New York Law Journal

August 19, 2013

Jurisdictional Uncertainties Complicate Debtor Class Actions In Bankruptcy Court

by Brian V. Otero

Since the economic downturn took hold in 2008, millions of Americans have turned to the bankruptcy courts for relief. Some of these debtors have alleged systemic violations of the Bankruptcy Code by banks and other providers of financial services, and have sought to certify nationwide debtor-plaintiff classes. Yet fundamental tensions between the traditional precepts of bankruptcy jurisdiction and the principles underlying class actions have given rise to uncertainty as to whether bankruptcy courts can certify such classes.

To understand the roots of this uncertainty, one must first consider the nature of bankruptcy jurisdiction. Congress passed the current Bankruptcy Code in 1984, under its Constitutional authority to "establish... uniform laws on the subject of bankruptcies throughout the United States."[1] The Code was revised in response to Northern Pipeline Constr. v. Marathon Pipe Line, 458 U.S. 50 (1982), in which the Supreme Court held that the Bankruptcy Act of 1978 unconstitutionally conferred Article III judicial powers on non-Article III bankruptcy judges (who do not enjoy life tenure and other Article III protections).

Congress resolved the constitutional issue by changing the jurisdictional framework of the district and bankruptcy courts. Under the Code, Congress vests "original and exclusive jurisdiction of all cases under title 11" in the U.S. District Courts, just as it did under the 1978 Act.[2] But bankruptcy courts no longer "exercise all of the jurisdiction conferred... on the district courts," as they did under the 1978 Act.[3] Instead, the bankruptcy courts now act as "unit[s] of the district court," and bankruptcy judges serve as "judicial officers" of the district courts.[4] Moreover, under the Code, bankruptcy courts have jurisdiction only when the district court exercises its authority to refer any or all bankruptcy matters to the bankruptcy judges within the district.[5]

The Code provides that district courts may refer to bankruptcy courts any or all matters that "arise under" Title 11; that "arise in" a Title 11 case; or that are "related to" a case under Title 11.[6] Claims that "arise under" Title 11 are those that invoke substantive rights under the Bankruptcy Code, while claims that "arise in" a case under Title 11 are those that by their nature could arise only in a bankruptcy case. The broadest of the jurisdictional bases—"related to" jurisdiction—embraces claims that could conceivably have an effect on the estate being administered in bankruptcy.[7]

By standing order, each U.S. District Court has referred all bankruptcy matters to its corresponding bankruptcy court. As the Supreme Court has recently stated, the jurisdiction of bankruptcy courts is thus derived from and cannot exceed that of the "parent" federal district court.[8]

Congress also provided in the Code that bankruptcy jurisdiction is in rem and exclusive. [9] Prior Codes did not explicitly state that bankruptcy jurisdiction is in rem, though bankruptcy courts have always treated their jurisdiction as in rem.[10] This means that bankruptcy courts have exclusive jurisdiction over the property in a bankruptcy estate, no matter where the property is located, and that other courts lack jurisdiction to adjudicate disputes affecting the estate.[11] The year before the Bankruptcy Code was passed, the Supreme Court issued an order that adopted the Federal Rules of Bankruptcy Procedure, including the incorporation of Federal Rule of Civil Procedure 23, which sets out the procedures governing class actions in the federal courts. Rule 23 is now incorporated as Rule 7023 of the Rules of Bankruptcy Procedure. The Rules became effective on Aug. 1, 1983.

Since 1984, then, bankruptcy courts have had exclusive in rem jurisdiction over the estates referred to them and class actions have been available under the Bankruptcy Rules. Yet, after nearly 30 years, courts still have not resolved the fundamental tensions between the bankruptcy jurisdictional grant and class action procedures.

Must Absent Class Members' Claims Relate to the Named Plaintiff's Estate? The first of these tensions arises when bankruptcy courts ask whether class members' claims are "related to" the bankruptcy estate before the court. The problem here is clear enough: How can a claim by a class member in California be "related to" the named class plaintiff's case pending in New York bankruptcy court if the test for "related to" jurisdiction is that the Californian's claim must have some conceivable effect on the New Yorker's estate?

The issue here is whether the three heads of bankruptcy jurisdiction should be understood conjunctively or disjunctively. One line of authority holds that the three bases for jurisdiction should be read conjunctively. In In re Wood, 825 F.2d 90, 93 (5th Cir. 1987), the Fifth Circuit concluded that it is "not necessary to distinguish between" the three heads of jurisdiction because they "operate conjunctively to define the scope of jurisdiction." Thus, the court concluded, "it is necessary only to determine whether a matter is at least related to' the bankruptcy" because that is the broadest of the jurisdictional bases.

In In re Cline, 282 B.R. 686 (W.D. Wash. 2002), the district court reversed on appeal an order of the bankruptcy court that certified a nationwide class alleging violations of the automatic stay. The bankruptcy court had held that it had "arising under" jurisdiction to adjudicate absent class members' claims. But the district court held that any "proceedings" before the bankruptcy court—even for claims so clearly arising under the Code as for violation of the automatic stay—must still meet the "related to" requirement.[12] Finding that putative class members' claims would have "no impact" on the Clines' bankruptcy, the district court concluded that the class members' claims should have been brought in the courts where their own bankruptcies were pending.[13]

Other courts have rejected a conjunctive reading of bankruptcy jurisdiction and have held that satisfying just one of the three jurisdictional bases is sufficient for bankruptcy court jurisdiction. So, for example, in In re Cano, 410 B.R. 506, 546 (S.D. Tex. 2009), the court concluded that the "arising in" and "arising under" prongs of §1334 provide jurisdictional grounds independent of the "related to" prong.[14] The court in Cano thus exercised jurisdiction over a nationwide class because it concluded that the debtors' claims fell within the "arising in" and "arising under" jurisdictional prongs, even though the claims did not "relate to" any bankruptcy estate before the court.[15]

Other courts have rejected the "conjunctive" understanding of bankruptcy jurisdiction in Wood and Cline on the grounds that bankruptcy courts have jurisdiction to adjudicate nationwide class actions as long as the class members' claims are "core matters," notwithstanding that the "related to" test is not met. Thus, in In re Aiello, 231 B.R. 693, 703-705 (N.D. Ill. 1999), the court held that it had jurisdiction over the putative class because there was no reason to limit "core jurisdiction in debtor class actions to 'relatedto' situations." But whether a proceeding is "core" is a separate inquiry from whether it has bankruptcy jurisdiction.[16] Core proceedings include "all cases under title 11" and all proceedings listed in 28 U.S.C. §157(b)(2) that arise under Title 11, or arise in a case under Title 11.[17] Bankruptcy judges have the authority to enter appropriate orders and decisions in these proceedings.[18] Non-core proceedings are those that are related to a case under Title 11 and for which district court judges retain authority to enter orders and decisions based on the proposed findings and conclusions of the bankruptcy courts.[19] By conflating the jurisdictional analysis with the core/non-core distinction, Aiello and other cases have arrived at the same conclusion as courts adopting a disjunctive reading of bankruptcy jurisdiction—that claims that "arise in" or "arise under" the Code need not "relate to" the plaintiff's estate, hence, the court has jurisdiction to certify a nationwide class even when the class members' claims do not relate to a claim before the court.

Jurisdictional Exclusivity. The second cause of tension between bankruptcy jurisdiction and the availability of class actions is that §1334(e) grants exclusive bankruptcy jurisdiction to a presiding court over "all the property, wherever located, of the debtor... and of property of the estate." The problem, then, is whether certifying a nationwide class of debtors whose bankruptcies are pending in courts throughout the country improperly interferes with the exclusive jurisdiction of the courts in which class members' bankruptcies are pending.

Some courts have relied on §1334(e) to bar nationwide class actions. Thus, in In re **Williams**, 244 B.R. 858, 866 (S.D. Ga. 2000), the court found that the class members' claims were property of their estates pursuant to 11 U.S.C. §541(a)(1), and held that the exclusivity provision of §1334(e) barred it from exercising jurisdiction over the claims of debtors whose bankruptcies were pending in other district courts. The court found further support for its conclusion by considering the underlying function of §1334(e)—to provide one forum for the administration of a debtor's bankruptcy estate.[20]

Other courts have rejected the argument that §1334(e) bars nationwide class certification. Thus, in Noletto, the court held that §1334(e) exclusivity applies only to in rem claims, not claims such as those of the debtor class that had "nothing to do with a specific item of property" held by the debtors.[21] Likewise, in Cano, the court distinguished between control over the property of an

estate (which clearly lies with the class members' "home" courts) and having jurisdiction to determine "whether rights in a lawsuit are meritorious."[22] Under this view, a "non-home court" has jurisdiction to determine that someone is liable to a debtor and must pay damages to the trustee or debtor-in-possession, while the home court retains jurisdiction to distribute the money according to its own rulings and procedures.[23]

These courts have also held that a contrary result would render §1334 inconsistent with other provisions of the Bankruptcy Code, including its venue provisions, concluding that the venue provisions in §1409, which governs the location where certain causes of action may be brought, would be rendered "meaningless" if proceedings could occur only in the district where debtors' cases were filed.[24]

It might be noted that if a claim does not constitute property of the estate, §1334(e) exclusivity will not apply regardless of how courts interpret the provision. The court in **Williams** concluded that it had jurisdiction in a class action to issue a prospective injunction against the defendant because such an injunction is not the property of any bankruptcy estate.[25] Thus, a bankruptcy court may conclude that it has jurisdiction over a 7023(b)(2) class seeking only injunctive relief for future violations and not money damages.

Class Actions for Contempt. The third source of tension between bankruptcy jurisdiction and class actions arises when plaintiffs seek a finding of contempt under 11 U.S.C. §105 based on violations of discharge injunctions. Some bankruptcy courts have held that they lack subject-matter jurisdiction over nationwide contempt classes because "only the court which issues an injunction has the authority to enforce it."[26] This principle is based on the premise that contempt is an affront to the court that issued the order, which the issuing court alone should adjudicate. 27

However, at least one bankruptcy court has held that it has jurisdiction to certify a nationwide contempt class on the ground that discharge injunctions are not individually crafted.[28] This rationale has been rejected by the Beck court, which held that there is no reason it should make a difference whether the injunctions are individually crafted because the policy underlying the jurisdictional limitation on enforcement of contempt orders "requires the issuing court to enforce its own orders in order to preserve the integrity of its processes."[29]

Other courts have recently held that bankruptcy courts retain "remedial authority" under §105 to hear and determine claims for contempt in the context of nationwide classes even if they lack the "inherent authority" to do so.[30] Although observing that "[r]equiring Plaintiffs to seek civil contempt damages from their 'home court' may be the more appropriate remedy and the only remedy authorized," the Cano court concluded that such a remedy might not be sufficient to carry out the provisions of the Bankruptcy Code or to enforce or implement court orders or rules pursuant to §105.31 The court also observed that using §105 to remedy violations of the Code "may be particularly appropriate in the context of a nationwide class action" due to the logistical challenges of adjudicating such claims "before dozens of different judges in multiple jurisdictions."[32]

Conclusion. Counsel prosecuting or defending putative class actions in bankruptcy court can draw few concrete conclusions about potential jurisdictional impediments to class certification.

Much depends on the nature of the claims asserted and on the court in which a case is pending. And because traditional bankruptcy jurisdictional principles seem to be starkly in conflict with the Rule 7023, definitive resolution of this conflict seems likely to follow only upon review in the Courts of Appeal and, perhaps, the Supreme Court.

1. U.S. Constitution, Art. 1, Sect. 8.

2. Compare 28 U.S.C. §1334(a), with 28 U.S.C. §1471(a) (repealed).

3. See §1471(c) (repealed).

4. See 28 U.S.C. §§151 and 152.

5. 28 U.S.C. §157(a).

6. Id.

7. Celotex v. Edwards, 514 U.S. 300, 308, n.6 (1995).

8. Stern v. Marshall, 131 S. Ct. 2594, 2618-19 (2011).

9. 28 U.S.C. §1334(e)(1).

10. See Central Virginia Community College v. Katz, 546 U.S. 356, 369 (2006) ("Bankruptcy jurisdiction, as understood today and at the time of the framing, is principally in rem...").

11. E.g., Tennessee Student Assistance v. Hood, 541 U.S. 440, 447 (2004) (finding that bankruptcy courts have exclusive in rem jurisdiction "over a debtor's property, wherever located..."); Chesley v. Union Carbide, 927 F.2d 60, 66 (2d Cir. 1991) (observing that a "common-law rule of long standing prohibits a court...from assuming in rem jurisdiction over a res that is already under the in rem jurisdiction of another court").

12. Cline, 282 B.R. at 695 (holding that "jurisdiction must be interpreted to require a relationship between the claims that arise under title 11 and the bankruptcy case in which they are asserted").

13. Id.

14. Accord Noletto, 244 B.R. 845, 849 (S.D. Ala. 2000) ("The three categories offer alternative bases of bankruptcy jurisdiction").

15. Cano, 410 B.R. at 548-49.

16. E.g., Noletto, 244 B.R. at 856 (observing that whether proceeding is core is analytically distinct from whether the court has jurisdiction).

17. 28 U.S.C. §157(b)(1)-(2).

18. Id.

19. Id. at §157(c)(1).

20. Id.

21. 244 B.R. at 853-54.

22. 410 B.R. at 553.

23. Noletto, 244 B.R. at 854.

24. Id. at 852-53.

25. Id. at 868.

26. In re Beck, 283 B.R. 163, 166 (Bankr. E.D. Pa. 2002).

27. E.g., Waffenschmidt v. MacKay, 763 F.2d 711, 716 (5th Cir. 1985).

28. In re Heath, No. 88-42576 (Bankr. N.D. Miss. Oct. 31, 1997).

29. 283 B.R. at 171.

30. E.g., Cano, 410 B.R. at 555.

31. Id. at 553.

32. Id. at 541.

BRIAN V. OTERO, a partner at **Hunton & Williams** in New York, heads the firm's financial services litigation practice and cochairs its financial institutions steering committee. STEPHEN BLACKLOCKS, a partner, and KRISTIN KRAMER, an associate, assisted in the preparation of this article.

LexisNexis, a Division of Reed Elsevier, Inc.