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7th Circ. Does The Math, Settlement Upheld

Law360, New York (January 06, 2012, 1:06 PM ET) -- Sometimes, appellate decisions are notable because they address new legal questions or answer old questions in a new way. In other circumstances, they shed light on the manner in which advocates should explicate their positions in an area where the law is well determined. In its recent decision in In re: Fort Wayne Telsat Inc., the United States Court of Appeals for the Seventh Circuit achieved the latter in upholding a Chapter 7 trustee's settlement of litigation.

The opinion is interesting for two reasons: first, its implication that creditors opposing a settlement could be met with the response that their failure to "outbid" the settlement result and acquire the claim on their own exposes their objection as hollow, and second, its focus on the details of the "expected gain" of the litigation, rather than any change to or sharpening of the basic standards for approving a settlement under Federal Rule of Bankruptcy Procedure 9019.

The bankruptcy case arose out of the demise of an Indiana television broadcaster, Fort Wayne Telsat. Among its assets, the debtor had a third-party beneficiary claim with regard to the ownership and value of a broadcasting license. The trustee agreed to settle the estate's claims for payment of $100,000, an amount that would not lead to distributions to unsecured creditors. The holder of approximately 85 percent of the unsecured debt (an entity owned by the equity holders of the debtor) objected. The settlement was nonetheless approved over the objection, and the approval was affirmed by the district court.

The aggrieved creditor appealed to the Seventh Circuit. Interestingly, Judge Posner, writing for the court, did not cite In re Energy Coop, Inc. 886 F 2d 921 (7th Circuit 1989), in which the Seventh Circuit determined that "only if a settlement falls below the low end of possible litigation outcomes will it fail the reasonableness equivalent standard." In re Energy Coop, 886 F 2d at 929.

Similarly, Judge Posner did not refer directly to the abuse of discretion standard that the Seventh Circuit has employed in connection with the review of bankruptcy courts' settlements. To be sure, however, the opinion's citation of In re Doctors Hospital of Hyde Park, 474 F 3d 421 (7th Circuit 2007), provides an easy path to both the "low end" hurdle and the "abuse of discretion" standards.

After a nod to the well-recognized reasonableness standard used in class action cases, Judge Posner set out the "basic analysis required to determine whether an amount accepted in settlement of a claim is reasonable" as follows:

> Determining the reasonableness of a settlement requires comparing the amount of the settlement to the net expected gain of seeking a litigating judgment. "Expected gain" is the gain if the judgment is favorable, discounted (that is multiplied) by the probability of a favorable judgment. The qualification "net" signals the need to subtract the cost of pressing ahead to judgment in order to estimate the value of litigating to judgment rather than of settling.

Because the economic analysis of the settlement set forth in the court of appeals' decision is thorough, the issue of fees and costs was handled in a granular fashion. For tactical reasons, however, trustees rarely provide a detailed estimate of the expected fees and costs associated with a litigation they propose to settle, although motions for approval of settlements always refer to taking the costs of litigation into consideration.

Every settlement tends to be its own universe, however, and though future citations to Fort Wayne Telsat are hard to predict, the decision, by means of unusual punctuation and reference to a truism, appears to have provided a catchphrase for future use by movants proposing approval of the deals they reach — "Litigation is expensive!" (exclamation point in original).

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