



## BANKRUPTCY STATISTICS

### Business

Going into 2007, most prognosticators predicted the economy would increase risks for companies and push bad debts higher, leading to an increase in the number of U.S. business bankruptcies. Those predictions have proven to be true. Business filings for the six-month period ending June 30, 2007, totaled 12,985, a 45 percent increase over the first half 2006 total of 8,944. The 2007 filings consisted of 8,404 Chapter 7 liquidations, a 65 percent increase over the 5,087 business liquidations in the first half of 2006. Chapter 11 reorganizations also increased with 2,713 in the first half of 2007 compared to 2,370 in the first half of 2006.

### Consumer

The consumer bankruptcy landscape since the 2005 Bankruptcy Act is still developing. Immediately before the Act's October 17, 2005, effective date there was a stampede to file, but 2006 filings dropped significantly. Now though, consumer filings are starting to pick up again. In the first half of 2007, filings increased by 48 percent from the first half of 2006. There were 404,090 filings in the first half of 2007 compared to 272,604 in the first half of 2006. Of the total 2007 filings, the percentage that were Chapter 13 reorganizations dropped about 3 percent from the first half of 2006, while the percentage that were Chapter 7 liquidations increased about 3 percent. Most predict consumer bankruptcy filings will continue to rise. Even with these increases, however, current filings are still only about 50 percent of what they were prior to the new Act.

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*For additional  
information on  
SHB's Bankruptcy  
& Creditors' Rights  
Group, please contact  
**Mark Moedritzer** at  
(816) 559-2317 or  
[mmoedritzer@shb.com](mailto:mmoedritzer@shb.com).*

[www.shb.com](http://www.shb.com)

## CASE REPORT

### **U.S. Supreme Court Allows Recovery of Attorney's Fees Incurred Protecting Rights in Bankruptcy**

On March 20, 2007, the U.S. Supreme Court found that where an entity is party to a contract containing an attorney fee clause and the other party files bankruptcy, the entity can assert a claim for fees incurred litigating bankruptcy issues. In *Travelers Casualty & Surety Co. of America v. Pacific Gas & Electric Co.*, 127 S.Ct. 1199 (2007), Travelers was surety on a bond covering payment of PGE's workers' compensation obligations in the event of a PGE default. The agreement provided Travelers could recover attorney's fees if it had to litigate rights related to the bond. PGE later filed Chapter 11 bankruptcy, and Travelers and PGE negotiated language in the plan protecting Travelers' indemnification if PGE defaulted on its obligations. Travelers then filed an amended proof of claim to include fees incurred in the bankruptcy. PGE objected that the fees resulted from litigating issues peculiar to bankruptcy law rather than a contract dispute, and thus under then existing case law, they should not be allowed.

The bankruptcy court, district court and Ninth Circuit agreed with PGE and denied Travelers' claim for post petition fees. The Supreme Court reversed. The Court held that the Bankruptcy Code does not prohibit contract-based attorney's fees solely on the fact the fees were incurred litigating bankruptcy law issues. (The court expressed no opinion on whether Bankruptcy Code § 506(b), which allows attorney's fees only if the creditor is oversecured, would disallow unsecured claims for contractual attorney's fees.)

The decision in *Travelers Casualty* is significant. The case allows companies party to a contract with another that later files bankruptcy to recover their fees incurred in litigating bankruptcy issues with the other party. The fees would still need to come within the scope of the fee provision to be recoverable, but this decision means that the fact the fees are related to bankruptcy issues will no longer prevent their recovery. Given this development, companies will want to ensure that any attorney fee clauses in their contracts include fees incurred in a bankruptcy case. Also, companies that incur such fees litigating with another party in a bankruptcy will want to file a claim (or amend a previously filed claim) to include such fees.

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## BANKRUPTCY-RELATED TIP

### **Important Bankruptcy-Related Defense Potentially Available to Corporate Defendants**

An important defense potentially available to companies being sued arises from bankruptcy law. Federal bankruptcy laws require debtors to disclose all of their assets—including all potential lawsuits against other parties. Under the doctrine of judicial estoppel, a party that fails to disclose a claim is prohibited from subsequently asserting that claim after it emerges from bankruptcy. In



*Cannon-Stokes v. Potter*, 453 F.3d 446 (7th Cir. 2006), the Seventh Circuit Court of Appeals agreed with six other federal appellate courts in finding that a debtor in bankruptcy who denies owning an asset, including a legal claim, cannot realize on that concealed asset after the bankruptcy. In other words, the debtor in this situation will be prevented from pursuing the claim against the potential defendant.

The lesson to be learned is that this doctrine may give a defendant the means to dismiss the case. Thus, when sued, creditors should consider investigating whether the plaintiff filed a prior bankruptcy. This can be accomplished in minutes via an electronic search of the national bankruptcy records. If the search reveals the plaintiff filed a prior bankruptcy and the claim had arisen at that time but was not disclosed, the plaintiff can be prevented from asserting the claim. A minority of courts leave open the possibility that the claim could still be brought by a bankruptcy trustee for the benefit of the debtor's creditors. Even if that occurs, however, it is generally easier to deal with a trustee than the plaintiff, and thus the chances of a favorable settlement improve significantly.

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## BANKRUPTCY & CREDITORS' RIGHTS GROUP

The Bankruptcy & Creditors' Rights Group of Shook, Hardy & Bacon L.L.P. specializes in all aspects of bankruptcy and creditors' rights under U.S. law. If you wish to discuss any of the articles in this newsletter with us or find out more about our bankruptcy and creditors' rights practice, please call us.

### Kansas City

Mark Moedritzer  
mmoedritzer@shb.com  
(816) 559-2317

Todd Ruskamp  
truskamp@shb.com  
(816) 559-2319

Kristen Trainor  
ktrainor@shb.com  
(816) 559-2461

### Miami

Lea Souza-Rasile  
lrasile@shb.com  
(305) 960-6984



## OFFICE LOCATIONS

**Geneva, Switzerland**  
011-41-22-787-2000

**Houston, Texas**  
(713) 227-8008

**Irvine, California**  
(949) 475-1500

**Kansas City, Missouri**  
(816) 474-6550

**London, United Kingdom**  
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**Miami, Florida**  
(305) 358-5171

**San Francisco, California**  
(415) 544-1900

**Tampa, Florida**  
(813) 202-7100

**Washington, D.C.**  
(202) 783-8400