



The Second Circuit Revisits the "Timely Adjudication" of State Law Claims in the Context of Mandatory Abstention: Parmalat Capital Finance Limited v. Bank of America Corporation

by

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The United States Court of Appeals for the Second Circuit recently revisited the issue of whether state law claims may be "timely adjudicated" under the mandatory abstention provision of 28 U.S.C. § 1334(c)(2) in *Parmalat Capital Finance Limited v. Bank of America Corporation*, Nos. 09-4302-cv, 09-4306-cv, and 09-4373-cv, 2012 U.S. App. LEXIS 3391 (2d Cir. Feb. 21, 2012).

By way of factual background, Plaintiff-appellant Dr. Enrico Bondi represents Parmalat Finanziaria, S.p.A.'s ("Parmalat") Italian bankruptcy estate as its Extraordinary Commission under Italian law. Plaintiff-appellant Parmalat Capital Finance Limited ("PCFL") is a Grand Caymans-based corporate subsidiary of Parmalat and is party to liquidation proceedings in the Cayman Islands. In 2004, Bondi and PCFL commenced separate proceedings under 11 U.S.C. § 304 in the United States Bankruptcy Court for the Southern District of New York for the purpose of enjoining litigation against Parmalat and PCFL in United States courts. The Bankruptcy Court entered a preliminary injunction shielding Parmalat from American lawsuits. Subsequently, Bondi filed suit against Grant Thornton (who had been auditors for Parmalat and PCFL) in Illinois state court, alleging professional malpractice, fraud, negligent misrepresentation and unlawful civil conspiracy claims under Illinois state law. Bondi filed a similar suit against Citigroup in New Jersey state court. Grant Thornton subsequently removed the Illinois case to the United States District Court for the Northern District of Illinois on grounds that the case was "related to" the section 304 proceeding.^[1] Bondi moved to remand the case on mandatory abstention grounds pursuant to 28 U.S.C. 1334(c)(2). The Judicial Panel on Multidistrict Litigation transferred the Illinois action to the United States District Court for the Southern District of New York. The New York District Court denied Bondi's motion, finding that it had jurisdiction pursuant to 28 U.S.C. § 1334(b) and that abstention was not mandatory. The District Court subsequently denied Bondi's motion for an interlocutory appeal.

In October 2005, the Italian bankruptcy court approved the Concordato. Pursuant to the Concordato, a newly-formed entity, Parmalat, S.p.A. ("New Parmalat") assumed all of the assets and liabilities of its predecessor companies. New Parmalat also acts as claims administrator for creditors of Parmalat under the Concordato. In 2007, the District Court denied Bondi's motion to bar plaintiffs that had brought securities fraud litigation against Parmalat, banks and auditing firms (including Grant Thornton) from bringing direct claims against New Parmalat. The District Court also permitted Grant Thornton to file third party contribution claims in the securities class action litigation. The securities class action litigation eventually settled.

After Bondi's motion for mandatory abstention was denied and the Concordato was approved, PCFL filed a suit similar to Bondi's against Grant Thornton in Illinois state court. PCFL also filed a complaint against Bank of America in North Carolina state court alleging some similar claims to those asserted by Bondi. Grant Thornton removed the Illinois case to the United States District Court for the Northern District of Illinois, and PCFL moved for abstention and remand, arguing that abstention was mandatory. The Illinois District Court denied PCFL's motion. The Illinois District Court proceeded to transfer the case to New York for consolidation with Bondi's case. In a separate and unrelated development, the North Carolina matter was transferred to the Southern District of New York as well.

After discovery, the New York District Court granted summary judgment to the defendants. The Second Circuit ultimately affirmed the District Court's summary judgment ruling as to Bank of America. With respect to the Illinois actions against Grant Thornton, the Second Circuit vacated the decisions not to abstain from deciding the cases pursuant to the mandatory abstention provision in 28 U.S.C. § 1334(c)(2). The Second Circuit remanded the cases to the District Court for a determination of whether the cases could be "timely adjudicated" consistent with the factors set forth in its opinion. [2] On remand, the New York District Court again concluded that mandatory abstention did not apply. [3] Bondi and PCFL renewed their appeals, arguing that mandatory abstention was required.

The Second Circuit identified four factors in evaluating whether state law claims can be "timely adjudicated" in state court: first, the backlog of the state court's calendar relative to the federal court's calendar; second, the complexity of the issues presented and the respective expertise of each forum; third, the status of the title 11 bankruptcy proceeding to which the state law claims are related; and fourth, whether the state court proceeding would prolong the administration or liquidation of the estate.

With respect to the first factor, the backlog comparison (state versus federal), there was "no allegation in the record that the Illinois courts are 'backlogged,'" and there was no dispute between the parties that "the difference in time it takes to resolve a case between federal and Illinois state courts, when both start at the same time, is no more than a few months." Accordingly, while the Second Circuit observed that the factor "does tip in denying abstention," the court indicated that the real issue is whether the action can be "'timely adjudicated'" in the state court; the Second Circuit implied that the Illinois court was capable of timely adjudicating the cases.

Considering the second factor, the Second Circuit determined that the factor weighed in favor of remand. The District Court concluded that the cases were factually complex. The Second Circuit keyed on the fact that the District Court did not address the complexity of the legal issues involved. Specifically, there was no question that the *in pari delicto* defense was unsettled under Illinois law. Further, Illinois law does not permit the Second Circuit to certify state law issues to the Illinois Supreme Court. Accordingly, the Second Circuit was prepared to let the Illinois state courts address this unsettled issue of state law. The Second Circuit also noted that the District Court's concern with the complexity of the factual record was offset by the availability of the summary judgment record.

The Second Circuit found that the third factor – the status of the title 11 proceeding – favored remand. The Second Circuit focused on the nature of a section 304 proceeding, observing that there was no explanation as to why swift resolution of the state law claims was required in a context where the bankruptcy court was not tasked with overseeing a reorganization or liquidation.

The Second Circuit also concluded that the potential state court proceeding would not prolong the administration or liquidation of the estate and, accordingly, the (fourth) factor should weigh in favor of remand to the state court. The Second Circuit determined that there was no administrative urgency associated with the Italian reorganization of Parmalat or the Cayman liquidation of PCFL that required prompt adjudication of the Illinois claims brought by the appellants. Further, the Second Circuit rejected the appellees' argument that remand was not warranted because it would harm creditors by increasing the cost of litigation; the court noted that the issue is "not whether abstention increases the ultimate payout to the creditors, but whether it 'unduly prolong[s] the administration of the estate' at issue." The Second Circuit deferred to the appellants' respective statuses as estate administrators, noting that they "were presumably 'well versed in the timeliness concerns of their respective foreign bankruptcy proceedings when they selected the state forum.'"

In sum, considering the four factors together, the Second Circuit concluded that they weighed in favor of abstention. The Second Circuit noted the importance of keeping the proverbial "forest" in view; "[t]he four factors are meant to guide courts' analyses with respect to the ultimate balance, struck by Congress, between, on the one hand, creating a federal forum for purely state law cases which, due to delay, might impinge upon the federal interest in the administration of a bankruptcy estate, and, on the other, ensuring that purely state law cases remain in state courts when they would not significantly affect that federal interest." In considering whether the subject action might be "timely adjudicated" in state court, the Second Circuit underscored the need to evaluate whether the action at issue "substantially affects the bankruptcy estate, or whether the estate's resolution is contingent upon the state action."