FEDERALISM PRINCIPLES IN BANKRUPTCY AFTER *KATZ*

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The Supreme Court's decision in *Katz*[1] could be narrowly read to do nothing more than making the affirmative defense of sovereign immunity unavailable to government defendants when the suit arises under bankruptcy law or in a bankruptcy case. After all, the Supreme Court's opinion merely affirmed the bankruptcy court's denial of Virginia's motion to dismiss.[2] Since the opinion's analysis had mostly to do with sovereign immunity, it is difficult to see how it could have any effect on bankruptcy cases or issues other than sovereign immunity. However, because the vast majority of bankruptcy cases, and even adversary proceedings, do not involve attempts to recover money from States, *Katz* might have little broader significance for bankruptcy law generally than did *Owen*,[3] *Farrey*,[4] *Begier*[5] or *Kelly*.[6]

The rationale of *Katz* actually may have far broader effects that change some very fundamental premises of bankruptcy law and practice, particularly on the scope of *Butner*[7] or perhaps even *Marathon*.[8] *Katz* could have a profound impact on the extent of bankruptcy jurisdiction, the choice of law to be applied, the equitable powers of bankruptcy courts, and whether there are any federalism limits on

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[1] Cent. Va. Cmty. College v. Katz, 126 S. Ct. 990 (2006).

[2] *See id.* at 994–95, 1005 (affirming judgment of Sixth Circuit Court of Appeals, which affirmed bankruptcy court's denial of petitioners' motions to dismiss proceedings on basis of sovereign immunity).

[3] Owen v. Owen, 500 U.S 305, 313–14 n.6 (1991) (holding judicial liens avoided before property acquired its exempt status in bankruptcy).

[4] Farrey v. Sanderfoot, 500 U.S 291, 292 (1991) (denying avoidance of judicial lien awarded to former spouse in divorce decree).

[5] Begier v. I.R.S., 496 U.S 53, 56 (1990) (holding payment of withholding taxes are not transfers of property of debtor).

[6] Kelly v. Robinson, 479 U.S. 36, 53 (1986) (holding criminal restitution award not dischargeable in chapter 7 case).

[7] Butner v. United States, 440 U.S. 48, 56 (1979) (confirming state law defines property rights for bankruptcy purposes).

[8] N. Pipeline Constr. Co. v. Marathon Pipeline Co., 458 U.S. 50, 87 (1982) (holding Bankruptcy Code unconstitutional in vesting judicial power of United States in limited-term judges).

application of bankruptcy law. These effects could be felt in almost any kind of bankruptcy case or adversary proceeding, even those that do not involve a State or an assertion of sovereign immunity.

I. THE BROADER HOLDINGS OF *KATZ*

The rationale of *Katz*, as distinguished from its narrow result, does seem to establish four principles, each of which has implications beyond the context of sovereign immunity or even adversaries against States.

A. Uniformity Is a Power

First, *Katz* established for the first time that the uniformity provision in Article I, section 8 of the Constitution[9] is a grant of a power, instead of a limitation on Congress' powers.[10] This alone changes over a century of bankruptcy jurisprudence, and has implications far beyond the context of suits against States.[11]

Apparently the first time the Court ever construed[12] the significance of the uniformity provision in the Constitution was shortly after the enactment of the Bankruptcy Act. *Moyses*[13] was a direct attack on the historic compromise first made in 1867[14] that allowed states to define property that is exempt for federal

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[9] U.S. CONST. art. I, § 8, cl. 4 ("[Congress shall have the Power] [t]o establish an uniform Rule of Naturalization, and uniform Law on the subject of Bankruptcies throughout the United States.").

[10] *See Katz*, 126 S. Ct. at 1003 ("[T]he Bankruptcy Clause of Article I, the source of Congress' authority to effect the intrusion upon state sovereign immunity, simply did not contravene the norms this Court has understood the Eleventh Amendment to exemplify.").

[11] *See* Kids World of Am., Inc. v. Georgia (*In re* Kids World of Am., Inc.), 349 B.R. 152, 165–66 (Bankr. W.D. Ky. 2006) ("[Georgia's sovereign immunity claim] would ignore the Congressional intent to subject the states to uniform 'laws on the subject of Bankruptcies.'" (quoting *Katz*, 126 S. Ct. at 1004–05)); *In re* Tubular Techs., LLC, 348 B.R. 699, 713 (Bankr. D.S.C. 2006) ("Bankruptcy Clause and Supremacy Clause pre-empt this area of state law [i.e., property of debtors] regarding landlord-tenant relations."); Brian Herman & Penny Dearborn, *Supreme Court 2006: The Supremes Expand Bankruptcy Court Jurisdiction*, 25 AM. BANKR. INST. J. 48, 49 (2006) ("The Bankruptcy Clause . . . is drafted more broadly to achieve uniformity not just as to dischargeability issues, but also as to the entire 'subject of Bankruptcies.'").

[12] The Supreme Court noted, but did not really construe, "the peculiar terms of the grant" of the bankruptcy power in *Sturges*. *See* Sturges v. Crowninshield, 17 U.S. (4 Wheat.) 122, 193–94 (1819) ("[The Bankruptcy Clause permits] Congress . . . [to] establish uniform laws on the subject throughout the United States."). Another early case apparently assumed that the uniformity provision was a requirement or a limitation, rather than a grant of a power, but similarly did not explicate the basis of that unstated assumption. *See* Stellwagen v. Clum, 245 U.S. 605, 614 (1918) (incorporation of state fraudulent conveyance law does not render Bankruptcy Act non-uniform).

[13] Hanover Nat'l Bank v. Moyses, 186 U.S. 181 (1902).

[14] The Bankruptcy Act of 1867 was vigorously debated in Congress for five years, and one of the compromises necessary to obtain sufficient southern-state support for its passage was to allow states to define exempt property. *See* Randolph J. Haines, *Getting to Abrogation*, 75 AM. BANKR. L.J. 447, 462–63 (2001) ("[S]outhern and western states insisted that any bankruptcy legislation must recognize and preserve the exemptions they had adopted."); *see also* Lasich v. Estate of A.N. Wickstrom (*In re* Wickstrom), 113 B.R. 339, 350 (Bankr. W.D. Mich. 1990) ("Under the . . . prior Bankruptcy Act of 1867, property generally exempted by state law from the claims of creditors formed no part of the assets in bankruptcy . . . ." (quoting Lockwood v. Exch. Bank, 190 U.S. 294, 298–99 (1903))); Liberty State Bank & Trust v. Grosslight (*In re*

bankruptcy purposes. The argument was that such a lack of uniformity in bankruptcy law violated Article I, section 8, which arguably *limited* Congress' powers to the enactment of bankruptcy laws that are uniform.[15] While the Court ultimately concluded that variation in exemption laws among the states does not result in an unconstitutional lack of uniformity, its analysis unfortunately accepted the unstated premise of the argument, that the uniformity reference in Article I, section 8 imposes a limitation on Congress, rather than conferring a power.[16] Although the implicit adoption of that premise in *Moyses* might be regarded as dictum, since the ultimate holding was that it was not violated, a subsequent case confirmed it as a holding by striking down a law that was not constitutionally uniform.[17] In the century since *Moyses* was decided, no case has ever challenged the implicit premise that "uniform" in the Constitution imposes a limitation rather than a grant of power.[18]

Katz indisputably changed that century-long understanding of the Constitutional foundation of all bankruptcy law. The opinion repeatedly references the Constitutional provision as granting a power, rather than as imposing a limitation.[19] In footnote thirteen, the Court specifically noted that even if the clause does impose some limitation, this is not inconsistent with the conclusion that it also grants Congress a more "robust" power.[20]

This holding alone changes the understanding of Congress' bankruptcy power from a power that is more limited than its other Article I powers to a power that is at least equal to the other Article I powers and broader than some aspects of the taxing powers, which *are* limited by a uniformity requirement.[21]

B. The Bankruptcy Power Is More Robust than Other Article I Powers

Second, *Katz* and *Seminole Tribe*[22] together establish that the bankruptcy power is *broader* than any other power conferred on Congress by Article I, at least with respect to the retained sovereignty of the States.

Grosslight), 757 F.2d 773, 775 (1985) ("[Under Bankruptcy Act of 1867] only a state court would have jurisdiction over claims against exempt assets." (citing *Lockwood*, 190 U.S. at 298–99)).

[15] *Moyses*, 186 U.S. at 190 (declining argument that enforcement of state exemption laws was a violation of "the constitutional requirement of uniformity").

[16] *Moyses*, 186 U.S. at 191 ("The general operation of the law is uniform although it may result in certain particulars differently in different states.").

[17] *See* Railway Labor Executives Ass'n v. Gibbons, 455 U.S. 457, 474 (1982) ("[A] bankruptcy law . . . confined . . . to the affairs of one named debtor can hardly be considered uniform.").

[18] *See, e.g.*, Reg'l Rail Reorganization Act Cases, 419 U.S. 102, 158–59 (1974) (treating uniformity provision as restriction); Vanston Bondholders Protective Comm. v. Green, 329 U.S. 156, 172 (1946) (Frankfurter, J., concurring) (describing uniformity as "Constitutional requirement[,]" not power).

[19] *See* Cent. Va. Cmty. College v. Katz, 126 S. Ct. 990, 994 (2006) (describing Bankruptcy Clause as Congressional power).

[20] *See id.* at 1004 n.13.

[21] *See* U.S. CONST. art. I, § 8, cl. 4. ("[A]ll Duties, Imposts and Excises shall be uniform throughout the United States.").

[22] Seminole Tribe of Fla. v. Florida, 517 U.S. 44 (1996).

Seminole held, at least in dictum, that Congress had no power under *any* clause of Article I of the Constitution to abrogate States' sovereign or Eleventh Amendment immunity.[23] While the holding of *Seminole* might have been limited to the Indian Commerce Clause, subsequent cases unequivocally held that Congress had no such power under the expansive powers granted by the Commerce Clause or the Copyright Clause.[24]

Yet without reversing the analysis of *Seminole*, *Katz* held that the Framers had abrogated sovereign immunity under the Bankruptcy Clause.[25] This did not directly contradict the dictum of *Seminole*, because it was not a holding that *Congress* had the power to abrogate sovereign immunity under the Bankruptcy Clause, but rather that the Framers had already done so.[26]

Because Congress can ignore sovereign immunity when exercising the powers conferred by the Bankruptcy Clause, Congress' bankruptcy power is necessarily broader than all the other great Article I powers, including the Commerce Clause power, the taxing power, the copyright and trademark power, or even the Necessary and Proper Clause powers.

However, this rationale of *Katz* does not illuminate its full potential scope, because the power is broader not only with respect to sovereign immunity, but also with respect to States' sovereignty more generally. This is better demonstrated by the Sixth Circuit's analysis in *Hood*,[27] which is largely absent from the Supreme Court opinion, and yet not disavowed either.[28] In *Federalist* paper No. 32, Alexander Hamilton explained that the Constitution's delegation to Congress of a power to establish "uniform" laws signaled a complete "alienation of State sovereignty."[29] In *Katz*, the Supreme Court held that this alienation is so complete

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[23] *Id*. at 57.

[24] *See, e.g.*, Welch v. Tex. Dept. of Highways & Pub. Transp., 483 U.S. 468, 478 (1987) (refusing to accept argument that there is a silent power to abrogate sovereign immunity from the Commerce Clause); Florida Prepaid Postsecondary Ed. Expense Bd. v. Coll. Sav. Bank, 527 U.S. 627, 635 (1999) (holding Patent Remedy Act abrogating State sovereign immunity cannot be sustained under either the Commerce Clause or Patent Clause).

[25] *Katz*, 126 S. Ct. at 1004 (stating bankruptcy power leads to power to subordinate state sovereignty).

[26] *See id.* at 1005 ("Congress may, at its option, either treat States in the same way as other creditors insofar as concerns 'Laws on the subject of Bankruptcies' or exempt them from operation of such laws. Its power to do so arises from the Bankruptcy Clause itself; the relevant 'abrogation' is the one effected in the plan of the Convention, not by statute.").

[27] Hood v. Tenn. Student Assistance Corp. (*In re* Hood), 319 F.3d 755 (6th Cir. 2003), *aff'd on other grounds*, 541 U.S. 440 (2004).

[28] Although the Court stated that its conclusion "does not rest on the peculiar text of the Bankruptcy Clause," as had the Sixth Circuit's analysis, it did rely on that textual analysis to support its conclusion that "Congress has the power to enact bankruptcy laws the purpose and effect of which are to ensure uniformity in treatment of state and private creditors." *Katz*, 126 S. Ct. at 1004 n.13.

[29] THE FEDERALIST NO. 32, at 169 (Alexander Hamilton) (E.H. Scott ed., 1898); *see In re Hood*, 319 F.3d at 759 ("*The Federalist No. 32* shows that Congress' power to make uniform laws required states to surrender their own power to make such laws and thus an important degree of their sovereignty."); *see also In re* Microage Corp., 288 B.R. 842, 845 (Bankr. D. Ariz. 2003) (noting Supreme Court regularly employs *Federalist* No. 32 in its effort "[t]o determine the structure of the original Constitution").

in the context of "the subject of bankruptcies" that it includes even an abrogation of State sovereign immunity from suit.[30]

But the complete "alienation of State sovereignty" implies not only that sovereign immunity is inapplicable, but also that federalism principles in general should have no place in bankruptcy law, except to the extent otherwise indicated by Congress. Indeed, in the absence of an express indication of contrary Congressional intent, courts should assume that Congress intended to establish a uniform national law on the subject of bankruptcy that pays no heed whatsoever to state law.

C. The Reason for Broader Powers Is to Achieve Uniformity for Creditors' Benefit

The mere fact that the Bankruptcy Clause confers a broader power would have limited significance if it were only broader with respect to States as adversary defendants. But the true significance of this broader power is more evident from the Framers' *purpose* in conferring this broader power, as elucidated by the *Katz* opinion. As the history recited in the *Katz* opinion makes evident, the historical driving need for this broader power was ultimately to benefit *creditors* generally, not necessarily to provide greater relief to debtors vis-a-vis the States.[31]

Katz recites the historical problem of how a discharge from debtor's prison granted by one state could not be made effective as against another state.[32] But it is essential to remember that from 1704[33] to 1841,[34] the discharge was a creditor's remedy that was not primarily intended to provide debtor relief. It was a carrot that creditors could provide to induce a debtor to cooperate and turn over all his assets. That it was not intended as a debtor's remedy is apparent from the fact that the bankruptcy laws that provided this remedy for this almost century and a half were purely involuntary—only creditors could invoke the remedy.[35]

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[30] *Katz*, 126 S. Ct. at 1004 ("The ineluctable conclusion, then, is that States agreed in the plan of the Convention not to assert any sovereign immunity defense they might have had in proceedings brought pursuant to 'Laws on the subject of Bankruptcies.'").

[31] *Id.* at 1002 (describing Bankruptcy Act of 1800 as "chiefly a measure designed to benefit creditors").

[32] *Id.* at 997–1000. The problem also undoubtedly existed among the Colonies, but we here reference the problem among the States because the reported cases the Court considered were decided after States came into existence under the Articles of Confederation but prior to the adoption of the Constitution in 1789.

[33] The Statute of Anne, adopted in 1705, is the first English bankruptcy act that included a discharge of debts for bankrupts who fully cooperated with the process. *Id.* at 997 ("Not until 1705 did the English Parliament extend the discharge (and then only for traders and merchants) to include release of debts.").

[34] The American Bankruptcy Act of 1841, ch. 9, 5 Stat. 440 (repealed 1843), was the first one to allow a debtor to file a voluntary case. Prior to that the Bankruptcy Act of 1800, ch. 19, 2 Stat. 19 (repealed 1803), "was, like the English law, chiefly a measure designed to benefit creditors." *Id.* at 1002. Although, despite such design, clever debtors and their lawyers did find ways to use it to their own benefit. *See generally* BRUCE MANN, REPUBLIC OF DEBTORS: BANKRUPTCY IN THE AGE OF AMERICAN INDEPENDENCE (Harvard University Press 2003) (2002); Charles Jordan Tabb, *The History of the Bankruptcy Laws in the United States*, 3 AM. BANKR. INST. L. REV. 5, 14 (1995) (suggesting debtors could circumvent exclusive involuntary nature of bankruptcy prior to Bankruptcy Act of 1841 by persuading a friendly creditor to initiate proceeding).

[35] Tabb, *supra* note 34, at 8 n.20 (noting voluntary bankruptcy first appeared in Bankruptcy Act of 1841, indicating that three-and-a-half centuries of English bankruptcy law and post-Statute of Anne bankruptcy

While the discharge might provide a useful carrot under a single sovereign such as England, it was quickly found to be wanting once the atom of sovereignty is split. No rational interstate entrepreneur would turn over all of his assets to creditors in one state only to be free from prison in that state alone. He would instead hold out until either all his creditors agreed to the discharge, or the market turned and his fortunes revived. The answer, provided by the Framers in the Constitution, was to permit creditors to petition Congress to grant debtors' discharges that would be effective in every state.

As both the historical analysis and the language of the *Katz* opinion make clear, the purpose of the uniformity clause was to ensure that Congress could provide uniform treatment of creditors: "Congress has the power to enact bankruptcy laws the purpose and effect of which are to ensure uniformity in treatment of state and private creditors."[36]

D. The Intended Uniformity Was Uniformity Among the States, Not Just Within a State

Even more significantly, the purpose of this more robust power was to achieve uniformity *among* the States, rather than within a particular State. This is a significant departure from the century-old understanding of uniformity derived from *Moyses.* The *Moyses*' uniformity was a misnamed and probably mistaken "geographical uniformity" that merely required bankruptcy law to be uniform within a particular state, but permitting the law to yield different results in different states.[37] The historical analysis in *Katz*, however, makes clear that the motivation for the uniformity clause in the Constitution was to empower Congress to make bankruptcy law uniform from state to state.[38]

The more robust uniformity power that *Katz* affirmed does not strictly overrule *Moyses*, because *Moyses* only dealt with the Constitutional minimum level of uniformity whereas *Katz* dealt with Congress' power to do more than what is minimally required. In that sense the holdings do not conflict and can continue to co-exist. But *Katz* does overrule *Moyses* in a more important sense, in that *Katz*, rather than *Moyses*, elucidates the Framers' intent in granting the uniformity power. Consequently it is the more robust uniformity identified in *Katz*, rather than the

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law were entirely involuntary); *see also* Cont'l Ill. Nat'l Bank & Trust Co. v. Chicago, R. I. & P. R. Co., 294 U.S. 648, 670 (1935) ("[T]he act of 1841 took what then must have been regarded as a radical step forward by conferring upon the debtor the right by voluntary petition.").

[36] *Katz*, 126 S. Ct. at 1004 n.13.

[37] *See* Randolph J. Haines, *The Uniformity Power: Why Bankruptcy Is Different*, 77 AM. BANKR. L.J. 129, 163 (2003) ("[Koffler] has also demonstrated that *Moyses* got *Knowlton*'s uniformity rule wrong, and that the *Moyses* uniformity rule, which permits states to opt out of a uniform federal scheme, is probably not what the Framers intended." (citing Judith Schenck Koffler, *The Bankruptcy Clause and Exemption Laws: A Reexamination of the Doctrine of Geographic Uniformity*, 58 N.Y.U. L. REV. 22, 77–85 (1983))).

[38] *See Katz*, 126 S. Ct. at 1004 ("[T]he Framers, in adopting the Bankruptcy Clause, plainly intended to give Congress the power to redress the rampant injustice resulting from States' refusal to respect one another's discharge orders.").

cramped and almost meaningless uniformity applied in *Moyses*, that should inform the interpretation of bankruptcy statutes that do not expressly state which kind of uniformity Congress intended.

Together, these four broader implications of *Katz* suggest that it may signify a reversal of the long-standing presumption that bankruptcy law should be construed and applied with the limits of federalism in mind, even in the absence of any express Congressional intent. This changed presumption could have a profound impact on the interpretation and application of bankruptcy law far beyond merely dealing with the affirmative defenses available to State defendants. It could affect bankruptcy jurisdiction, how bankruptcy law is interpreted (the federal common law of bankruptcy), the incorporation of or reliance on nonuniform state law, and the federalism limits that might otherwise be construed to limit the plain meaning of bankruptcy laws.

II. JURISDICTION

Bankruptcy jurisdiction is federal question jurisdiction, not only where the Bankruptcy Code provides the rule of decision, but also because it is litigation that affects the rights of a federally-created entity, the estate.[39] Like all federal jurisdiction, bankruptcy jurisdiction is limited, and federalism principles are certainly at least one of the motivating reasons for this limitation. But, at minimum, if sovereignty has been completely "alienated" in the field of bankruptcy as Hamilton and now *Katz* have indicated, then bankruptcy jurisdiction should be at least as broad as any other federal question jurisdiction, and perhaps broader.

The rationale of *Katz* is not merely something for Congress to consider when enacting bankruptcy laws. It is also something for the judiciary to consider in interpreting the laws that have been passed. Although Hamilton's analysis in *Federalist* Nos. 32 and 81 considered the scope of *legislative* authority to abrogate sovereign immunity, he also argued in *Federalist* No. 82 that the same conclusion—that the Constitution's vesting of "uniform" power signals an alienation of State sovereignty—should also apply to the judiciary: "These principles may not apply with the same force to the judiciary as to the legislative power; yet I am inclined to think that they are in the main just with respect to the former as well as the latter."[40] And *Katz* itself holds that in light of the uniformity clause in the Constitution, it was not necessary for Congress to expressly abrogate sovereign immunity in section 106, because that had already been accomplished when the Constitution was ratified.[41] Consequently courts are free to interpret Congress' laws without regard to

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[39] Ralph Brubaker, *On the Nature of Federal Bankruptcy Jurisdiction: A General Statutory and Constitutional Theory*, 41 WM. & MARY L. REV. 743, 813 (2000) ("[F]ederal bankruptcy jurisdiction is constitutional federal question jurisdiction . . . a bankruptcy estate is a federally created entity, such that any claim to which a bankruptcy estate is a party, even a state-law claim, contains federal law.").

[40] THE FEDERALIST NO. 82, at 450 (Alexander Hamilton) (E.H. Scott ed., 1898).

[41] *See Katz*, 126 S. Ct. at 1005 (discussing Court's holding).

concerns for State sovereignty unless Congress indicates such an intent in the law itself.

A. "Related To" Jurisdiction—Pacor *or* Gibbs*?*

This suggests that "related to" jurisdiction for bankruptcy courts should be at least as broad, if not broader, than the "related to" jurisdiction of other federal courts, including district courts sitting in diversity. Congress should be presumed to have intended bankruptcy jurisdiction to be at least as broad as its power to enact bankruptcy legislation. As Hamilton said in *Federalist* No. 80: "If there are such things as political axioms, the propriety of the judicial power of a government being co-extensive with its legislative, may be ranked among the number."[42]

In other words, the proper test for "related to" jurisdiction should not be the effect on the estate, as *Pacor*[43] postulated.[44] While the estate gives rise to the existence of federal jurisdiction, just as does the existence of a federal question, it is not a benefit or detriment to the estate that should establish the limit of federal jurisdiction. Instead, the focus should be on how closely the federal question issues and the state law issues are related in terms of how they would be litigated, *i.e.*, do the state and federal law issues arise from such a nucleus of common fact that they form a single litigation unit, as was held in *United Mine Workers v. Gibbs.*[45] If *Pacor* were the general test for all federal "related to" jurisdiction, it would mean that an ancillary state law cause of action could be litigated with a federal cause of action only if the state law had an effect on the federal law—the reason that federal jurisdiction exists, like the federally-created estate in the bankruptcy context—which is obviously not the rule that *Gibbs* established. Under *Gibbs*, most properly ancillary state law causes of action have no relationship whatsoever to the federal cause of action, because what makes federal ancillary jurisdiction appropriate is the relationship of the underlying facts, not the relationship of the laws.

A single litigation unit can easily be found to exist even when there is clearly no effect on the estate. The most obvious example is when a creditor seeks to have a debt declared nondischargeable and there has been no other adjudication of the existence or the amount of the debt, which is unliquidated. The creditor would prove both that he had been defrauded, or the victim of the debtor's willful and malicious tort, and also prove the amount of damages and hence the debt. If the creditor prevails as to both the existence of the debt and its nondischargeable character, then the creditor will ask for a judgment on both grounds. A debtor might respond that bankruptcy jurisdiction is lacking to enter judgment for the debt, because that judgment can have no effect on the estate. Indeed, the whole purpose

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[42] THE FEDERALIST NO. 80, at 435 (Alexander Hamilton) (E.H. Scott ed., 1898).

[43] Pacor, Inc. v. Higgins, 743 F.2d 984 (1984).

[44] *Id.* at 995 (concluding examined action is not related to bankruptcy since "primary action . . . would have no effect on the Manville bankruptcy estate").

[45] United Mine Workers v. Gibbs, 383 U.S. 715, 725 (1966) (ruling "state and federal claims must derive from a common nucleus of operative fact").

of the litigation was not the allowance of a claim against the estate, but rather to establish what the creditor would collect from the debtor after the estate is exhausted. Under the *Pacor* test, bankruptcy jurisdiction would be lacking, and some courts have so concluded.[46]

But it is much more obvious that it makes no sense to litigate only the issue of whether the creditor was injured by a debtor's fraud or willful and malicious tort, without also litigating the amount of the debt. It certainly makes no sense, as used to be the practice prior to about 1970, to litigate only the issue of dischargeability, and then send the creditor and debtor to state court to litigate the amount of the debt. The amount of the debt and its dischargeability are a single litigation unit, so that under *Gibbs* federal jurisdiction over the one can extend to the other, *even though* the ultimate judgment on the state law issue—the amount of the debt—has no bearing on why federal jurisdiction exists—the determination of its dischargeable character.

The discharge context is by no means unique in its simultaneous involvement of both bankruptcy and state law issues, some of which have no effect on the estate. Suppose a trustee seeks to avoid as a preference a car lender's late-perfected lien. The car lender, who took an assignment from the dealer, contends it was the dealer's fault, but certainly does not want to have two separate litigations, one in bankruptcy court to establish whether the lien was timely filed, and another in state court with the dealer, who will defend that he submitted the lien in a timely fashion. The logical solution is for the lender to bring a third party complaint against the dealer. But what if the dealer argues that bankruptcy jurisdiction is lacking under *Pacor*, because the lender's complaint against the dealer can have no possible impact on the estate? The answer is easy under *Gibbs*, because the state and federal issues form a logical litigation unit.[47]

The analysis of *Katz* may help courts conclude that *Pacor* was simply wrong. This may come from the new perspective that *Katz* brings to judicial interpretation of Congress' purpose and intent in granting bankruptcy jurisdiction. It was not intended to be limited, at least not any more limited than any other federal jurisdiction. To the contrary, it was intended to be at least as broad, if not broader, than other federal jurisdiction. After all, it was intended from the time of the

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[46] *See, e.g.*, First Omni Bank N.A. v. Thrall (*In re* Thrall), 196 B.R. 959, 963–71 (Bankr. D. Colo. 1996) (finding bankruptcy court lacked jurisdiction to enter judgment on nondischargeable debt); *In re* Barrows, 182 B.R. 640, 653 (Bankr. D.N.H. 1994) (stressing "remedies and form of judgment" of non-discharged debts is not within jurisdiction of bankruptcy courts); *see also* United States v. Fleet Nat'l Bank (*In re* Calore Express Co.), 288 B.R. 167, 169 (D. Mass. 2002) ("[W]here there is no estate, the only logical conclusion is that there is no bankruptcy jurisdiction.").

[47] *See* Cowen v. Kennedy (*In re* Kennedy), 108 F.3d 1015, 1018 (9th Cir. 1997) (upholding bankruptcy court jurisdiction over entry of monetary judgment of non-dischargeable debt); Pierce v. Conseco Fin. Servicing Corp. (*In re* Lockridge), 303 B.R. 449, 455–56 (Bankr. D. Ariz. 2003) (authorizing bankruptcy jurisdiction over third party complaint based on state law since it was "so related" to initial complaint); Davis v. C.G. Courington (*In re* Davis), 177 B.R. 907, 912 (B.A.P. 9th Cir. 1995) (concluding "the federal and state claims arise out of the same general controversy and that the bankruptcy court has supplemental jurisdiction over the state law claims").

drafting of the Constitution to authorize a federal court to order a state official to release a prisoner, which was the essence of the bankruptcy discharge at the time of debtors' prisons. But that unique federal jurisdiction was broader than any other that existed for the next seven decades. Until the Civil War, a bankruptcy court discharge was the *only* federal court order that could compel a state official to release a state prisoner,[48] or that could enjoin a state court.[49] Since bankruptcy jurisdiction was originally conceived to be profoundly broader than any other federal jurisdiction, so there is no reason to assume that almost 200 years later, when both bankruptcy jurisdiction and federal jurisdiction had generally been expanding, Congress suddenly and inexplicably intended 28 U.S.C. § 1334 to be suddenly *narrower* than other federal jurisdiction. There is certainly no statutory language or legislative history to support that conclusion.

B. Supplemental Jurisdiction

This analysis also suggests that Congress similarly intended the supplemental jurisdiction provided by 28 U.S.C. § 1367 to apply to bankruptcy courts as well as to federal district courts. Although the Ninth Circuit has held that "the bankruptcy court's 'related to' jurisdiction also includes the district court's supplemental jurisdiction pursuant to 28 U.S.C. § 1367,"[50] other courts[51] and commentators[52] have disagreed. The rationale of *Katz* gives greater weight to the Ninth Circuit's

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[48] *See* Cent. Va. Cmty. College v. Katz, 126 S. Ct. 990, 1003 (2006) ("This grant of habeas power [in the Bankruptcy Act of 1800] is remarkable not least because it would be another 67 years, after ratification of the Fourteenth Amendment, before the writ would be made generally available to state prisoners.").

[49] *See* Toucey v. N.Y. Life Ins. Co., 314 U.S. 118, 132 (1941) (recognizing only legislative exception directly written into act to prohibit enjoining state courts was for bankruptcy proceedings); Amalgamated Clothing Workers v. Richman Bros. Co., 348 U.S. 511, 514 (1955) (stating prior to 1948 amendment, section 265 of the Judicial Code read: "The writ of injunction shall not be granted by any court of the United States to stay proceedings in any court of a State, except in cases where such injunction may be authorized by any law relating to proceedings in bankruptcy."); Callaway v. Benton, 336 U.S. 132, 154 (1949) (noting policy expressed in section 265 regarding stay of proceedings by federal courts was "frowned on" in most cases with the exception of bankruptcy jurisdiction).

[50] *In re* Sasson, 424 F.3d 864, 869 (9th Cir. 2005) (citing Montana v. Goldin (*In re* Pegasus Gold Corp.), 394 F.3d 1189, 1195 (9th Cir. 2005)); *see also* Sec. Farms v. Intl'l Bhd. of Teamsters, 124 F.3d 999, 1008 n.5 (9th Cir. 1997) (affirming bankruptcy court's subject matter jurisdiction based on supplemental jurisdiction).

[51] *See* Walker v. Cadle Co. (*In re* Walker), 51 F.3d 562, 570–73 (5th Cir. 1995) (reasoning bankruptcy courts do not have supplemental jurisdiction because Congress never granted such); *In re* Premium Escrow Servs., Inc., 342 B.R. 390, 406, 410 n.10 (Bankr. D.D.C. 2006) (limiting bankruptcy courts' "related to" jurisdiction and listing federal court decisions denying bankruptcy courts supplemental jurisdiction).

[52] *See* Susan Block-Lieb, *The Case Against Supplemental Bankruptcy Jurisdiction: A Constitutional, Statutory, and Policy Analysis*, 62 FORDHAM L. REV. 721, 831 (1994) (concluding "statutory and constitutional authority" for supplemental jurisdiction for bankruptcy courts is "uncertain" and should be restricted by either by courts or Congress); Daniel C. Burton, *To Infinity and Beyond: Related to "Related To" Jurisdiction: Supplemental Jurisdiction of Bankruptcy Courts*, 24–5 ABIJ 28, 64 (2005) ("The Ninth Circuit's [grant of supplemental jurisdiction to bankruptcy courts] not only supplants the careful congressional construct of 28 U.S.C. § 157, limiting bankruptcy jurisdiction to core and related-to matters, but also cuts against the Supreme Court's directive that courts *not* 'read jurisdictional statutes broadly.'" (quoting Finley v. United States, 490 U.S. 545, 549 (1989))).

conclusion. Since Congress' powers respecting bankruptcy are at least as broad as, if not broader than, its other legislative powers under Article I, and the reason for these broader powers was to afford creditors uniform relief, there is no reason to assume that Congress intended bankruptcy jurisdiction to be more limited.

C. Bankruptcy as a Court of Equity

The rationale of *Katz* also suggests that it is appropriate to infer that Congress intended bankruptcy courts to be courts of equity. Although there is substantial Supreme Court authority for the proposition,[53] it has recently been questioned, largely on the basis of what may have been a drafting oversight in the complex cure of the *Marathon* problem.[54]

Katz suggests that in drafting the jurisdictional statutes for bankruptcy courts, Congress intended to exercise its Constitutional powers to provide the broadest possible and most uniform relief, which would be inconsistent with an assumption that Congress intended to divest bankruptcy courts of their historical status as courts of equity.

One important area where this analysis might have significance concerns the application of *Grupo Mexicano*[55] in the context of bankruptcy. *Grupo Mexicano* held that federal district courts, sitting as courts of equity, are limited to the kinds of relief available in English courts of equity as of 1789.[56] Some courts and commentators have suggested this might mean that bankruptcy courts lack jurisdiction to grant equitable remedies, such as injunctive relief[57] or substantive consolidation,[58] that are neither found in the Bankruptcy Code nor existing in England in 1789.

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[53] *See, e.g.*, Pepper v. Litton, 308 U.S. 295, 304 (1939) ("[C]ourts of bankruptcy are essentially courts of equity, and their proceedings are inherently proceedings in equity." (quoting Local Loan Co. v. Hunt, 292 U.S. 234, 240 (1934))).

[54] *See In re* Jordan, 313 B.R. 242, 255 (Bankr. W.D. Tenn. 2004) ("Many believe that due to Congress' rush at the last moment to resolve and finalize the *Marathon* jurisdictional problem**,** a similar 'cure or waiver of defects' statute was inadvertently omitted as a drafting error or omission."); Alan M. Ahart, *The Limited Scope of Implied Powers of a Bankruptcy Judge: A Statutory Court of Bankruptcy, Not a Court of Equity*, 79 AM. BANKR. L.J. 1, 22 (2005) (stating Congress took away bankruptcy court's equitable powers after *Marathon* decision). *But see* Adam J. Levitin, *Toward a Federal Common Law of Bankruptcy: Judicial Lawmaking in a Statutory Regime*, 80 AM. BANKR. L.J. 1, 30 (2005) (suggesting legislation after *Marathon* removed all statutory authority granting bankruptcy courts equitable powers).

[55] Grupo Mexicano de Desarrollo, S.A. v. Alliance Bond Fund, Inc., 527 U.S. 308 (1999).

[56] *Id.* at 318 ("Because such a remedy was historically unavailable from a court of equity, we hold that the District Court had no authority to issue a preliminary injunction preventing petitioners from disposing of their assets pending adjudication of respondents' contract claim for money damages.").

[57] *See* Rubin v. Pringle (*In re* Focus Media Inc.), 387 F.3d 1077, 1085 (9th Cir. 2004) ("*Grupo Mexicano* thus exempts from its proscription against preliminary injunctions freezing assets cases involving bankruptcy and fraudulent conveyances, and cases in which equitable relief is sought." (citing United States v. Oncology Assocs., P.C., 198 F.3d 489, 496 (4th Cir. 1999) and CSC Holdings, Inc. v. Redisi, 309 F.3d 988, 996 (7th Cir. 2002))).

[58] *See* Wells Fargo Bank of Tex., N.A. v. Sommers (*In re* Amco Ins.), 444 F.3d 690, 694 (5th Cir. 2006) (noting district court's holding that *Grupo Mexicano* did not render substantive consolidation an unavailable remedy in bankruptcy, but ruling on other grounds); *In re* American Homepatient, Inc., 298 B.R. 152, 164–

Of course bankruptcy courts are Article I courts, although *Marathon* held that they exercise the judicial power of the United States.[59] *Katz* suggests that the broad powers granted to Congress under the Bankruptcy Clause might enable Congress to vest in bankruptcy courts broader powers than was vested in the federal district courts by virtue of Article III and the Judiciary Act of 1789.[60]

III. CHOICE OF LAW—STATE LAW OR A FEDERAL COMMON LAW OF BANKRUPTCY?

Because bankruptcy jurisdiction exists by virtue of the federal nature of the litigant—the estate—the *Erie* doctrine that applies in diversity cases does not directly apply.[61] At least where the estate is a party, state law should not apply as it properly did in *Parnell*.[62] While a court might nonetheless occasionally choose to apply state law, the analysis of *Clearfield* would ordinarily caution that a uniform federal rule should be adopted when the federally-created estate is a litigant:

> The application of state law, even without the conflict of laws rules of the forum, would subject the rights and duties [of the trustee or debtor in possession] to exceptional uncertainty. It would lead to great diversity in results by making identical transactions subject to the vagaries of the laws of the several states. The desirability of a uniform rule is plain. And while the federal law merchant developed for about a century under the regime of *Swift v. Tyson*,[63] represented general commercial law rather than a choice of a federal rule designed to protect a federal right, it nevertheless stands as a convenient source of reference for fashioning federal rules applicable to these federal questions.[64]

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65 (Bankr. M.D. Tenn. 2003) (holding *Grupo Mexicano* does not bar substantive consolidation); *In re* Stone & Webster, Inc., 286 B.R. 532, 540 (Bankr. D. Del. 2002) ("I seriously doubt that the above discussed longstanding judicial precedent [substantive consolidation] has been overruled by *Grupo Mexicano*.").

[59] *See* N. Pipeline Constr. Co. v. Marathon Pipeline Co., 458 U.S. 50, 87 (1982) (determining bankruptcy courts have Article III judicial power under Bankruptcy Act of 1978).

[60] *See* Cent. Va. Cmty. College v. Katz, 126 S. Ct. 990, 1000 (2006) ("The Framers would have understood that laws 'on the subject of Bankruptcies' included laws providing, in certain limited respects, for more than simple adjudications of rights in the res.").

[61] *See* Clearfield Trust Co. v. United States, 318 U.S. 363, 574–75 (1943) (agreeing *Erie* rule inapplicable to bankruptcy procedures).

[62] Bank of Am. Nat'l Trust & Sav. Ass'n. v. Parnell, 352 U.S. 29, 33–34 (1956) ("Securities issued by the Government generate immediate interests of the Government [as were addressed in *Clearfield*]. But they also radiate interests in transactions between private parties. The present litigation is purely between private parties and does not touch the rights and duties of the United States, [whose interest] is far too speculative, far too remote a possibility to justify the application of federal law to transactions essentially of local concern.").

[63] 14 U.S. (1 Pet.) 1 (1842).

[64] *Clearfield Trust Co.*, 318 U.S. at 367.

Of course the historical analysis of *Katz* further bolsters this "desirability of a uniform [federal] rule" for bankruptcy.

This means that there is, and should be, a federal common law of bankruptcy. Where the Code does not provide an express answer, bankruptcy courts should fill the interstices by application of federal common law, not by reference to state law unless the Code expressly refers to it or legislative history indicates Congress intended state law to be used. And given the Framers' intent to achieve uniform results for the benefit of creditors, the presumption might even be that an estate representative should be as favored a litigant as is the FDIC under the doctrine of *D'Oench Duhme*.[65]

A. Property Rights

How would a presumption in favor of a federal common law of bankruptcy apply? Does it mean that *Butner*[66] was wrongly decided? Instead of a mortgagee's rights to rents being dependant on state law, when nothing in the language or history of the Bankruptcy Code so indicates, should we have a uniform federal rule based on federal common law?

Probably not. Even during the heyday of *Swift v. Tyson*, federal courts relied on state law to define property rights.[67]

But the answer is really not so easy. Both for purposes of federal tax law and bankruptcy law, the Supreme Court has held that the federal statutes "create[] no property rights but merely attach[] consequences, federally defined, to rights created under state law."[68] In *Drye*,[69] the Supreme Court held that a federal tax lien could attach to a disclaimed inheritance notwithstanding state law providing that no property ever passed to the initially-named heir. Yet the Ninth Circuit Bankruptcy Appellate Panel subsequently rejected the *Drye* analogy in holding a debtor's

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[65] D'Oench Duhme & Co. v. FDIC., 315 U.S. 447, 457–58 (1942) (revealing Court's discussion of FDIC's position as litigant).

[66] Butner v. United States, 440 U.S. 48 (1979) (affirming state law's control for determination of property rights in assets of debtor's estate under Bankruptcy Act).

[67] *See generally* Jackson v. Chew, 25 U.S. (12 Wheat.) 153 (1827) (revealing federal courts use of state law to define property rights); *see also* Columbia Gas Transmission Corp. v. Exclusive Natural Gas Storage Easement, 962 F.2d 1192, 1198 (6th Cir. 1992) ("[P]roperty rights have traditionally been, and to a large degree are still, defined in substantial part by state law."); United States v. MidPac Lumber Co., Ltd., 976 F. Supp. 1310, 1315 (D. Haw. 1997) ("In determining whether such property or rights to property exists, federal and state courts must look to state law." (citing Aquilino v. United States, 363 U.S. 509, 513 (1960))).

[68] United States v. Bess, 357 U.S. 51, 55 (1958); *see also* United States v. Nat'l Bank of Commerce, 472 U.S. 713, 722 (1985) (quoting and upholding Court's decision in *Bess*); *Butner*, 440 U.S. at 54 ("Congress has generally left the determination of property rights in the assets of a bankrupt's estate to state law.").

[69] Drye v. United States, 528 U.S. 49, 52 (1999) ("We hold that the disclaimer did not defeat the federal tax lien.").

disclaimer not to constitute a fraudulent transfer because there was no "property" interest recognized by state law that had been transferred.[70]

In fact, of course, in neither the tax law nor in Bankruptcy Code section 548 did Congress expressly state whether property rights were to be determined according to state law or federal common law.[71] Both conclusions, in *Drye* and *Butner*, rested on the courts' inferences from the whole structure of each Code. *Butner* found no federal interest at stake that would provide a reason to deviate from state law,[72] while in *Drye* the Court noted that "federal tax law 'is not struck blind by a disclaimer.'"[73]

Katz suggests there is substantial federal reason to adopt a uniform federal rule that might deviate from a particular state's law—to provide a uniform result for the benefit of creditors regardless of the state in which their debtor files for bankruptcy relief. *Katz* holds that this is exactly the benefit the Framers' intended when they authorized Congress to establish uniform law on the subject of bankruptcies throughout the United States. And its intent to abrogate sovereign immunity would certainly have been regarded as a greater affront to State sovereignty than mere adoption of a federal definition of property for fraudulent transfer purposes.

B. Equitable Defenses, e.g., In Pari Delicto

Katz similarly suggests that some equitable defenses provided by some state laws should not be applied in the bankruptcy context. In particular, it might mean that bankruptcy courts should not apply a state law defense of *in pari delicto* to defeat an estate representative's recoveries for the benefit of creditors. Instead, they should develop a federal common law of when that defense should be available. In so doing, they might well reach the same conclusion for debtors in possession and

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[70] Gaughan v. The Edward Dittlof Revocable Trust (*In re* Costas), 346 B.R. 198, 204 (B.A.P. 9th Cir. 2006).

[71] While this is true under today's Bankruptcy Code, *Butner* was actually decided under the Act which did contain specific references to state law. However, the Bankruptcy Commission concluded that "a reference to nonbankruptcy law to determine the property to be administered for the benefit of creditors is a mistake." REPORT OF THE COMM. OF THE BANKRUPTCY LAWS OF THE UNITED STATES, H.R. DOC. NO. 93-137, pt. 2, at 148 (1st Sess. 1973). Consequently section 541 was drafted to eliminate the Act's multiple references to state law. The Commission recommends that "[t]he property of the estate be defined in the act comprehensively and that the tests of transferability and leviability under state law be abandoned." *Id.* pt. 1, at 17.

[72] *See Butner*, 440 U.S. at 55 ("Property interests are created and defined by state law. Unless some federal interest requires a different result, there is no reason why such interests should be analyzed differently simply because an interested party is involved in a bankruptcy proceeding. Uniform treatment of property interests by both state and federal courts within a State serves to reduce uncertainty, to discourage forum shopping, and to prevent a party from receiving 'a windfall merely by reason of the happenstance of bankruptcy.'").

[73] *Drye*, 528 U.S. at 51.

trustees as the Seventh and Ninth Circuit reached for receivers in *Scholes*[74] and *O'Melveny*.[75]

C. Causes of Action

Katz might also mean that certain estate representatives' causes of action should be defined by federal common law rather than state law. Delaware, for example, has recently interpreted its notoriously corporate-friendly statutes to preclude creditors' actions for corporate officers' and directors' breach of fiduciary duty after insolvency to the extent that the corporate charter would insulate the directors from such claims when asserted by the shareholders.[76] Therefore to the extent that the fiduciary duty that an insolvent corporation owes its creditors is derived solely from Delaware law, corporate directors and shareholders could insulate themselves from such liability by simple corporate charter provisions, over which creditors have no say. Presumably this would provide an even greater encouragement for such corporations to incorporate under Delaware law.

But there is a federal common law of fiduciary duties owed by corporations to creditors. The absolute priority rule evolved as federal common law in federal equity receiverships, such as *Boyd*.[77] It held that the corporate capital "was a trust fund charged primarily with the payment of corporate liabilities," without any reliance on the state law under which it was incorporated.[78] This federal common law could provide the basis for the fiduciary duties that corporate directors owe to creditors upon insolvency, free from the defenses provided by the exculpating clauses found in the corporate charter and authorized by Delaware law.

Katz suggests that Congress was expected to adopt such a uniform rule that would benefit creditors equally regardless of some States' attempts to protect the directors, and noting in the Bankruptcy Code suggests that was not Congress' intent.

Such an application of the rationale of *Katz* is even more appropriate after the adoption of BAPCPA.[79] The great compromise that gave rise to the uniformity challenge to the Bankruptcy Act—the ability of states to define exempt property[80]—was one of the principal BAPCPA reforms. The reforms did two things. First, they reduced states' homestead exemptions by imposing a federal $125,000 cap under

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[74] Scholes v. Lehman, 56 F.3d 750, 754 (7th Cir. 1995) (discussing treatment of receivers).

[75] F.D.I.C. v. O'Melveny & Myers, 61 F.3d 17, 19 (9th Cir. 1995) ("[T]here is little reason to impose the same punishment [the *in pari delicto* defense] on a trustee, receiver, or similar innocent entity that steps into a party's shoes pursuant to court order or operation of law.").

[76] *See* Prod. Res v. NCT Group, 863 A.2d 772, 787–95 (Del. Ch. 2004) (discussing creditor's rights against corporate officers and directors after company insolvency).

[77] N. Pac. Ry. Co. v. Boyd, 228 U.S. 482 (1913).

[78] *Id.* at 504.

[79] Pub. L. No. 109-8, 119 Stat. 23 (2005); *cf.* Robert Wann, Jr., Note, *"Debt Relief Agencies:" Does the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 Violate Attorneys' First Amendment Rights?*, 14 AM. BANKR. INST. L. REV. 273, 273 n.1 (2006) (discussing BAPCPA's enactment).

[80] *See supra* note 14 (discussing compromise related to exempt property).

certain circumstances notwithstanding state law,[81] and eliminating the exemption altogether if the value derived from a transfer prohibited a new federal law.[82] More importantly for present purposes, however, the reforms added several explicit references to when bankruptcy courts must apply state law, and which state law must be applied.[83] These explicit references create the negative implication that where Congress does not mandate application of a specified state law, it intended a uniform federal rule to apply.

IV. FEDERALISM PRINCIPLES AS LIMITS TO BANKRUPTCY LAW

The complete "alienation" of state sovereignty in bankruptcy may also mean that federalism principles have no role in interpreting bankruptcy law that unquestionably does supplant state law. Perhaps the best example of this is the federalism discussion in *BFP*.[84] The Court there bolstered its unique interpretation of "reasonably equivalent value" by a concern for federalism: "Federal statutes impinging upon important state interests 'cannot . . . be construed without regard to the implications of our dual system of government.'"[85] But *Katz* and Hamilton's *Federalist* papers suggest such concern for the dual system of government is misplaced in the area of bankruptcy, at least absent indication of Congressional intent. Since the States agreed to a complete alienation of their sovereignty in the area of bankruptcy, such federalism concerns are wholly out of place unless Congress decided to consider them in its draft of the bankruptcy law. There is no indication of any such intent in Code section 548, which inherently overrides state law such as the laws of contract and gifts.[86]

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[81] *See* 11 U.S.C. § 522(p), (q) (2006) (capping property exemption at $125,000 in certain circumstances).

[82] *See* 11 U.S.C. § 522(o) (2006) (reducing property exemption to extent debtor intended to hinder, delay, or defraud creditor).

[83] *See, e.g.*, 11 U.S.C. § 522(b)(3)(A) (2006) (allowing debtor to apply state exemption statutes).

[84] BFP v. Resolution Trust Corp., 511 U.S. 531 (1994) (holding price received at regularly conducted foreclosure sale is conclusively presumed to be "reasonably equivalent value" for purposes of federal fraudulent transfer law).

[85] *Id*. at 554 (quoting F. Frankfurter, *Some Reflections on the Reading of Statutes*, 47 COLUM. L. REV. 527, 539–40 (1947)).

[86] Of course there is also another reason why federalism principles were out of place in *BFP*. States had adopted fraudulent conveyance laws long before they were incorporated into the Bankruptcy Code, and the constructive fraudulent conveyance by an insolvent was initially a creature of state law, the Uniform Fraudulent Conveyance Act that was proposed in 1919, and adopted by many states. *See* Boss-Linco Lines, Inc. v. Laidlaw Trans. Ltd. (*In re* Boss-Linco Lines, Inc.), 55 B.R. 299, 307 (Bankr. W.D.N.Y. 1985) (referencing district court's discussion regarding origin of fraudulent conveyance law); *see also* Jon Finelli, Comment, *In re* Costas*: The Misapplication of Section 548(a) to Disclaimer Law*, 14 AM. BANKR. INST. L. REV. 567, 572 (2006) (noting lack of uniformity among states' fraudulent conveyance laws prior to 1918). It did not become federal law under the 1978 Bankruptcy Code, which sought consistency with state law. *See* Am. Nat'l Bank v. MortgageAmerica Corp. (*In re* MortgageAmerica Corp.), 714 F.2d 1266, 1275 (5th Cir. 1983) (recognizing Bankruptcy Code's incorporation of state fraudulent conveyance law in 1978); Phillip I. Blumberg, *The Increasing Recognition of Enterprise Principles in Determining Parent and Subsidiary Corporation Liabilities*, 28 CONN. L. REV. 296, 328–29 n.118 (1996) (indicating state fraudulent conveyance laws were replaced by Bankruptcy Code in 1978). Thus, the concept of "reasonably equivalent value" that was at issue in *BFP* was, and still remains, a significant state-law concept. Whether it trumps a state law

V. *KATZ*'S RELIANCE ON HAMILTON'S ANALYSIS MIGHT SUPPORT REVERSAL OF *HANS*

Might the rationale of *Katz* signify anything for sovereign immunity law outside of the bankruptcy context? The *Katz* Court's heavy reliance on the "uniform" clause may provide a basis for the Court to reconsider its modern sovereign immunity law, particularly to the extent the opinion gives some credence to Hamilton's analysis in *Federalist* Nos. 32 and 81, on which the Sixth Circuit relied in *Hood.* Hamilton's analysis may provide the basis for a challenge to the very foundation of the modern expansion of sovereign immunity, *Hans v. Louisiana.*[87]

The analytical problems inherent in *Union Gas*,[88] *Seminole* and *Katz* really all stem from the Constitutional analytical flaws in *Hans v. Louisiana.* The language of the Eleventh Amendment was clearly drafted to eliminate the diversity jurisdictional basis in Article III that would have permitted a suit against a State based on State law.[89] That is consistent with its historical origins, because the concern was that diversity jurisdiction might allow a state to be sued on war bonds in a federal court, rather than the presumably more State-protective State courts. So the obvious solution was to eliminate this basis of jurisdiction in federal courts, not to create a new definition of sovereign immunity.

There are two major propositions in *Hans*, one of which is soundly grounded in Constitutional history, and the other of which is wholly unfounded. First, the *Hans* Court correctly concluded that the purpose, intent and effect of the Eleventh Amendment was merely to overrule *Chisholm*.[90] In other words, the Eleventh Amendment did not create a new basis for sovereign immunity, it merely restored the understanding of sovereign immunity that existed when the Constitution was adopted. Second, however, *Hans* concluded that sovereign immunity would apply in federal courts when jurisdiction arose on a federal question, as well as when it arose from diversity.[91] In other words, *Hans* also implied that the original understanding of sovereign immunity was the same as to state law causes of action that might be asserted against a State, as to causes of action arising from federal law.

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foreclosure is as much a state law question as a federal law question, so the answer should not be influenced by federalism concerns.

[87] 134 U.S. 1 (1890).

[88] Pennsylvania v. Union Gas Co., 491 U.S. 1 (1989).

[89] *See* U.S. CONST. amend. XI ("The Judicial power of the United States shall not be constructed to extend to any suit in law or equity, commenced or prosecuted against one of the United States by Citizens of another State, or by Citizens or Subjects of any Foreign State.").

[90] *See* Hans v. Louisiana, 134 U.S. 1, 10–11 (1890) ("[Chisholm] created such a shock of surprise throughout the country that . . . the eleventh amendment to the Constitution was almost unanimously proposed, and was in due course adopted . . . .").

[91] *Id.* at 10 ("That a state cannot be sued by a citizen of another state, or of a foreign state, on the mere ground that the case is one arising under the Constitution or laws of the United States, is clearly established by the decisions of this court . . . .").

Sovereign immunity as analyzed in *Hans* is based heavily on Hamilton's analysis.[92] Consequently it provides no basis whatsoever to argue that sovereign immunity would provide a defense to federal causes of action based on federal laws passed in reliance on those Constitutional powers that Hamilton identified as being outside the sphere of sovereign powers retained by the States under the structure of the Constitution.

Even if *Katz* does not ultimately rely on Hamilton's analysis, it certainly lends support to it. It means, at minimum, that one of Hamilton's conclusions was correct—the uniformity provision in Article I, section 8, clause 4 does in fact signify an abrogation of sovereign immunity. And to the extent that *Katz* does lend credence to Hamilton's analysis, then it may have broader significance for sovereign immunity concepts outside of the bankruptcy context. This is because if Hamilton's analysis was both historically correct and now validated by a Supreme Court holding, then it may signal the ultimate demise of the second proposition of *Hans*—that sovereign immunity is the same in federal question cases as it is in diversity cases.

Under Hamilton's analysis (perhaps now adopted by the Court in *Katz)*, the plaintiff's suit in *Hans* would not be barred by sovereign immunity because it was premised on the federal question basis of the Constitutional prohibition on states abrogating the obligations of contracts.[93]

While the Supreme Court does not often overrule precedent, it has already done so at least once in the law of sovereign immunity, when *Seminole* overruled *Union Gas*. And there is another reason why *Hans* is on even less sound footing than was *Union Gas*: the *Hans* Court lacked jurisdiction.

Hans sued Louisiana in federal court based on federal question jurisdiction, the federal question arising from the Impairment Clause of the Constitution.[94] But in

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[92] *Id.* at 12–15 ("The eighty-first number of *The Federalist*, written by Hamilton, has the following profound remarks: 'It has been suggested that an assignment of the public securities of one state to the citizens of another would enable them to prosecute that state in the federal courts for the amount of those securities, a suggestion which the following considerations prove to be without foundation: It is inherent in the nature of sovereignty not to be amenable to the suit of an individual without its consent. This is the general sense and the general practice of mankind; and the exemption, as one of the attributes of sovereignty, is now enjoyed by the government of every state in the Union.'").

[93] *See* THE FEDERALIST No. 81 (Alexander Hamilton) (revealing Hamilton's discussion of sovereign immunity); *see also* Gray v. Fla. State Univ. (*In re* Dehon, Inc.), 327 B.R. 38, 39 (Bankr. D. Mass. 2005) ("In *The Federalist* No. 81. Alexander Hamilton affirmed the States' retention of sovereignty in the Constitution's federalist system."); *cf.* Hood v. Tenn. Student Assistance Corp. (*In re* Hood), 262 B.R. 412, 415 (Bankr. Fed. App. 2001) (recognizing Supreme Court "has often relied" on *The Federalist* papers to "determine the contemporaneous understanding of the circumstances in which the States yielded their sovereignty as a part of the formation of the Union").

[94] *See Hans*, 134 U.S. at 1–2 ("The grounds of the action are stated in the petition as follows: 'Your petitioner avers that by the issue of said bonds and coupons said state contracted with and agreed to pay the bearer thereof the principal sum . . . and said legislature, by an act approved January 24, 1874, proposed an amendment to the constitution of said state, which was afterwards duly adopted, and is as follows, to-wit: 'No. 1. The issue of consolidated bonds, authorized by the general assembly of the state at its regular session in the year 1874, is hereby declared to create a valid contract between the state and each and every holder of said bonds, which the state shall by no means and in no wise impair.'").

reality he was suing on Louisiana's war bonds, not on the Impairments Clause. The Impairments Clause did not give Hans a cause of action. Rather, it was merely his defense to Louisiana's defense that it was not liable on its war bonds because its state constitution had modified that liability.[95] Federal question jurisdiction cannot be based on a federal defense to a state law cause of action, and it certainly cannot be based on a federal-law response to a state law defense on a state law cause of action.[96]

This is not merely an interesting historical quirk of the *Hans* litigation. It has much broader significance for sovereign immunity issues. While the language Hamilton identified might abrogate sovereign immunity in certain contexts, it is still necessary for Congress to create a cause of action on which someone could sue the State in that context. Congress apparently never passed a law creating federal causes of action for States' war bond obligations.[97]

CONCLUSION

Katz may signal a sea-change in the interpretation and application of bankruptcy law. It signals that bankruptcy law and jurisdiction should not be regarded as limited, but rather as "robust." It signals that a federal common law is appropriate in the absence of expressed intent to adopt state laws. And it signals that the Framers and Congress place a higher value on having a uniform rule, for the benefit of creditors, than on avoiding a variation between bankruptcy rights and powers and those that would exist under the laws of a particular state.

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[95] *Id*. at 3 ("Petitioner also avers that said provisions of said constitution are in contravention of said contract, and their adoption was an active violation thereof, and that said state thereby sought to impair the validity thereof with your petitioner, in violation of article 1, section 10, of the Constitution of the United States, and the effect so given to said state constitution does impair said contract.").

[96] *See* Beneficial Nat'l Bank v. Anderson, 539 U.S. 50, 12 (2003) ("A federal court does not have original jurisdiction over a case in which the complaint presents a state-law cause of action, but also asserts that federal law deprives the defendant of a defense he may raise, . . . or that a federal defense the defendant may raise is not sufficient to defeat the claim." (quoting Franchise Tax Bd. of Cal. v. Constr. Laborers Vacation Trust for S. Cal., 463 U.S. 1, 10 (1983))).

[97] *See* Lilley v. Missouri, 920 F.Supp. 1035, 1041 (E.D. Mo. 1996) (holding plaintiffs did not have federal cause of action under Fourteenth Amendment Equal Protection Clause against state for refusing to honor Civil War bonds); Spears v. Robinson, 431 F.2d 1089, 1090–91 (8th Cir. 1970) (affirming plaintiffs did not have jurisdiction under the Civil Rights amendments to enforce state bond obligation).