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Full 3rd Circ. Won't Review Deepening Insolvency Ruling

By Ben Conarck

Law360, New York (February 24, 2015, 6:53 PM ET) -- The full Third Circuit on Monday declined to rehear a precedential decision in a suit concerning a bankrupt nursing home that endorsed so-called deepening insolvency as a cause of action for corporate creditors, though a minority of judges who voted against the rehearing indicated support for revisiting the concept in a future ruling.

Only one of the 13 judges on the panel expressed support for a rehearing in the **suit**, originally filed in 2005 by the unsecured creditors of bankrupt Pittsburgh nursing home Lemington Home for the Aged who accused executives of mismanaging the home and worsening its financial situation.

But a concurrence written by Third Circuit Judge Kent A. Jordan and joined by three other judges agreed with the petitioners' assertion that a 2001 ruling in *Official Committee of Unsecured Creditors v. R.F. Lafferty & Co. Inc.* was based on observations at the time that federal courts were identifying deepening insolvency — a theory regarding the wrongful prolongation of a company's existence beyond insolvency — as a cognizable injury to corporate debtors, which led the court to conclude that the Pennsylvania Supreme Court would likely arrive at the same conclusion.

"As petitioners note, however, much has changed in acceptance of deepening insolvency since *Lafferty*," Judge Jordan said in the concurrence. "What had appeared to our court then to be a plausible argument gaining increasing acceptance has since been widely repudiated."

The concurrence cited several cases arguing against deepening insolvency as a valid theory of damages for an independent cause of action.

"Thus, while the Pennsylvania Supreme Court has not weighed in on the topic, there is reason to believe that our prediction in *Lafferty* about the acceptance of deepening insolvency as a cause of action under Pennsylvania law has been undermined and ought to be reconsidered," Judge Jordan said.

But the panel denied the rehearing regardless, citing difficulties like questions about whether the issue should have been put forward for en banc review "much earlier in the tortuous procedural history of this case."

Judge Jordan also said that certification of the question to the Pennsylvania Supreme Court would be the best route forward "when next a claim of deepening insolvency rears its head" in a case governed by state law.

Michael J. Bowe, counsel to the appellants, pointed out that the Third Circuit denied his Jan. 23 motion requesting certification, and indicated that he was exploring his options in moving the case forward despite the rehearing denial.

"We are pleased the panel acknowledged the need to revisit Lafferty but very disappointed they apparently feel this can only be addressed by a motion for certification, because they just denied our motion for certification last month," Bowe told Law360 on Tuesday.

Kirk B. Burkley, attorney for the official committee of unsecured creditors, told Law360 on Tuesday that the court made the right decision. He emphasized that deepening insolvency was not the only course of action in Lafferty, but agreed that theory should be clarified by state courts.

"I certainly think that, in the right case, the Pennsylvania courts should certify whether or not [deepening insolvency] is a good action in Pennsylvania," Burkley said. "Even though these actions have been criticized in other jurisdictions, what really matters is what Pennsylvania would say."

Appellants are represented by Michael J. Bowe and Jennifer S. Recine of Kasowitz Benson Torres & Friedman LLP.

The unsecured creditors committee is represented by Kirk B. Burkley and Nicholas D. Krawec of Bernstein-Burkley PC.

The case is In re: Lemington Home for the Aged, case number 13-2707, in the U.S. Third Circuit Court of Appeals.

--Editing by Katherine Rautenberg.

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