

An emerging but controversial theory of tort liability based upon actions that allegedly cause or contribute to the "deepening insolvency" of a company was addressed in several significant bankruptcy and appellate court decisions issued during 2006. In *Seitz v. Detweiler, Hershey & Assoc. (In re CitX Corp.),* 448 F.3d 672 (3d Cir. 2006), the Third Circuit Court of Appeals considered whether an accountant for an internet company could be held liable for the deepening insolvency of the company because the accountant was allegedly negligent in his review of the company's finances. The Court concluded that a claim of negligence cannot sustain a deepening insolvency cause of action, explaining that, notwithstanding its descriptions of deepening insolvency in a previous ruling as a "type" or "theory" of injury, it had never held that deepening insolvency was "a valid theory of damages for an independent cause of action." Shortly after the Third Circuit issued its ruling in *CitX*, the Delaware Chancery Court rejected deepening insolvency as a valid cause of action under Delaware law in *Trenwick Am. Litig. Trust v. Ernst & Young, LLP*, 906 A.2d 168 (Del. Ch. 2006).

Taking its cue from the Third Circuit and the Delaware Chancery Court, the bankruptcy court in *In re Greater Southeast Community Hosp. Corp. I*, 2006 WL 2793177 (Bankr. D.D.C. 2006 Sept. 21, 2006), ruled that deepening insolvency is properly treated as a theory of harm, not as a separate cause of action under Delaware law. Finally, in *In re Southwest Florida Heart Group, P.A.*, 346 B.R. 897 (Bankr. M.D. Fla. 2006), the bankruptcy court held that no viable claim exists under Florida law against members of a bankrupt physicians' association for prolonging the association's existence and thereby deepening its insolvency. According to the court, the alleged deepening of the association's insolvency was relevant only to the measure of damages on breach of fiduciary duty and other claims, and was not a viable claim in its own right.

From the Top

The U.S. Supreme Court issued three rulings on the subject of bankruptcy during 2006. In *Central Virginia Community College v. Katz*, 126 S. Ct. 990 (2006), a 5-4 majority of the Court ruled that an adversary proceeding brought by a chapter 11 trustee to set aside alleged preferential transfers to state agencies was not barred by the agencies' sovereign immunity. In ratifying the Bankruptcy Clause of the U.S. Constitution, the Court emphasized, the individual states acquiesced in the subordination of whatever sovereign immunity they might otherwise have asserted in proceedings brought to enforce the *in rem* jurisdiction of the bankruptcy court, such as litigation to avoid preferences.

In *Marshall v. Marshall*, 126 S. Ct. 1735 (2006), the Court held that the probate exception to federal jurisdiction did not deprive a bankruptcy court of jurisdiction over a debtor's counterclaim asserting that her stepson tortiously interfered with her expectancy of inheritance from her deceased husband, because the counterclaim sought a judgment against the stepson personally and did not involve probate or annulment of the husband's will or administration of his estate, or seek to reach property in the custody of the state probate court.

Finally, in *Howard Delivery Service, Inc. v. Zurich American Ins. Co.*, 126 S. Ct. 2105 (2006), a 6-3 majority of the Court ruled that an insurance company's unsecured claim against a chapter 11 debtor-employer for unpaid premiums for workers' compensation coverage was not entitled to priority status as a claim for “contributions to an employee benefit plan arising from services rendered.”

Bankruptcy issues to be addressed by the Supreme Court in 2007 include whether a chapter 7 debtor’s alleged bad faith has any bearing on the debtor’s right to convert his chapter 7 case to a case under chapter 11 or 13 of the Bankruptcy Code. The Court heard oral argument in *Marrama v. Citizens Bank of Massachusetts (In re Marrama)*, 313 B.R. 525 (Bankr. 1st Cir. 2004), *aff’d*, 430 F.3d 474 (1st Cir. 2005), *cert. granted*, 126 S. Ct. 2859 (2006), on November 6, 2006 and is expected to issue its ruling in the Spring of 2007. On January 16, 2007, the Court heard argument in *Travelers Casualty & Surety Co. of America v. Pacific Gas & Electric Co.*, 2006 WL 285977 (9th Cir. Feb. 7, 2006), *cert. granted*, 127 S. Ct. 377 (2006), to consider whether a creditor who engages an attorney to assert its claim in a bankruptcy proceeding is entitled to an award of attorneys fees from the bankruptcy estate, where a pre-bankruptcy contract between the creditor and the debtor provides for an award of such fees.

Largest Public Airline Chapter 11 Filings

Company	***Petition Date***	***Assets***
UAL Corp.	12/9/02	$25.2 billion
Delta Air Lines, Inc.	9/14/05	$21.8 billion
Northwest Airlines Corp.	9/14/05	$14.04 billion
US Airways Group, Inc. (2004)	9/12/04	$8.35 billion
US Airways Group, Inc. (2002)	8/11/02	$8.025 billion
Continental Airlines Holdings, Inc.	12/03/90	$7.66 billion
Eastern Air Lines, Inc.	3/09/89	$4.04 billion
Trans World Airlines, Inc. (1992)	1/31/92	$2.86 billion
Trans World Airlines, Inc. (1995)	6/30/95	$2.5 billion
Pan Am Corp. (1991)	1/08/91	$2.44 billion
Trans World Airlines, Inc. (2001)	1/10/01	$2.14 billion
Atlas Air Worldwide Holdings, Inc.	1/30/04	$2.08 billion

America West Airlines, Inc.	6/27/91	$1.17 billion
Kitty Hawk, Inc.	5/01/00	$983 million
ATA Holdings Corp.	10/26/04	$870 million
FLYi, Inc.	11/07/05	$678 million
Midway Airlines, Inc. (1991)	3/25/91	$468 million
Tower Air, Inc.	2/29/00	$351 million
Midway Airlines Corp. (2001)	8/13/01	$349 million
Hawaiian Airlines, Inc.	3/21/03	$305 million
Fine Air Services Corp.	9/27/00	$303 million
Braniff, Inc.	9/28/89	$238 million
Western Pacific Airlines, Inc.	10/05/97	$120 million
HAL, Inc.	9/21/93	$106 million

Legislative Update

The end of 2006 heralded the completion of the first full year that the Bankruptcy Abuse Prevention and Consumer Protection Act ("BAPCPA") applied to U.S. bankruptcy filings. Developments during 2006 indicate that the new legislative regime may have created new problems in its attempt to curb perceived bankruptcy abuse and to streamline the process for business bankruptcies. For example, the new chapter 7 means test, the credit counseling requirements applicable to all individual bankruptcy cases and the new restrictions on "debt relief agencies" have ignited a flurry of protest and litigation over, among other things, the fairness of the means test as a gatekeeper for consumer chapter 7 cases, confusion concerning the credit counseling rules, and application by some courts of the restrictions governing debt relief agencies to preclude bankruptcy attorneys from charging fees for services rendered in anticipation of individual bankruptcy filings. The latter dispute has already resulted in a handful of court rulings declaring the debt relief agency rules to be unconstitutional — the application to attorneys of the Bankruptcy Code's prohibition of advice from a paid provider of "bankruptcy assistance" to incur additional debt in contemplation of a bankruptcy filing has been deemed to violate the First Amendment right to free speech. This and other problems encountered in applying the new rules have already provoked calls on Capitol Hill to roll back the reforms.

BAPCPA also made significant and controversial changes to the rules and procedures governing business bankruptcy cases. Notable among these are limitations on the duration of a chapter 11 debtor's exclusive period to propose and solicit acceptances for chapter 11 plan, creditors' committee disclosure requirements, significant limitations on a debtor's ability to defer the decision to assume or reject commercial real property leases, and strict limitations on a chapter 11 debtor's ability to institute key employee retention and severance programs. Other significant changes include new rules governing the modification of employee benefits by insolvent companies that later file for chapter 11 protection, and the newly-created administrative priority for trade debts incurred in the ordinary course of business by a debtor within 20 days of filing for bankruptcy. Certain of these amendments have already sparked a significant volume of litigation. In addition, the new commercial real property lease and chapter 11 exclusivity limitations are likely to have a marked impact on the progress of some chapter 11 cases.

BAPCPA implemented sweeping changes to the Bankruptcy Code's provisions governing financial contracts to ensure that a bankruptcy filing by any party to a securities contract, forward contract, commodities contract, swap agreement or other type of financial contract does not in any way hinder the free operation of the market. Even so, the new rules proved to be deficient in certain respects, prompting lawmakers to devise legislation in 2006 designed to fix the problems. President George W. Bush gave his imprimatur on December 12, 2006 to the Financial Netting Improvements Act of 2006 (the "FNIA"). The FNIA builds on BAPCPA and is intended to clarify the treatment of certain financial contracts in the event of the insolvency of a counterparty and to promote a reduction of systemic risk.

The creation of an entirely new framework of rules to govern cross-border bankruptcy cases was a prominent feature of BAPCPA. New chapter 15 of the Bankruptcy Code replaced section 304 of the statute, which allowed an accredited representative of a debtor in a foreign bankruptcy proceeding to file an ancillary bankruptcy case in the U.S. for the purpose of protecting the foreign debtor's U.S. assets. Chapter 15 is patterned on the Model Law on Cross-Border Insolvency (the "Model Law"), a system of legal principles formulated by the United Nations Commission on International Trade Law in 1997 to deal with the rapidly expanding volume of international insolvency cases. Chapter 15 significantly expands the power of U.S. bankruptcy courts to grant relief for the purpose rendering assistance to foreign bankruptcy or insolvency proceedings.

Chapter 15 is still very much in its infancy, but it is maturing rapidly. Over 80 chapter 15 petitions were filed in U.S. bankruptcy courts by the end of 2006, with the Southern District of New York by far being the preferred forum (54 cases). During that same period, the courts entered over 60 orders officially recognizing qualified foreign bankruptcy proceedings.

The United Kingdom enacted its own version of the Model Law in April of 2006. On November 23, 2006, the first application seeking recognition of a foreign bankruptcy proceeding — a U.S. chapter 7 bankruptcy case pending in a Georgia bankruptcy court — was filed under the U.K.'s

Cross-Border Insolvency Regulations on behalf of the U.S. bankruptcy trustee for the purpose of recovering the chapter 7 debtor's U.K. assets.

The perceived ease with which financially-strapped chapter 11 debtors such as United Airlines and US Air, and most recently Delta Air Lines, were able to jettison nearly $12 billion in pension liabilities has figured prominently in recent headlines. Assumption of these obligations by the beleaguered Pension Benefit Guaranty Corporation ("PBGC") contributed to a deficit that aggregated nearly $23 billion at the end of fiscal year 2005 and was reported at $18.1 billion at the end of fiscal year 2006. Lawmakers responded to the crisis in 2006 by passing the most sweeping pension reform in 30 years. The Pension Protection Act of 2006 became law on August 17, 2006, and includes provisions that require employers to make sufficient contributions to their single-employer defined benefit pension plans over the next seven years to achieve 100 percent funding.

According to some commentators, the reforms are unlikely to restore PBGC to solvency, but they may improve the embattled insurer's financial outlook, at least in the short term. In fact, the $4.7 billion net improvement in PBGC's financial picture from 2005 to 2006 is attributable mainly to the airline relief provisions in the Pension Protection Act that led to a sharp reduction in the amount of "probable" liabilities reflected on the agency's balance sheet. Even so, as more and more employers make the transition away from defined benefit plans because of stricter funding requirements, PBGC's premium base may actually diminish in the long run. Moreover, the rules governing pension plan funding are not the only factors influencing PBGC's troubled financial condition — legislation can do little to stave off major business failures that are inevitable in a volatile economy.

Pension Plans Assumed by PBGC in 2005-2006
(b) = in bankruptcy

Company	***Date***	***Shortfall Assumed***
Republic Storage Systems Co., Inc. (b)	October 23, 2006	$29 million
Levitz Home Furnishings, Inc. (b)	October 3, 2006	$23.5 million
Plymouth Rubber Co. (b)	July 19, 2006	$11.9 million
Victory Memorial Hospital	July 5, 2006	$29 million
Pittsburgh Brewing Co. (b)	May 23, 2006	$11 million
Jernberg Industries Inc.	May 5, 2006	$10.2 million
Aloha Airlines Inc. (b)	April 28, 2006	$117 million
Falcon Products Inc. and sub. Shelby Williams Industries Inc.(b)	November 25, 2005	$31.6 million
Huffy Corp. (b)	October 5, 2005	$80 million
Westpoint Stevens Corp. (b)	August 19, 2005	$286 million
Amcast Industrial Corporation (b)	July 28, 2005	$83 million
Techneglas Inc. (b)	June 30, 2005	$70 million
United Airlines (b)	April 22, 2005	$6.6 billion
Liam Ventures Inc.	March 31, 2005	$133 million
Lobdell Emery Corp. and Howell Industries, subsidiaries of Oxford Automotive Inc. (b)	February 25, 2005	$35 million
Penn Traffic Co. (b)	February 24, 2005	$125 million
US Airways (b)	February 2, 2005	$2.3 billion
Murray Inc. (b)	January 19, 2005	$103 million

2006 was also the year that China finally enacted a permanent bankruptcy law designed to establish a comprehensive legal framework for corporate bankruptcies and the discharge of debts and interests. China's National People's Congress approved the PRC Enterprise Bankruptcy Law on August 26, 2006, although the legislation is not slated to become effective until June 1, 2007. With limited exceptions, the law applies to all types of business entities, including state-owned enterprises and foreign invested enterprises. For the first time, the law sets out clear procedures regarding the bankruptcy of China's financial institutions, an issue that had long been a grey area. It also creates a mechanism for corporate reorganizations similar to chapter 11 of the U.S. Bankruptcy Code — a clear departure from current rules, which focus on liquidation as the sole mechanism for dealing with a bankrupt enterprise.

Significant Autopart Supplier Bankruptcies 2004-06

Company	***Filing Date***
Citation Corp.	September 21, 2004
Intermet Corp.	September 30, 2004
Amcast Industrial Corp.	November 30, 2004
Oxford Automotive Inc.	December 7, 2004
Tower Automotive Inc.	February 2, 2005
Meridian Automotive Systems Inc.	April 26, 2005
Collins & Aikman Corp.	May 17, 2005
Universal Automotive Industries Inc.	May 27, 2005
Metalforming Technologies Inc.	June 16, 2005
Uniboring	June 9, 2005
Jernberg Industries Inc.	June 29, 2005
Delphi Corp.	October 5, 2005
J.L. French Automotive Castings	February 10, 2006
Dana Corp.	March 3, 2006
Oris Automotive Parts AL, Ltd.	March 16, 2006
Q.C. Onics Ventures LP	May 2, 2006
Steel Parts Corp.	September 15, 2006
Creative Engineered Polymer Products	September 20, 2006
Union Stamping & Assembly Inc.	October 3, 2006
Dura Automotive Systems, Inc.	October 30, 2006