



Insights

Third Circuit Confirms Limits of the Rooker-Feldman Doctrine

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On January 11, 2018, the Third Circuit issued a decision in *In re Philadelphia Entertainment & Development Partners*¹ that limited the reach of the Rooker-Feldman doctrine as a defense to bankruptcy avoidance actions. The court's reasoning, however, has implications that go well beyond the particular facts of the case and may limit the use of the Rooker-Feldman doctrine as a threshold defense in federal court litigation more broadly, whether in bankruptcy cases or otherwise.

Factual Background

PEDP was a company that had planned to operate a Foxwoods-branded casino in Philadelphia. As part of PEDP's casino plans, it applied for one of only two available slot machine licenses and, in 2006, the Pennsylvania Gaming Control Board awarded one of the licenses to PEDP. PEDP paid a \$50 million fee to the commonwealth for the license. However, as time went on, PEDP was unable to meet the board's requirements for maintaining the license, and the board revoked it. PEDP unsuccessfully appealed the board's revocation order to the Pennsylvania Commonwealth Court, and then the Supreme Court of Pennsylvania denied PEDP's application to review that decision. PEDP, having exhausted its other options, filed for bankruptcy protection.

Subsequently, the fiduciary appointed to pursue claims for the benefit of PEDP's creditors (the "litigation trustee") brought an adversary proceeding against the commonwealth in an attempt to recover the \$50 million license fee PEDP had paid for the now-revoked license. The litigation trustee argued that the license revocation should be avoided because it was a fraudulent transfer under Sections 544 and 548 of the

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Bankruptcy Code, as well as under Pennsylvania law. The bankruptcy court rebuffed the litigation trustee, holding that it did not have subject matter jurisdiction to consider the trustee's claims because they were barred by the Rooker-Feldman doctrine.²

The Rooker-Feldman doctrine deprives federal district and bankruptcy courts of jurisdiction over suits that are essentially appeals from state court judgments. The policy is based on the idea that a litigant should not be able to challenge state court orders in federal court as a means of relitigating matters that already have been considered and decided. The Rooker-Feldman doctrine applies when four requirements are met: (1) the federal plaintiff lost in state court, (2) the plaintiff complains of injuries caused by the state court judgment, (3) that judgment issued before the federal suit was filed, and (4) the plaintiff invites the district court to review and reject the state court judgment.

The bankruptcy court explained that it believed the Rooker-Feldman doctrine divested subject matter jurisdiction from the court because undoing the revocation and obtaining compensation for the revocation were “opposite sides of the same coin”; that is, the right to be compensated for the value of the license is the “functional equivalent” of the right to retain the license.³ And because the state courts had already ruled that PEDP had no right to retain the license, the bankruptcy court held it could no longer consider the litigation trustee's lawsuit.

Unsatisfied with the bankruptcy court's ruling, the trustee appealed to the district court, which affirmed the bankruptcy court's analysis of the Rooker-Feldman doctrine. The trustee then appealed the district court's decision to the Third Circuit.

The Third Circuit's Reversal

On appeal, the Third Circuit reversed the bankruptcy and district courts, concluding that the bankruptcy court erred when it held that the Rooker-Feldman doctrine barred its review of the fraudulent transfer claims.

The appeal primarily focused on the counts of the litigation trustee's claims to recover alleged constructive fraudulent transfers under Sections 544 and 548 of the Bankruptcy Code. However, the Third Circuit expressly declined to rule on the merits of these claims. Instead, the opinion only addressed whether the Rooker-Feldman doctrine was properly applied to bar the action from proceeding.

The Third Circuit's analysis focused on the fourth prong of the Rooker-Feldman test, which asks whether the plaintiff has invited the federal court to review and reject the state court judgment. As the Third Circuit noted, there is some tension between the application of the Rooker-Feldman doctrine and the prosecution of avoidance claims under the Bankruptcy Code. This is because the avoidance of a judgment seems to authorize what the Rooker-Feldman doctrine prohibits — appellate review of state court judgments by federal courts other than the Supreme Court. However, the tension may be more apparent than real: The U.S. Supreme Court has cautioned against applying the Rooker-Feldman doctrine too broadly. Rather, the doctrine is supposed to be confined to “limited circumstances” where “state-court losers complain[] of injuries caused by state-court judgments rendered before the district court proceedings commenced and invit[e] district court review and rejection of those judgments.”⁴ Thus, as understood by the Third Circuit in

PEDP, a federal court has jurisdiction “as long as the ‘federal plaintiff present[s] some independent claim,’ even if that claim denies a legal conclusion reached by the state court.”⁵

The Third Circuit disagreed with the bankruptcy court’s analysis that because payment for the value of the license was the functional equivalent to invalidating the state court decision, the Rooker-Feldman doctrine applied. The Third Circuit explained instead that because the fraudulent transfer claim stood independently of the Gaming Act and due process claims previously advanced in the state court, it did not matter for Rooker-Feldman purposes that the relief that the trustee sought, if granted, would frustrate the Pennsylvania court’s order. The important thing was that the trustee’s fraudulent transfer claims did not ask the bankruptcy court to conduct an appellate review of the revocation order.

The Commonwealth Court considered whether the board had authority under the Gaming Act to revoke the slot machine license due to PEDP’s noncompliance with the board’s orders, and whether the requirements were sufficiently clear and afforded due process to the licensee during the revocation proceedings. On the other hand, a constructive fraudulent transfer claim in bankruptcy asks an entirely different question: whether a transfer, which may have been otherwise lawful, can nonetheless be avoided for the benefit of creditors where there was not a reasonably equivalent exchange of value. For that reason, the Third Circuit explained that the constructive fraudulent transfer analysis could be conducted without deciding the same question as the Commonwealth Court or the Pennsylvania Supreme Court had already decided, and the Rooker-Feldman doctrine was therefore not implicated.

Analysis

PEDP is an important decision, both from the perspective of federal civil procedure generally as well as specifically in the Chapter 11 context. In the context of federal civil procedure generally, the decision confirms the limits of the Rooker-Feldman doctrine which, when stretched beyond its natural limits, begins to read like a de facto exception to the supremacy clause of the Constitution.

But the decision is particularly important in bankruptcy cases specifically, because bankruptcy law, under the express terms of Article I of the U.S. Constitution, is a federal body of jurisprudence with nationwide, uniform application. It is therefore to be expected that bankruptcy law is going to conflict at times with the laws of the individual states. To further the goals of bankruptcy policy, which include the equitable distribution of estate assets to creditors (among several others), it is important that the provisions of the Bankruptcy Code that seek to accomplish those goals not be retarded by state laws that have the opposite effect, if not the opposite purpose. Under a given state’s laws, it may be legal for a governmental entity to appropriate a private entity’s property in exchange for no consideration under particular circumstances. But it may, in that same state, be perfectly legal for that private entity to gift its property to a third party for no consideration as well. In the latter case, no one would claim that the fact that the transfer was lawful under state law should prevent a trustee from avoiding that transfer under the applicable provisions of Chapter 5 of the Bankruptcy Code. PEDP confirms that, in the former case, the result is no different: In all events, Bankruptcy Code provisions may independently operate to affect transactions that, under state law, could not otherwise be challenged.

1. In re Philadelphia Entm't & Dev. Partners, 17-1954, 2018 WL 358216 (3d Cir. Jan. 11, 2018). Depending on the context, reference to PEDP may refer to either the Third Circuit opinion or the debtor-entity itself.
2. The Rooker-Feldman doctrine derives its name from two U.S. Supreme Court cases, *Rooker v. Fidelity Trust Co.*, 263 U.S. 413 (1923) and *District of Columbia Court of Appeals v. Feldman*, 460 U.S. 462 (1983).
3. *Id.* at *3.
4. In re Philadelphia Entm't & Dev. Partners, 17-1954, 2018 WL 358216, at *5 (3d Cir. Jan. 11, 2018) citing *Exxon Mobil Corp. v. Saudi Basic Indus. Corp.*, 544 U.S. 280, 284, 125 S. Ct. 1517, 1521, 161 L. Ed. 2d 454 (2005).
5. In re Philadelphia Entm't & Dev. Partners, 17-1954, 2018 WL 358216, at *6 (3d Cir. Jan. 11, 2018).

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