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# The Bankruptcy Clause and the Eleventh Amendment: An Uncertain Boundary Between Federalism and State Sovereignty

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Even when the Constitution vests in Congress complete lawmaking authority over a particular area, the Eleventh Amendment prevents congressional authorization of suits by private parties against unconsenting States.<sup>1</sup>

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.”<sup>2</sup>

## Introduction

THE BANKRUPTCY CLAUSE of Article I of the Constitution<sup>3</sup> lives in uneasy coexistence with state sovereignty. The Bankruptcy Clause provides Congress with the authority to establish “uniform Laws on the subject of Bankruptcies throughout the United States.”<sup>4</sup> Legal tradition, embodied in the Constitution by the Eleventh Amendment,<sup>5</sup> holds states immune from suit by citizens absent the state’s consent. There are, nonetheless, many provisions of the Bankruptcy Code that permit litigation to recover assets of the debtor or to administer the debtor’s estate. These include suits by debtors or trustees against creditors, suits by creditors against the debtor, and suits against third parties.<sup>6</sup> States or state agencies are interested parties in almost every

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1. *Seminole Tribe of Fla. v. Florida*, 517 U.S. 44, 72 (1996).

2. *Cent. Va. Cmty. Coll. v. Katz*, 546 U.S. 356, 377 (2006).

3. U.S. CONST. art. I, § 8, cl. 4.

4. *Id.*

5. U.S. CONST. amend. XI.

6. A bankruptcy trustee (including a trustee in a chapter 7 liquidation as well as a trustee in a reorganization under chapters 9, 11, 12, and 13) may request the bankruptcy

bankruptcy and are frequently litigants because of their relationship to the debtor. The Bankruptcy Code generally does not differentiate between state and non-state actors, and section 106 of the Code expressly abrogates state immunity for most types of bankruptcy litigation.<sup>7</sup> These provisions come into conflict with the Eleventh Amendment.

The tension between bankruptcy jurisdiction and state immunity has been a heated issue in a number of court cases. There is no majority consensus on this subject, but the opposing positions—preeminence of a federal bankruptcy system versus strict application of state immunity—are clear, and their arguments exhaustively developed.

The most recent Supreme Court decision on this matter is *Central Virginia Community College v. Katz*.<sup>8</sup> In a five-to-four decision, the Court permitted a bankruptcy trustee to sue the State of Virginia to recover assets of the bankruptcy estate because states had consented to suit when they ratified the Bankruptcy Clause.<sup>9</sup> The *Katz* decision stunned observers because it essentially reversed the Court's decision ten years earlier in *Seminole Tribe of Florida v. Florida*.<sup>10</sup> *Seminole Tribe* held that Congress did not have authority to abrogate state immunity when leg-

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court to avoid certain types of pre- and post-petition liens and transfers of property that are prejudicial to the bankruptcy estate. The types of liens and transfers subject to the trustee's "avoidance" powers are set forth in Chapter 5 of the Bankruptcy Code, 11 U.S.C. §§ 544–549 (2000), and include, inter alia, transfers that could otherwise be avoidable by a secured creditor in the ordinary course of business, § 544, statutory liens that become fixed due to insolvency, § 545, fraudulent transfers made to third parties or "insiders" for less than fair value in order to move assets out of the reach of legitimate creditors, § 548, and post-petition transfers not authorized by the bankruptcy court, § 549. The most common use of the trustee's avoidance powers is "preferential transfers" under section 547. A preferential transfer is a transfer made for the benefit of a creditor on account of an antecedent (pre-petition) debt within the ninety days immediately prior to the petition date (one year if the transferee is an insider) and while the debtor is insolvent, and which enables the creditor to receive more than the creditor would have received in a liquidation or if the transfer had not been made. *Id.* § 547. There are several defenses to a preference action set forth in section 547, and much of the litigation over preference deals with whether the transfer at issue in the case falls within one of the defenses.

An avoidance action is commenced as an "adversary proceeding" under Bankruptcy Rule 7003 and acts as a separate litigation within the underlying bankruptcy case. FED. R. BANKR. P. 7003. If the bankruptcy court rules that a lien or transfer is avoided, section 550 provides that "the trustee may recover, for the benefit of the estate, the property transferred, or . . . the value of such property." 11 U.S.C. § 550. Thus, exercise of the bankruptcy trustee's avoidance power typically involves two steps: first, adjudication that the transfer is avoidable under sections 544 through 549, and second, recovery of the funds or res by the trustee pursuant to section 550.

7. 11 U.S.C. § 106(a).

8. 546 U.S. 356 (2006).

9. *Id.* at 377–78.

10. 517 U.S. 44 (1996).

islating pursuant to Article I.<sup>11</sup> After *Seminole Tribe*, it was generally assumed that sovereign immunity would apply to bankruptcy.<sup>12</sup> *Seminole Tribe*, however, was also a five-to-four decision, and in light of the result in *Katz*, the boundary between state immunity and bankruptcy jurisdiction is clearly not fixed.

This Article will examine the conflict between the Bankruptcy Code and state sovereignty. The Article shows that while state substantive law is extensively incorporated into federal bankruptcy law, the Bankruptcy Code prevails over state sovereign immunity when applying bankruptcy law. In other words, under the present judicial regime, the Bankruptcy Code presents a glaring exception to the otherwise firm rule of state sovereignty.

Part I examines the Bankruptcy Clause and several national bankruptcy statutes, including the current Bankruptcy Code. This discussion includes an explanation of how the Bankruptcy Clause sits within the framework of the Supremacy Clause.<sup>13</sup> Part II discusses the doctrine of state sovereign immunity as embodied in the Eleventh Amendment and as applied in key cases. This part highlights the tension between court majorities that interpret federal powers broadly, and those that favor strict application of Eleventh Amendment immunity. Part III then considers this controversy in the context of national bankruptcy law, where the conflict is particularly sharp and enduring, and the majorities on either side are razor thin. The Article concludes in Part IV with a look at the future of bankruptcy law and state sovereignty under the rule of *Katz* and suggests that *Katz* might not be such a radical departure from the Eleventh Amendment after all.

## I. Bankruptcy and the Constitution

### A. The Bankruptcy Clause

The Bankruptcy Clause, contained in Article I, Section 8, clause 4 of the Constitution, reads simply enough: “The Congress shall have

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11. *Id.* at 72–73.

12. See, e.g., Leonard H. Gerson, *A Bankruptcy Exception to Eleventh Amendment Immunity: Limiting the Seminole Tribe Doctrine*, 74 AM. BANKR. L.J. 1, 2 (2000).

13. U.S. CONST. art. VI, cl. 2 (“This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.”).

power . . . [t]o establish a uniform rule of naturalization, and uniform laws on the subject of bankruptcies throughout the United States.”<sup>14</sup>

There is little in the record of the history of the Bankruptcy Clause.<sup>15</sup> One known fact, however, is that one of the Framers’ concerns was the patchwork of bankruptcy laws (or lack of them) among the states in the early republic.<sup>16</sup>

Emblematic of the Framers’ concern was the disparate treatment between the debtors in the cases of *James v. Allen*<sup>17</sup> and *Millar v. Hall*.<sup>18</sup> In *James*, a debtor who had been released from prison in New Jersey traveled to Pennsylvania, where he was arrested for nonpayment of a Pennsylvania debt.<sup>19</sup> The Pennsylvania court ruled that the New Jersey discharge did no more than release the debtor from the county gaol where he was imprisoned, but did not authorize a subsequent discharge anywhere else.<sup>20</sup> The court in *Millar*, however, ruled the opposite, holding that a debtor discharged in Maryland could not thereafter be imprisoned for a Pennsylvania debt, since, having been “obliged to transfer his effects for the benefit of all his creditors . . . [the debtor was] deprived of every means of payment.”<sup>21</sup>

In drafting the Bankruptcy Clause, the Framers intended for United States bankruptcy law to have expansive application, well beyond the limited purpose of insolvency statutes under English law.<sup>22</sup> English bankruptcy law, from the time of Henry VIII, was intended

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14. U.S. CONST. art. I, § 8, cl. 4.

15. Many believe that it was drafted by Charles Pinckney of South Carolina and passed late in the Constitutional Convention Proceedings after very little debate. Jonathon C. Lipson, *Debt and Democracy: Towards a Constitutional Theory of Bankruptcy*, 83 NOTRE DAME L. REV. (forthcoming 2007) (manuscript at 12–14), available at <http://lsr.nellco.org/cgi/viewcontent.cgi?article=1153&context=upenn/wps>. Lipson’s article provides a concise overview of facts and authorities on the history of the Bankruptcy Clause.

16. Some states had no insolvency laws, while others provided for release from debtor’s prison, but not for discharge of debt. BRUCE H. MANN, *REPUBLIC OF DEBTORS: BANKRUPTCY IN THE AGE OF AMERICAN INDEPENDENCE* 55, 59–60 (2002). Pennsylvania had an actual bankruptcy law which permitted discharge of unpaid debts, but only to commercial debtors. *Id.*

17. 1 U.S. (1 Dall.) 188 (Pa. Ct. Com. Pl. 1786).

18. 1 U.S. (1 Dall.) 229 (Pa. 1788).

19. *James*, 1 U.S. (1 Dall.) at 188.

20. *Id.* at 192.

21. *Millar*, 1 U.S. (1 Dall.) at 232, cited in *Cent. Va. Cmty. Coll. v. Katz*, 546 U.S. 356, 368 (2006). In the time-honored tradition of legal practice, the lawyer for the debtor *Millar*, Jared Ingersoll, made exactly the opposite argument when he represented the State of Pennsylvania in *James*. *Id.* at 229. The majority in *Katz* would cite these two cases over two hundred years later. *Katz*, 546 U.S. at 366–86.

22. *In re Klein*, 42 U.S. (1 How.) 277 (1843) (holding that the extent of Congress’s power under the Bankruptcy Clause is not limited to the principles of English bankruptcy law).

primarily to protect the interests of trade creditors, as debtors were considered to be criminals.<sup>23</sup> In contrast, United States bankruptcy law at an early point not only protected trade creditors against debtor fraud, but also “rescue[d] the honest but unfortunate insolvent from the oppression of a vindictive creditor.”<sup>24</sup> As Justice Sutherland noted, “From the beginning, the tendency of legislation and of judicial interpretation has been uniformly in the direction of progressive liberalization in respect of the operation of the bankruptcy power.”<sup>25</sup> That is still the focus of American bankruptcy law today.<sup>26</sup>

## B. Federal Bankruptcy Statutes

### 1. Pre-Bankruptcy Code Acts

Chief Justice Marshall considered the scope of congressional power under the Bankruptcy Clause to be broad: “The peculiar terms of the grant [in the Bankruptcy Clause] certainly deserve notice. Congress is not authorized merely to pass laws, the operation of which shall be uniform, but to establish uniform laws on the subject throughout the United States.”<sup>27</sup> Notwithstanding, Congress used this power sparingly during the first one hundred years of the republic and only in response to economic pressures.

The first law enacted pursuant to the Bankruptcy Clause was the Bankruptcy Act of 1800<sup>28</sup> (“Act of 1800”), passed by Federalists in the wake of the Panic of 1797.<sup>29</sup> The Act of 1800 expanded upon English

23. See MANN, *supra* note 16, at 46; see generally Kurt H. Nadelmann, *On the Origin of the Bankruptcy Clause*, 1 AM. J. LEGAL HIST. 215 (1957).

24. Statement of Harrison Gray Otis, Federalist party member and early U.S. Representative in debates regarding the proposed Bankruptcy Act of 1800, cited in MANN, *supra* note 16, at 212 (quoting 9 Annals of Cong. 2660, 2675 (1799)).

25. *Cont'l Bank v. Rock Island Ry.*, 294 U.S. 648, 668 (1935).

26. *Local Loan Co. v. Hunt*, 292 U.S. 234, 244 (1934) (holding that a key purpose of bankruptcy law is to give debtors “a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of pre-existing debt”); accord *Harris v. Zion's Sav. Bank & Trust Co.*, 317 U.S. 447, 451 (1943); *Stellwagen v. Clum*, 245 U.S. 605, 617 (1918). Bankruptcy law does not preempt other rights under the Constitution. For example, oral testimony that is compelled pursuant to bankruptcy authority may not be used for self-incrimination. 11 U.S.C. § 344 (2000). Creditors cannot be denied the right of due process. *Louisville Joint Stock Land Bank v. Radford*, 295 U.S. 555, 589, 602 (1935).

27. *Sturges v. Crowninshield*, 17 U.S. (4 Wheat.) 122, 193–94 (1819).

28. Ch. 19, 2 Stat. 19, *repealed by* Act of 1803, ch. 6, 25 Stat. 248.

29. Erik Berglöf & Howard Rosenthal, *Power Rejected: Congress and Bankruptcy in the Early Republic* 5 (May 31, 2005) (unpublished manuscript), available at <http://www.finance.ox.ac.uk/NR/rdonlyres/0FCCE7A6-408E-4E1D-B224-DB33C9DAA4A9/0/howardrosenthalPowerRejected7.pdf>. The Panic of 1797 started with the contraction of credit in Europe incident to the outbreak of war in 1793. DAVID J. SKEEL, JR., *DEBT'S DOMINION: A HISTORY OF BANKRUPTCY LAW IN AMERICA* 202–04 (2001). Additionally, deprivation on

law by including traders, bankers, brokers, and underwriters as lawful debtors in insolvency proceedings.<sup>30</sup> Although it eliminated debtor's prisons,<sup>31</sup> the Act of 1800 had little impact otherwise for most people and was repealed in 1803.<sup>32</sup>

The Bankruptcy Act of 1841<sup>33</sup> ("Act of 1841") followed the Panic of 1837.<sup>34</sup> The law added merchants and corporations to bankruptcy law coverage and, for the first time, provided for voluntary petitions and rehabilitation of the debtor.<sup>35</sup> In 1843, the same Congress that passed the Act of 1841 also repealed it.<sup>36</sup> During the year the Act of 1841 was in effect, however, there were 40,000 bankruptcy filings, representing one percent of the total adult male population of the United States.<sup>37</sup>

The nation's third bankruptcy law, the Bankruptcy Act of 1867<sup>38</sup> ("Act of 1867"), was passed in the aftermath of the Civil War.<sup>39</sup> The scope of persons that file bankruptcy was expanded to include almost all persons and corporations, and for the first time, a debtor was permitted to propose terms that would be binding upon creditors, if approved by a majority of creditors.<sup>40</sup> Congress repealed the Act of 1867 in 1872.<sup>41</sup>

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American shipping disrupted American commerce, further driving up the cost of money. *Id.* Holders of private notes, which were ubiquitous during an era of primitive banking, suddenly looked to the guarantors for payment, most of who could not pay. *Id.* Businesses failed, and hundreds of otherwise reputable merchants went to prison or fled to avoid creditors. *Id.*

30. MANN, *supra* note 16, at 253.

31. The Act's most significant result may have been to release Robert Morris, signer of the Declaration of Independence and member of the Constitutional Convention, from debtor's prison in Philadelphia. *Id.*

32. *Id.*

33. Ch. 9, 5 stat. 440, *repealed by* Act of 1843, ch. 82, 5 Stat. 614.

34. SKEEL, *supra* note 29, at 25. The panic of 1837 was caused by the sudden collapse in the value of unregulated paper notes, much of it issued by states to encourage settlement. CHARLES WARREN, BANKRUPTCY IN UNITED STATES HISTORY 52-55 (1935). Easy credit caused widespread speculation in land and commodities, leading in turn to inflation, then more paper notes, and eventually the value of the notes fell. *Id.* Thousands of banks and businesses closed, and the country went into depression. *Id.*

35. WARREN, *supra* note 34, at 60, 66 (1935).

36. *Id.* at 81.

37. *Id.* at 86. Given that the law did not apply to agrarian debtors or to laborers (the vast majority of American workers at the time), this is a significant number.

38. Ch. 176, 14 Stat. 517, *amended by* Act of 1874, ch. 390, § 17, 18 Stat. 178.

39. WARREN, *supra* note 34, at 103-09.

40. *In re Reiman*, 20 F. Cas. 490 (S.D.N.Y. 1874) (No. 11673).

41. Ch. 390, § 17, 18 Stat. 178.

The Bankruptcy Act of 1898<sup>42</sup> (“Act of 1898”) was the nation’s first “permanent” bankruptcy law. The Act of 1898 established rules for corporate reorganization, which at that time was a new concept.<sup>43</sup> The law provided for an adversarial system in which referees played mostly an adjudicative function, with the process left mostly to the parties themselves.<sup>44</sup> Later, the 1938 Chandler Act<sup>45</sup> (“Chandler Act”) introduced consumer repayment plans and gave referees authority to grant discharges.<sup>46</sup> The Chandler Act gave rise to an efficient bankruptcy bar administration, but many viewed the bankruptcy process as prone to collusion and obscure to outsiders.<sup>47</sup>

## 2. The Bankruptcy Code of 1978 and Recent Amendments

The Bankruptcy Code of 1978<sup>48</sup> (“Code”) is the current national bankruptcy law. The Code accommodates individual, business, farm, railroad, and municipal bankruptcy.<sup>49</sup> The Code is fluid, with new sections added or existing ones modified as Congress deems necessary to respond to changing national needs. For example, when passed, chapter 11 of the Code had detailed provisions for corporate reorganization.<sup>50</sup> Section 1113,<sup>51</sup> however, which places restrictions on the ability of a business debtor to modify collective bargaining agreements, was added in 1984 in response to the Supreme Court decision in *NLRB v. Bildisco & Bildisco*.<sup>52</sup> Section 1114<sup>53</sup> was included in 1988 after the

42. Ch. 541, 30 Stat. 544, amended by Chandler Act, ch. 575, 52 Stat. 840 (1938), repealed by Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549.

43. SKEEL, *supra* note 29, at 58–60.

44. *Id.* at 43.

45. Ch. 575, 52 Stat. 838.

46. SKEEL, *supra* note 29, at 131.

47. *Id.* at 67–70, 131, 133.

48. Pub. L. No. 95-598, 92 Stat. 2549 (1978) (codified as amended at 11 U.S.C. §§ 101–112, 301–308, 321–333, 341–351, 361–366, 701–707, 721–727, 741–753, 761–767, 781–784, 901–904, 921–930, 941–946, 1101–1116, 1121–1129, 1141–1146, 1161–1174, 1201–1208, 1221–1231, 1301–1308, 1321–1330, 1501–1532 (2000)).

49. Individual debtors may file under chapter 7, 11 U.S.C. § 109(B) (2000) (liquidation), chapter 13, § 109(e) (adjustment of debts of an individual with regular income), and chapter 11, § 109(d) (reorganization). Businesses may file under chapter 7, § 109(B), chapter 11, § 109(d), and chapter 15, § 1501 (cross-border bankruptcies). Chapter 12, § 109(f), is for family farmers and family fishermen, while railroads may file under a special subchapter of chapter 11, § 109(d), and chapter 9, § 109(c), is for municipal bankruptcies.

50. *See id.* §§ 1123, 1129 (setting forth detailed provisions for the restructuring of business debt).

51. *Id.* § 1113.

52. 465 U.S. 513 (1984). *Bildisco* held that the decision by a chapter 11 debtor to reject a collective bargaining agreement must be subject to the same standard applicable to an executory contract under section 365 of the Code. *Id.* at 516. The Court also held that a

LTV Corporation, upon filing bankruptcy, terminated the health and life insurance benefits of 78,000 retirees.<sup>54</sup> Finally, Congress added section 524(g)<sup>55</sup> in 1994 as a means to deal with future personal injury claims against business debtors arising from exposure to asbestos-containing products.<sup>56</sup>

For individual debtors, the Code reflects contemporary consumer spending and a debtor-friendly political ideology. The Code allows a choice between chapter 7 “liquidation” and chapter 13 “reorganization.” Under chapter 7, the debtor turns over all non-exempt assets to the bankruptcy trustee.<sup>57</sup> The trustee then sells the assets to pay creditors,<sup>58</sup> and the debtor is discharged from all its unsecured debt.<sup>59</sup> State or federal exemptions, however, may allow a debtor to retain much or all of his or her personal property.<sup>60</sup> If the debtor is current on his or her obligations for secured debt (such as a mortgage or car payments), the debtor can keep the asset<sup>61</sup> and continue payments.<sup>62</sup> Some debts cannot be discharged. This includes most taxes,<sup>63</sup> spousal or child support obligations,<sup>64</sup> and debt incurred by fraud.<sup>65</sup> State or federal exemptions may allow a debtor to keep most or all of his or her property.<sup>66</sup> Under chapter 13, however, the debtor pays back a portion of his or her debt over time (up to five years) through a plan of reorganization<sup>67</sup> and may “cure” arrearages on secured debt during the plan.<sup>68</sup>

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bargaining unit could not enforce the provisions of a bargaining agreement pending the debtor’s decision to assume or reject the agreement. *Id.* at 515.

53. 11 U.S.C. § 1114.

54. *Id.* (Legislative History and Comment); see also NORTON BANKRUPTCY LAW AND PRACTICE 1231 (2d ed. 2006).

55. 11 U.S.C. § 524(g).

56. *Id.* (Legislative History and Comment); see also NORTON BANKRUPTCY LAW AND PRACTICE, *supra* note 54, at 724–25. Section 524(g) is notable in that it gives authority to the court to issue a “channel injunction” binding all future claims against the estate. 11 U.S.C. § 524(g).

57. 11 U.S.C. § 704. Section 522 specifies which assets of the debtor are exempt from turnover to the trustee. *Id.* § 522.

58. *Id.* § 726.

59. *Id.* § 727.

60. *Id.* § 522.

61. *Id.* § 521(a)(2)(A).

62. *Id.* § 522(c)(1).

63. *Id.* § 523(a)(1).

64. *Id.* § 523(a)(5).

65. *Id.* § 523(a)(4).

66. *Id.* § 522.

67. *Id.* § 1322.

68. *Id.* § 1325(a)(5).

In 2004, Congress enacted the latest change to bankruptcy law, the Bankruptcy Abuse Prevention and Consumer Protection Act<sup>69</sup> (“BAPCPA”). BAPCPA tightened restrictions for individual debtors filing chapter 7 bankruptcy, inter alia, by requiring debtors with income above certain statutory amounts to pay back at least a portion of their debt.<sup>70</sup>

### C. Bankruptcy and the Supremacy Clause

#### 1. The Supremacy Clause

The Supremacy Clause<sup>71</sup> is a defining attribute of United States federalism. It makes federal law superior to state laws that deal with the same subject matter. The Supremacy Clause provides:

This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.<sup>72</sup>

The effect of the Supremacy Clause is that in areas where Congress intends to legislate, federal law preempts state law.<sup>73</sup> As stated by Chief Justice Marshall, “acts of the State Legislatures . . . [which] interfere with, or are contrary to the laws of Congress, made in pursuance of the constitution,” are invalid under the Supremacy Clause.<sup>74</sup> More simply, state law that conflicts with federal law is “without effect.”<sup>75</sup>

69. Pub. L. No. 109-8, 119 Stat. 23 (2005).

70. 11 U.S.C. § 707(b)(2). See A Year After BAPCPA: How the Bankruptcy Abuse Prevention and Consumer Protection Act Has Impacted Practitioners, Lenders, Consumers, Turnaround Managers and Trustees (Oct. 16, 2006), <http://www.abiworld.org/pdfs/OneYearProgramTranscript.pdf>, for an extensive analysis of BAPCPA.

71. U.S. CONST. art. VI, cl. 2.

72. *Id.*

73. *McCulloch v. Maryland*, 17 U.S. (4 Wheat.) 316, 427 (1819).

74. *Gibbons v. Odgen*, 22 U.S. (9 Wheat.) 1, 211 (1824).

75. *Maryland v. Louisiana*, 451 U.S. 725, 746 (1981). Federal law preemption can be express or implied. The question is whether, in passing the law, Congress intends to “occup[y] the field.” *Pennsylvania v. Nelson*, 350 U.S. 497, 502 (1956). In *Pennsylvania v. Nelson*, the Supreme Court employed a three-part test to determine whether a federal law would preempt a state law. The first element of the test is whether “[t]he scheme of federal regulation [is] so pervasive as to make reasonable inference that Congress left no room for the States to supplement it.” *Id.* at 502 (citing *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 230 (1947)). The second element is whether the statute “touch[es] a field in which the federal interest is so dominant that the federal system [must] be assumed to preclude enforcement of state laws on the same subject.” *Id.* at 504 (citing *Rice*, 331 U.S. at 230). The third element is whether the enforcement of a state statute “presents a serious danger of conflict with the administration of the federal program.” *Id.* at 505.

This includes state law dealing with insolvency, debtors, and the rights of creditors.

In the absence of a national bankruptcy law, states were free to enact their own insolvency laws. The exercise of national bankruptcy power, not the mere existence of it, gives Congress exclusive right to legislate bankruptcy law.<sup>76</sup> In between the enactment and repeal of the several national bankruptcy laws, state bankruptcy laws were not repealed, but suspended. Upon repeal of the national bankruptcy law, state bankruptcy laws were again valid without further re-enactment.<sup>77</sup>

The supremacy of federal bankruptcy law is embodied in the landmark case, *International Shoe Co. v. Pinkus*.<sup>78</sup> In that case, a trade vendor, International Shoe, obtained a judgment in the amount of \$463.43 in an Arkansas county court against Pinkus, an insolvent merchant.<sup>79</sup> Pinkus had some forty-six creditors and owed over \$10,000, but his assets were less than \$3,000.<sup>80</sup> Pinkus commenced a chancery action under the Arkansas insolvency law to declare himself an insolvent.<sup>81</sup> Arkansas statutes provided a much greater personal property exemption than the Act of 1898, which meant that Pinkus would keep more of his assets if his case was adjudicated under state law.<sup>82</sup> Moreover, Pinkus had been discharged in voluntary bankruptcy proceedings less than six years prior.<sup>83</sup> If the Act of 1898 applied, he could not have received another discharge before the expiration of six years, so the debt owed to International Shoe and other creditors would not be discharged.<sup>84</sup>

International Shoe filed suit in federal court, arguing that the Act of 1898 superseded the Arkansas bankruptcy law, and thus the chancery action was a nullity.<sup>85</sup> The Supreme Court found that the Arkansas bankruptcy law “operates within the field occupied by the . . . Act [of 1898].”<sup>86</sup> Therefore, the Court was compelled to strike down the Arkansas law.

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76. *Ogden v. Saunders*, 25 U.S. (12 Wheat.) 213, 368 (1827); *Sturges v. Crowninshield*, 17 U.S. (4 Wheat.) 122, 199 (1819).

77. *Butler v. Goreley*, 146 U.S. 303, 314 (1892).

78. 278 U.S. 261 (1929).

79. *Id.* at 262.

80. *Id.*

81. *Id.*

82. *Id.* at 264.

83. *Id.*

84. *Id.* at 264–65.

85. *Id.* at 263.

86. *Id.* at 264.

The power of Congress to establish uniform laws on the subject of bankruptcies throughout the United States is unrestricted and paramount. The purpose to exclude state action for the discharge of insolvent debtors may be manifested without specific declaration to that end . . . . In respect of bankruptcies the intention of Congress is plain. The national purpose to establish uniformity necessarily excludes state regulation . . . . States may not pass or enforce laws to interfere with or complement the . . . Act [of 1898] or to provide additional or auxiliary regulations.<sup>87</sup>

Thus, according to the Supremacy Clause,<sup>88</sup> federal bankruptcy law must preempt state law where the effect of state law is to impede the full operation and purpose of federal bankruptcy law.

## 2. Bankruptcy Code Section 106

Section 106 of the Code<sup>89</sup> attempts to put state and non-state parties on parity by eliminating the defense of sovereign immunity for states and state agencies in bankruptcy.<sup>90</sup>

Section 106(a) eliminates state immunity as a defense to suit or process in bankruptcy, including proceedings to enforce the automatic stay,<sup>91</sup> treatment of leases and contracts,<sup>92</sup> proofs of claim,<sup>93</sup> ef-

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87. *Id.* at 265 (internal citations omitted).

88. U.S. CONST. art. VI, cl. 2.

89. 11 U.S.C. § 106 (2000).

90. Section 106 states:

(a) Notwithstanding an assertion of sovereign immunity, sovereign immunity is abrogated as to a governmental unit to the extent set forth in this section with respect to the following:

Sections 105, 106, 107, 108, 303, 346, 362, 363, 364, 365, 366, 502, 503, 505, 506, 510, 522, 523, 524, 525, 542, 543, 544, 545, 546, 547, 548, 549, 550, 551, 552, 553, 722, 724, 726, 728, 744, 749, 764, 901, 922, 926, 928, 929, 944, 1107, 1141, 1142, 1143, 1146, 1201, 1203, 1205, 1206, 1227, 1231, 1301, 1303, 1305, and 1327 of this title.

The court may hear and determine an issue arising with respect to the application of such sections to governmental units.

The court may issue against a governmental unit an order, process, or judgment under such sections . . . including an order or judgment awarding a money recovery, but not including an award of punitive damages . . . .

Nothing in this section shall create any substantive claim for relief or cause of action not otherwise existing under this title, the Federal Rules of Bankruptcy Procedure, or nonbankruptcy law . . . .

*Id.* Section 106 was revised in 1994 after the Supreme Court ruled in *Hoffman v. Conn. Department of Income Maintenance*, 492 U.S. 96 (1989), and *United States v. Nordic Village, Inc.*, 503 U.S. 30 (1992), that section 106 was not “unmistakably clear” in abrogating state immunity. See *FDIC v. Meyer*, 510 U.S. 471, 484 (1994).

91. 11 U.S.C. § 362.

92. *Id.* § 365.

93. *Id.* § 502.

fect of discharge,<sup>94</sup> discharge,<sup>95</sup> turnover of property of the estate,<sup>96</sup> and the trustee's lien avoidance powers,<sup>97</sup> such as avoidance of a preferential transfer.<sup>98</sup> Section 106(b) provides that if the government files a proof of claim, it waives sovereignty with respect to any claims arising out of the same occurrence from which the claim arose.<sup>99</sup> Pursuant to section 106(c), the debtor may assert a set-off to a claim or interest asserted by a governmental unit in bankruptcy.<sup>100</sup> Together, the provisions of section 106 clearly express Congress's intent to abrogate state immunity with respect to bankruptcy jurisdiction.

### 3. State Laws Incorporated into the Bankruptcy Code

The Code is highly amenable to state authority. Bankruptcy law is not, of itself, a source of property rights. Instead, it functions to re-adjust property rights that existed at the time that a bankruptcy was filed.<sup>101</sup> Thus, bankruptcy law looks to nonbankruptcy law to determine the existence of property of the estate.<sup>102</sup>

The Code frequently mandates the application of "nonbankruptcy law." For example, as provided in section 552,<sup>103</sup> the proceeds of property subject to a pre-petition security agreement are subject to the security agreement post-petition "to the extent provided by . . . applicable nonbankruptcy law."<sup>104</sup> Section 541(c)(2) mandates that a restriction on transfers of beneficial estates "that is enforceable under applicable nonbankruptcy law is enforceable in a case under this title," even if the result is to reduce the amount of assets available to creditors.<sup>105</sup> Under section 365(c), state law will determine if a breach of contract occurred pre-petition, which may remove the contract as property of the estate and terminate a debtor's rights in the contract.<sup>106</sup> As provided in section 523(a)(5) and section 523(a)(15), state law will determine whether a divorce obligation is considered

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94. *Id.* § 524.

95. *Id.*

96. *Id.* § 542.

97. *Id.* § 545.

98. *Id.* § 547.

99. *Id.* § 106(b).

100. *Id.* § 106(c).

101. *Butner v. United States*, 440 U.S. 48, 54–55 (1979).

102. *Zaylor v. U.S. Dep't of Agric. (In re Supreme Beef Processors, Inc.)*, 468 F.3d 248, 255 (5th Cir. 2006).

103. 11 U.S.C. § 552.

104. *Id.*

105. *Id.* § 541(c)(2).

106. *Id.* § 365(c).

support or distribution of property, which can be critical in whether the obligation can be discharged in bankruptcy.<sup>107</sup> Although deference to individual state law often results in different outcomes to debtors under similar facts, the Code tolerates these differences where “nonbankruptcy law” applies.<sup>108</sup>

Even if the Code does not expressly reference “nonbankruptcy law” in a specific instance, bankruptcy courts almost always look to state law on any substantive legal issue.<sup>109</sup> Thus, a corporation that has been dissolved under state law may not resurrect itself by filing a petition in bankruptcy court, even though bankruptcy law does not prohibit this.<sup>110</sup>

The Code provides significant accommodation to the states by authorizing them to opt out of the federal exemption scheme.<sup>111</sup> The Code allows debtors to choose the federal exemptions set forth in section 522(d),<sup>112</sup> or the exemptions provided by the laws of the state in which they live.<sup>113</sup> The Code, however, provides that states may opt

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107. *Id.* §§ 523(a)(5), 523(a)(15).

108. See Daniel A. Austin, *For Debtor or Worse: Discharge of Marital Debt Obligations Under The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005*, 51 WAYNE L. REV. 1369 (2005), for a discussion of differences among bankruptcy jurisdictions in how the discharge of domestic support obligations is treated.

109. See, e.g., *Hanover Nat'l Bank v. Moyses*, 186 U.S. 181, 190 (1902). See Paul R. Glassman, *Choice of Law State Law in Bankruptcy Cases*, 24 A.B.I.J. 32 (2005), for a comprehensive discussion of choice of state law in bankruptcy.

110. *Chi. Title & Trust Co. v. Wilcox Bldg. Corp.*, 302 U.S. 120, 129–30 (1937).

111. Exemptions are governed by section 522 of the Bankruptcy Code. See 11 U.S.C. § 522. Exemptions allow individual debtors to retain the unencumbered value of property they own, up to certain federal- or state-law maximum amounts. *Id.*

112. Section 522(d) exemptions include up to \$20,200 in the debtor's residence (the “homestead exemption”), up to \$3225 in one motor vehicle, \$10,775 in household goods, \$1350 in jewelry, plus a \$1075 “wildcard” exemption and up to \$10,125 in unused homestead exemption. 11 U.S.C. § 522(d). Some assets, such as social security benefits, alimony payments, and ERISA-qualified retirement assets are completely exempt from property of the estate. § 522(d)(10).

113. State exemption laws are intended to shield certain assets of a judgment debtor from seizure to pay judgments or creditors. The state exemptions vary widely. Florida's famous “homestead exemption” provides that the unencumbered value of a house is completely shielded from judgment creditors, whereas Florida's personal property exemption is only \$1000 per person. FLA. CONST. art. X, § 4. Pension assets and insurance proceeds are shielded from creditors. FLA. STAT. § 222.21 (2007). Pennsylvania exemptions, in comparison, are not generous to debtors. Pennsylvania has no homestead exemption, but property held jointly by spouses is exempt from creditors of an individual spouse. See *Patwardhan v. Brabant*, 439 A.2d 784 (Pa. Super. Ct. 1982). Other Pennsylvania exemptions include bibles, clothing, municipal pensions, and private pensions up to \$15,000 per year. See 42 PA. CONS. STAT. § 8124 (2007). California has opted out of the federal scheme, but allows debtors to choose from two sets of exemptions. The first set, including California Code of Civil Procedure sections 704.010 and 704.730, allows a minimum homestead ex-

out of the federal scheme, thus limiting the debtor to state law exemptions.<sup>114</sup> Two-thirds of states have opted out and permit only state exemptions.<sup>115</sup>

A tort of recent vintage suggests the further intersection between bankruptcy law and state law. “Deepening insolvency” is a tort whereby corporate officers, directors, and auditors can be subject to liability for artificially attempting to prolong the life of an already insolvent company. “The premise underlying the deepening insolvency theory is that even an insolvent company has value, which could be salvaged if the company is liquidated or restructured in a timely manner.”<sup>116</sup> To establish the cause of action, a plaintiff must prove that while the company was in the “zone of insolvency,” actions by the directors and officers to continue the enterprise breached a fiduciary duty to creditors and the debtor itself.<sup>117</sup> Whether liability exists under a given set of facts depends upon state laws governing fiduciary duty. Some states do not even recognize the tort.<sup>118</sup>

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emption of \$50,000, but somewhat less generous exemptions in certain personal property. See CAL. CIV. PROC. CODE §§ 704.010, 704.730 (West 2007). The second set, California Code of Civil Procedure section 703.140, mostly mirrors the federal scheme under Bankruptcy Code section 522(d), but is slightly more generous. See *id.* § 703.140.

114. 11 U.S.C. §522(b)(2).

115. States allowing debtors to choose either federal or state exemptions include Arkansas, Connecticut, District of Columbia, Hawaii, Massachusetts, Michigan, Minnesota, New Jersey, New Mexico, Pennsylvania, Rhode Island, South Carolina, Texas, Vermont, Washington, and Wisconsin.

116. Kyung S. Lee et al., *Deepening Insolvency – An Emerging Remedy Against Contemporary Corporate Malfeasance*, Univ. of Tex. 23d Annual Bankr. Conf. (Nov. 18–19, 2004) (on file with author).

117. Official Comm. of Unsecured Creditors v. R.F. Lafferty & Co., 267 F.3d 340, 347 (3d Cir. 2001) (defining the tort of deepening insolvency as “fraudulent expansion of corporate debt and prolongation of corporate life”); cf. Seitz v. Detweiler, Hershey & Assocs., P.C. (*In re* CitX Corp., Inc.), 448 F.3d 672, 680 (3d Cir. 2006) (suggesting at note 11 that the Third Circuit en banc should reconsider the case).

118. See, e.g., Official Comm. of Unsecured Creditors v. Rural Tel. Fin. Coop. (*In re* VarTec Telecom, Inc.), 335 B.R. 631, 634–35 (Bankr. N.D. Tex. 2005) (accusing VarTec’s lender of (1) making improper loans to the debtor; and (2) fraudulently arranging for the debtor to pay down those loans shortly before VarTec filed for bankruptcy). The bankruptcy court dismissed the case on motion of the lender under Federal Bankruptcy Rule 7012(b) for failure to state a claim upon which relief can be granted, since it determined that Texas courts would not recognize deepening insolvency as an independent cause of action. *Id.* at 646; see also N. Am. Catholic Educ. Programming Found., Inc. v. Gheewalla, 930 A.2d 92 (Del. 2007) (holding that no duties owed to creditors by directors and officers while the corporation was in the “zone of insolvency”).

#### 4. State Laws in Conflict with the Bankruptcy Code

While the Code clearly preempts state insolvency laws, the Code may also preempt a state nonbankruptcy law if it interferes with the purposes of federal bankruptcy law.

An analysis of whether a federal statute preempts state law starts “with the assumption that the historic police powers of the States [are] not to be superseded by [a] Federal Act unless that [is] the clear and manifest purpose of Congress.”<sup>119</sup> Justice Hugo Black in *Hines v. Davidowitz*,<sup>120</sup> stated:

This Court, in considering the validity of state laws in the light of treaties or federal laws touching the same subject, has made use of the following expressions: conflicting; contrary to; occupying the field; repugnance; difference; irreconcilability; inconsistency; violation; curtailment; and interference . . . . In the final analysis . . . [o]ur primary function is to determine whether, under the circumstances of this particular case, [a challenged state statute] stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.<sup>121</sup>

In the past, courts made preemption determinations by looking at the purpose of the state law in question, irrespective of its effects. In *Kesler v. Department of Public Safety*,<sup>122</sup> a Utah statute intended to promote automobile financial responsibility included a provision making judgments arising from automobile accidents non-dischargeable in bankruptcy.<sup>123</sup> A chapter 7 debtor challenged the law on the grounds that it frustrated the Act of 1898’s purpose of giving a debtor a financial fresh start.<sup>124</sup> The Supreme Court upheld the Utah law because the purpose of the law was not “to aid collection of debts but to enforce a policy against irresponsible driving.”<sup>125</sup> The Court reached this decision while admitting that the law left “the bankrupt to some extent burdened by the discharged debt” and in so doing, made “some inroad . . . on the consequences of bankruptcy.”<sup>126</sup>

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119. *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 230 (1947).

120. 312 U.S. 52 (1941).

121. *Id.* at 67. This test is has been adopted for analysis of state law under the Supremacy Clause. *See, e.g.*, *Sears, Roebuck & Co. v. Stiffel Co.*, 376 U.S. 225, 229 (1964); *Fla. Lime & Avocado Growers, Inc. v. Paul*, 373 U.S. 132, 141, 165 (1963); *Hill v. Florida*, 325 U.S. 538, 542 (1945).

122. 369 U.S. 153 (1962).

123. *Id.* at 155.

124. *Id.*

125. *Id.* at 169.

126. *Id.* at 171. The Court conceded that the law made “it more probable that the debt will be paid despite the discharge.” *Id.* at 173; *see also* *Reitz v. Mealey*, 314 U.S. 33, 37

Almost a decade after *Kesler*, the Court in *Perez v. Campbell*<sup>127</sup> abandoned the “purpose” test in favor of an “effects” test.<sup>128</sup> In 1956, the Arizona legislature adopted the Arizona Motor Vehicle Safety Responsibility Act<sup>129</sup> (“Arizona Act”). The Arizona Act required all motor vehicles registered in Arizona to be covered by a specified minimum level of liability coverage and provided that the license of a driver involved in an accident would be suspended if a judgment debt arising from the accident remained unpaid by the driver for more than sixty days after entry of such judgment.<sup>130</sup> The law also included a provision mandating that “a discharge in bankruptcy following the rendering of any such judgment shall not relieve the judgment debtor from any of the requirements of this article.”<sup>131</sup> After the plaintiffs were involved in an auto accident, the other driver sued the plaintiffs and won a judgment of nearly \$2500.<sup>132</sup> The plaintiffs filed a chapter 7 bankruptcy petition and listed the judgment as a dischargeable debt.<sup>133</sup> The debt was discharged, but Arizona suspended the plaintiffs’ licenses and automobile registration in accordance with the Arizona Act.<sup>134</sup> The issue before the Supreme Court was whether a state, in enacting legislation to accomplish a legitimate public policy objective, could suspend the effect of a discharge under the Code as a means to achieve that objective.<sup>135</sup>

The Court held that deciding whether a state statute is in conflict with a federal one is “essentially a two-step process of first ascertaining the construction of the two statutes and then determining the consti-

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(1941), in which a similar law in New York survived challenge from a debtor, despite the fact that the effect of the law frustrated the policy of the Act of 1898:

The penalty which [the New York law] imposes for injury due to careless driving is not for the protection of the creditor merely, but to enforce a public policy that irresponsible drivers shall not, with impunity, be allowed to injure their fellows . . . . [T]he legislature declared that a discharge in bankruptcy should not interfere with the operation of the statute. Such legislation is not in derogation of the Bankruptcy Act. Rather it is an enforcement of permissible state policy touching highway safety.

*Id.*

127. 402 U.S. 637 (1971).

128. *Id.* at 652.

129. ARIZ. REV. STAT. ANN. 28-1163 (1956). This act was based on the Uniform Motor Vehicle Safety Responsibility Act promulgated by the National Conference on Street and Highway Safety.

130. *Perez*, 402 U.S. at 639–40.

131. ARIZ. REV. STAT. ANN. 28-1163(B).

132. *Perez*, 402 U.S. at 638.

133. *Id.* at 639.

134. *Id.*

135. *Id.* at 643.

tutional question of whether they are in conflict.”<sup>136</sup> The Arizona Act provided leverage for the collection of damages from drivers who admit negligence or are adjudicated negligent.<sup>137</sup> The primary purpose of federal bankruptcy law is to “give debtors ‘a new opportunity in life, and a clear field for future effort, unhampered by the pressure and discouragement of preexisting debt.’”<sup>138</sup>

The Court expressly rejected the purpose test of *Kesler*, reasoning that such a doctrine would enable state legislatures to nullify nearly all unwanted federal legislation by simply “publishing a legislative committee report articulating some state interest or policy—other than frustration of the federal objective.”<sup>139</sup> The Court invalidated the Arizona Act, finding that “any state legislation which frustrates the full effectiveness of federal law is rendered invalid by the Supremacy Clause.”<sup>140</sup>

Since *Perez*, federal courts have held that state laws may not interfere with the full effect of bankruptcy discharge for public policy purposes.<sup>141</sup> For example, a state court was barred from proceeding with a foreclosure of a farm where the farmer had filed for bankruptcy and requested an extension of time in the bankruptcy court.<sup>142</sup> Federal bankruptcy law also discharged a debtor from a state court order directing the debtor to remediate a waste disposal site.<sup>143</sup> In *Agnew v. Franchise Tax Board of California (In re Sharon Steel Corporation)*,<sup>144</sup> a major chapter 11 case, the court ruled that it had jurisdiction to determine the identity of the component members of a group for California franchise-tax purposes because section 106 provided for limited abrogation of sovereign immunity in bankruptcy cases.<sup>145</sup> More re-

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136. *Id.* at 644.

137. *Id.* at 646–47. The Court concluded that the purpose of the law was not one of deterrence. The Court noted that the victim of the tortfeasor’s negligence could voluntarily waive the payment requirement, that there was no provision keeping careless drivers off the road, and that if both drivers were found negligent, then there was no liability for damages arising from the accident. *Id.* at 647–48.

138. *Id.* at 648 (quoting *Local Loan Co. v. Hunt*, 292 U.S. 234, 244 (1934)).

139. *Id.* at 652.

140. *Id.*

141. The New York State Attorney General later concluded that a motor vehicle law providing that a civil penalty is not dischargeable in bankruptcy is unconstitutional and superseded by the Bankruptcy Code. See N.Y. Op. Att’y Gen. 98-F10 (1998), available at [www.oag.state.ny.us/lawyers/opinions/1998/formal/98\\_f10.html](http://www.oag.state.ny.us/lawyers/opinions/1998/formal/98_f10.html).

142. *Kalb v. Feuerstein*, 308 U.S. 433 (1939).

143. *Ohio v. Kovacs*, 469 U.S. 274 (1984).

144. 118 B.R. 30 (Bankr. W.D. Pa. 1990).

145. *Id.*

cently, in *Sherwood Partners, Inc. v. Lycos, Inc.*,<sup>146</sup> the Ninth Circuit Court of Appeals ruled that section 544(b) of the Code, which allows a trustee to avoid a preferential transfer, preempts California's Assignment for the Benefit of Creditors.<sup>147</sup> States, of course, are bound by bankruptcy court discharge orders in the same way as any other creditor, and by other standard bankruptcy court rulings.<sup>148</sup>

## 5. Uniformity Theory of Bankruptcy Law

Central to the discussion of federalism and state sovereignty is the argument of uniformity—that the Bankruptcy Clause authorizes Congress to make “uniform laws” on the subject of bankruptcy, and that bankruptcy laws must be “uniform” and apply to states as equally as to all other creditors, in order to effectuate the purposes of bankruptcy. This argument is based upon Article I of the Constitution, which provides that Congress shall have the power to “establish a uniform Rule of Naturalization, and uniform Laws on the subject of Bankruptcies throughout the United States.”<sup>149</sup> The use of the word “uniform” is key. In Federalist Number 32, Hamilton described how state sovereignty is abrogated where the Constitution “granted an authority to the Union, to which a similar authority granted to the States would be absolutely and totally contradictory and repugnant.”<sup>150</sup> According to Hamilton, one example of this is the uniform powers of naturalization.<sup>151</sup> Thus, it can be concluded that by using the identical word, “uniform,” in connection with the Bankruptcy Clause and in immediate proximity to the naturalization clause, the Framers intended that the congressional power of bankruptcy would also abrogate state immunity, as it did with the naturalization power.<sup>152</sup> The uniformity theory is not concerned with whether Article I per se abrogates state

146. 394 F.3d 1198 (9th Cir. 2005).

147. *Id.* at 1204.

148. *Davie v. Rudgers (In re Davie)*, 302 B.R. 432 (Bankr. W.D.N.Y. 2003); see *New York v. Irving Trust Co.*, 288 U.S. 329, 333 (1932) (holding that New York proof of claim for taxes is barred as untimely); *Van Huffle v. Harkelrode*, 284 U.S. 225, 228–29 (1931) (holding that the bankruptcy court has authority to sell debtor's property free and clear of state tax lien); *In re Bluewater Palmas, Ltd.*, No. 02-07967, 2006 Bankr. LEXIS 3813 (Bankr. D.P.R. May 1, 2006) (holding that a debtor's estate is entitled to payment of interest on fees properly payable by the state to the estate).

149. U.S. CONST. art. I, § 8, cl. 4.

150. THE FEDERALIST NO. 32, at 241 (Alexander Hamilton) (Terrence Ball ed., 2003).

151. *Id.* The most complete articulation of this theory is in J. Haines, *The Uniformity Power: Why Bankruptcy is Different*, 77 AM. BANKR. L.J. 129 (2003).

152. This was the conclusion of the Sixth Circuit in *Hood v. Tenn. Student Assistance Corp. (In re Hood)*, 319 F.3d 755, 766 (6th Cir. 2003), *aff'd on other grounds*, 541 U.S. 440 (2004).

immunity. The use of the word “uniform” sets bankruptcy apart from the other Article I clauses.<sup>153</sup>

Moreover, uniformity does not mean just geographically uniform laws. It also means that bankruptcy law should be administered uniformly. Treating states as different from other creditors would frustrate this purpose.<sup>154</sup> The uniformity theory is compelling because it offers the simplicity and consistency of treating state and non-state parties alike.

## II. The Eleventh Amendment

The Eleventh Amendment provides: “The Judicial power of the United States shall not be construed 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.”<sup>155</sup>

The meaning of the Eleventh Amendment is straightforward: states are immune from suit, even under federal law, absent their consent or a valid abrogation of their immunity by Congress.<sup>156</sup> Conversely, the Eleventh Amendment is not a bar to suits where the court determines that Congress clearly expressed its intent to abrogate state

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153. See *Gray v. Univ. of Alaska (In re Dehon, Inc.)*, 327 B.R. 38, 54–56 (Bankr. D. Mass. 2005).

154. An example of this holding can be found in *Official Comm. of Unsecured Creditors v. New York State Department (In re Operation Open City, Inc.)*, 148 B.R. 184, 185–86 (Bankr. S.D.N.Y. 1992), *aff'd*, 170 B.R. 818 (Bankr. S.D.N.Y. 1994):

Bankruptcy is a collective process in which all parties share in an inevitably inadequate estate. The bankruptcy court is the forum in which all parties resolve disputes regarding distribution of estate assets. This process, however, cannot function properly if any significant participant remains immune from the system’s fundamental rules. This adversary proceeding involves a governmental unit which has extracted funds from a debtor’s estate without seeking prior court approval and now claims that sovereign immunity precludes this Court from reviewing the governmental unit’s actions.

*Id.*; see also *In re Dehon*, 327 B.R. at 57–58. For a critique of the “uniformity theory,” see Cecily Fuhr, *Sovereign Immunity: The “Uniform Laws” Theory Tries (And Fails) to Take a Bankruptcy-sized Bite out of the Eleventh Amendment*, 77 WASH. L. REV. 511 (2002).

155. U.S. CONST. amend XI.

156. See, e.g., *Bd. of Trustees v. Garrett*, 531 U.S. 356 (2001) (holding that states are immune from suit brought under Title I of the Americans with Disabilities Act); *Kimel v. Fla. Bd. of Regents*, 528 U.S. 62 (2000) (holding that states are immune from suit brought under the Age Discrimination in Employment Act); *College Savs. Bank v. Fla. Prepaid Postsecondary Educ. Expense Bd.*, 527 U.S. 666 (1999) (holding that states are immune from suit brought under the Lanham Act); *Seminole Tribe of Fla. v. Florida*, 517 U.S. 44 (1996) (holding that the state is immune from suit brought under the Indian Gaming Regulatory Act). Eleventh Amendment immunity does not extend to counties. See *N. Ins. Co. of N.Y. v. Chatham County*, 547 U.S. 189 (2006).

Eleventh Amendment immunity, and where Congress was authorized to do so.<sup>157</sup>

### A. *Chisholm v. Georgia on My Mind*

Although many consider the concept of state sovereign immunity to be implicit in the American constitutional scheme,<sup>158</sup> the Eleventh Amendment owes its existence to *Chisholm v. Georgia*.<sup>159</sup> In 1792, Alexander Chisholm, as executor of the estate of Robert Farquhar, sued the State of Georgia in federal court to recover monies owed to Farquhar for materials supplied to Georgia during the Revolutionary War.<sup>160</sup> With the war won, and the memory of marauding British troops receding, Georgia reneged on its war debt and refused to appear in the case on the grounds that it was sovereign.<sup>161</sup> The district and appellate courts found in favor of Chisholm, and the Supreme Court affirmed, holding that Article III, Section 2 of the Constitution per se abrogated state immunity and granted federal courts jurisdiction to hear disputes between citizens and states.<sup>162</sup>

The popular reaction to *Chisholm* was largely unfavorable, since it subjected states with war debt to suit by creditors in federal court. Legislation to enact the Eleventh Amendment was introduced the next day in the United States House of Representatives, and the Massachusetts legislature formally declared the ruling “repugnant to the first principles of a federal government.”<sup>163</sup> The Georgia House of Representatives went even further, decreeing that anyone attempting to en-

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157. *United States v. Georgia*, 546 U.S. 151 (2006) (holding that Title II of Americans with Disabilities Act abrogates state immunity); *Tennessee v. Lane*, 541 U.S. 506 (2004) (holding that Title II of Americans with Disabilities Act abrogates state sovereign immunity); *Nev. Dep’t of Human Res. v. Hibbs*, 538 U.S. 721 (2003) (holding that family care provisions of Family Medical Leave Act abrogate state immunity).

158. Alexander Hamilton’s statement in Federalist 81 is frequently cited: “It is inherent in the nature of sovereignty not to be amendable to the suit of an individual without its consent . . . . Unless, therefore, there is a surrender of this immunity in the plan of the convention, it will remain with the States . . . .” THE FEDERALIST NO. 81, at 511 (Alexander Hamilton) (Terrence Ball ed., 2003); *see also Idaho v. Coeur d’Alene Tribe of Idaho*, 521 U.S. 261, 267–68 (1997) (noting “the broader concept of immunity, implicit in the Constitution”).

159. 2 U.S. (2 Dall.) 419 (1793).

160. *Id.*

161. *Id.*

162. *Id.* at 423–24.

163. 15 PAPERS OF ALEXANDER HAMILTON 314 (H. Syrett & J. Cooke eds., 1969).

force the *Chisholm* decision would be guilty of a felony and suffer death by hanging “without benefit of clergy.”<sup>164</sup>

## B. The Eleventh Amendment in the Courts

A suit comes under Eleventh Amendment scrutiny when either “the judgment sought would expend itself on the public treasury,” or “the effect of the judgment would be ‘to restrain the Government from acting, or compel it to act.’”<sup>165</sup> The Eleventh Amendment insulates states from “private parties seeking to impose a liability [in federal court] which must be paid from public funds in the state treasury.”<sup>166</sup>

The scope of state sovereignty under federal statutes has been a contentious issue in constitutional litigation, and there is currently no consensus. The history of Eleventh Amendment litigation suggests that the border between federalism and state sovereignty is far from established.

### 1. *Hans v. Louisiana*

Contemporary Eleventh Amendment law begins with *Hans v. Louisiana*.<sup>167</sup> In *Hans*, a citizen of Louisiana owned bonds issued by the State of Georgia.<sup>168</sup> The Georgia legislature proposed a change in the state constitution that would have re-directed the interest on the bonds to defray state expenses.<sup>169</sup> Hans sued the State of Georgia, alleging that such a change in the state constitution would render his bonds worthless, thereby impairing the obligations of a contract in

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164. D. CURRIE, *THE CONSTITUTION IN CONGRESS: THE FEDERALIST PERIOD 1789–1801* 196 (1997).

165. *Dugan v. Rank*, 372 U.S. 609, 620 (1963) (internal citations omitted). Not all suits seeking monetary relief from a state automatically offend the Eleventh Amendment. It is well established that a suit that “serves directly to bring an end to a present violation of federal law is not barred by the Eleventh Amendment even though accompanied by a substantial ancillary effect” of compelling a state to expend public funds. *Papasan v. Allain*, 478 U.S. 265, 278 (1986). However, “[r]elief that in essence serves to compensate a party injured in the past . . . even though styled as something else,” is barred under the Eleventh Amendment. *Id.*

166. *Hufford v. Rodgers*, 912 F.2d 1338, 1341 (11th Cir. 1990) (citing *Edelman v. Jordan*, 415 U.S. 651 (1974)) (internal quotations omitted). Strictly interpreted, the Eleventh Amendment applies only to state and not local government. *Bd. of Trustees v. Garrett*, 531 U.S. 356 (2001).

167. 134 U.S. 1 (1890); see *Alden v. Maine*, 527 U.S. 706 (1999); *Seminole Tribe of Fla. v. Florida*, 517 U.S. 44 (1996).

168. *Hans*, 134 U.S. at 1.

169. *Id.* at 3.

violation of Article I, Section 10 of the United States Constitution.<sup>170</sup> The issue before the Supreme Court in *Hans* was that the Eleventh Amendment forbids citizens of one state from suing another state, but says nothing about citizens suing their own state.<sup>171</sup> The Court made little effort to establish a historical basis for state immunity, but simply concluded that immunity of the national government and of states “is called upon by the highest demands of natural and political law.”<sup>172</sup>

## 2. *Ex Parte Young*

*Ex parte Young*<sup>173</sup> somewhat pared back the sweeping rule of *Hans* and in so doing, created a legal fiction that is still in use today. In 1907, Minnesota passed laws that restricted the tariffs that railroads could charge for carrying freight within the state.<sup>174</sup> The laws imposed heavy penalties for violations, including fines and jail.<sup>175</sup> Railroads strongly opposed the law, so a number of railroad company shareholders filed suit in federal court against the Attorney General of Minnesota, Edward T. Young, to enjoin him from enforcing the law.<sup>176</sup> Young moved to dismiss, asserting that the Eleventh Amendment barred the federal court from hearing the case.<sup>177</sup> The federal court rejected Young’s argument and issued the injunction against enforcing the law.<sup>178</sup> The next day, Young filed in state court to enforce the law.<sup>179</sup> The federal court held Young in contempt of court and commenced proceedings to imprison him.<sup>180</sup> In response, Young filed a writ of habeas corpus with the Supreme Court.<sup>181</sup>

The case exposed a tension between the Fourteenth Amendment and the Eleventh Amendment. The railroads argued that the Minnesota law violated the Fourteenth Amendment by making freight rates so low that it amounted to a taking in violation of the right to due

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170. *Id.* at 2–3; *see* U.S. CONST. art. I, § 10, cl. 1 (“No State shall enter into any Treaty, Alliance, or Confederation; grant Letters of Marque and Reprisal; coin Money; emit Bills of Credit; make any Thing but gold and silver Coin a Tender in Payment of Debts; pass any Bill of Attainder, ex post facto Law, or Law impairing the Obligation of Contracts, or grant any Title of Nobility.”).

171. *Hans*, 134 U.S. at 10.

172. *Id.* at 21.

173. 209 U.S. 123 (1908).

174. *Id.* at 127.

175. *Id.*

176. *Id.* at 129.

177. *Id.* at 132.

178. *Id.*

179. *Id.*

180. *Id.*

181. *Id.* at 133.

process.<sup>182</sup> On the other hand, the Supreme Court had recently held in *Hans* that the Eleventh Amendment bars federal courts from hearing suits by citizens against their own states.<sup>183</sup>

To resolve the dilemma, the Court reasoned that when a state official does something that is unconstitutional, he or she must be acting as an individual, since, under the Supremacy Clause, states are forbidden to violate the Constitution.<sup>184</sup> Accordingly, a state official can act simultaneously in dual capacities: (1) as a non-state actor when doing the unconstitutional act, because the Fourteenth Amendment only prohibits unconstitutional state action; and (2) as an individual when sued to enjoin the state action, because a state cannot be sued.<sup>185</sup> Thus, pursuant to *Ex parte Young*, sovereign immunity is not a bar to actions seeking prospective injunctive relief against state officials to prevent a continuing violation of federal law.<sup>186</sup>

### 3. *California v. Deep Sea Research, Inc.*

*California v. Deep Sea Research, Inc.*<sup>187</sup> was the next significant development in the law of sovereign immunity. In 1994, Deep Sea Research located a valuable shipwreck four miles off the California coast.<sup>188</sup> The company filed a declaratory judgment action in federal court to adjudicate its rights to the wreck.<sup>189</sup> The State of California entered a limited appearance to dismiss the complaint for lack of jurisdiction and claimed title to the wreck under federal and California statutes purporting to grant the state title to abandoned shipwrecks.<sup>190</sup> The district court rejected the claim of immunity and the Ninth Circuit affirmed.<sup>191</sup> The issue before the Supreme Court was whether the

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182. *Id.* at 143–44.

183. *Hans v. Louisiana*, 134 U.S. 1, 3 (1890).

184. *Ex parte Young*, 209 U.S. 123, 159 (1908).

185. *Id.* at 159–60.

186. *In re Deposit Ins. Agency*, 482 F.3d 612, 618 (2d Cir. 2007). In order to determine whether the *Ex parte Young* exception applies, a court must ask “whether [the] complaint alleges an ongoing violation of federal law and seeks relief properly characterized as prospective.” *Verizon Md., Inc. v. Pub. Serv. Comm’n of Md.*, 535 U.S. 635, 645 (2002). The exception does not apply if Congress has provided a remedial scheme so that equitable remedy through the courts is not necessary. *Seminole Tribe of Fla. v. Florida*, 517 U.S. 44, 76 (1996). Additionally, the exception may not apply if certain state sovereign interests are present, such as state ownership and control of land. *Idaho v. Coeur d’Alene Tribe of Idaho*, 521 U.S. 261, 281, 287 (1997).

187. 523 U.S. 491 (1998).

188. *Id.* at 496.

189. *Id.* at 495.

190. *Id.* at 496.

191. *Deep Sea Research v. Brother Jonathan*, 102 F.3d 379, 387 (9th Cir. 1996).

Eleventh Amendment barred adjudication of the rights to a res when the res was not in the state's possession.<sup>192</sup>

The Court unanimously ruled that the Eleventh Amendment did not bar the federal district court from adjudicating California's rights in a shipwreck. The Court noted that under the Constitution, Article III, Section 2, clause 1, the judicial power of federal courts extends to all cases of admiralty and maritime jurisdiction, but that the Eleventh Amendment constrains the jurisdiction of federal courts.<sup>193</sup> There was no conflict in this case, however, because the res was not in the state's possession.<sup>194</sup> Owing to federal jurisdiction over admiralty, the federal court has jurisdiction in in rem admiralty actions where the state is not in possession of the disputed property.<sup>195</sup> This case stands for the rule that if the subject of jurisdiction is enumerated within the powers of Congress, federal courts have jurisdiction to adjudicate the state's interests in a res, even if the courts do not have authority to compel the state to hand over the res.

#### 4. *Pennsylvania v. Union Gas Company*

Two major battles in the struggle between federalism and state sovereignty were fought just six years apart and on almost identical ground. *Pennsylvania v. Union Gas Co.*<sup>196</sup> held that Congress had authority to abrogate state immunity under the Commerce Clause.<sup>197</sup> *Seminole Tribe of Florida v. Florida*<sup>198</sup> held that the Eleventh Amendment barred Congress from abrogating state immunity under the Indian Commerce Clause.<sup>199</sup> While *Seminole Tribe* was a slim five-to-four decision, there was no majority in *Union Gas*. The lack of a definitive consensus in these cases underscores the volatile nature of federalism versus state sovereignty.

*Union Gas Co.* dealt with whether Congress could properly subject states to suit by private individuals under the provisions of the Comprehensive Environmental Response, Compensation, and Liability Act

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192. *California v. Deep Sea Research*, 523 U.S. at 506–07.

193. *Id.* at 501.

194. *Id.* at 504.

195. *Id.* at 507.

196. 491 U.S. 1 (1989).

197. U.S. CONST. art. I, § 8, cl. 3 (providing that Congress shall have Power “[t]o regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes”).

198. 517 U.S. 44 (1996).

199. U.S. CONST. art. I, § 8, cl. 3.

of 1980<sup>200</sup> (“CERCLA”), enacted pursuant to the Commerce Clause.<sup>201</sup> A four-justice plurality, with Justice Stevens joining only in the result, upheld the private right of action under CERCLA on the grounds that “the States granted a portion of their sovereignty when they granted Congress the power to regulate commerce.”<sup>202</sup> The Court cited *Fitzpatrick v. Bitzer*,<sup>203</sup> which held that Congress may subject states to suits for money damages in federal court when legislating under the Fourteenth Amendment.<sup>204</sup> “Such enforcement [of the prohibitions of the Fourteenth Amendment] is no invasion of State sovereignty. No law can be, which the people of the States have, by the Constitution of the United States, empowered Congress to enact.”<sup>205</sup> On this reasoning, the Court concluded, “[e]ach of these points is as applicable to the Commerce Clause as it is to the Fourteenth Amendment,”<sup>206</sup> thus equating the Commerce Clause with the Fourteenth Amendment, with both allowing for abrogation of state immunity. The dissent castigated the plurality, asserting that the Eleventh Amendment and *Hans* clearly forbade abrogation of state immunity pursuant to the Commerce Clause.<sup>207</sup>

##### 5. *Seminole Tribe of Florida v. Florida*

The case of *Seminole Tribe* directly contradicted the plurality opinion in *Union Gas Co.* and, by its uncompromising approach, was clearly intended by the majority to be the definitive interpretation of the Eleventh Amendment.

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200. 42 U.S.C. § 9601 (1980), amended by Superfund Amendments and Reauthorization Act of 1986, Pub. L. 99-499, 100 Stat. 1613.

201. U.S. CONST. art. I, § 8, cl. 3.

202. *Union Gas Co.*, 491 U.S. at 14 (citing *Parden v. Terminal Ry. of Ala. Docks Dep't*, 377 U.S. 184, 191 (1964)). Other cases cited by the Court to the effect that states surrendered some of their sovereignty under the Commerce Clause include *Welch v. Texas Department of Highways & Public Transportation*, 483 U.S. 468, 475–76 (1987); *County of Oneida v. Oneida Indian Nation*, 470 U.S. 226, 252 (1985); *Employees v. Missouri Department of Public Health & Welfare*, 411 U.S. 279, 286 (1973) (“the states surrendered a portion of their sovereignty when they granted Congress the power to regulate commerce”). CERCLA invoked the Commerce Clause because environmental harm is “often not susceptible of a local solution,” as hazardous wastes and dumping and clean-up very often occur across state lines. *Union Gas Co.*, 491 U.S. at 20–21.

203. 427 U.S. 445 (1976).

204. *Id.* at 445–46.

205. *Union Gas Co.*, 491 U.S. at 16 (citing *Fitzpatrick v. Bitzer*, 427 U.S. 445, 454 (1976)).

206. *Id.*

207. *See id.* at 32, 35.

*Seminole Tribe* concerned the Indian Gaming Regulatory Act<sup>208</sup> (“IGRA”), enacted by Congress under the Indian Commerce Clause.<sup>209</sup> The IGRA allows an Indian tribe to conduct gaming activities, but only in conformance with a valid pact between the tribe and the state in which the gaming activities are located.<sup>210</sup> The IGRA requires states to negotiate in good faith with a tribe to formulate the compact<sup>211</sup> and provides that a tribe may sue a state in federal court to compel performance if the state refuses to negotiate.<sup>212</sup> After Florida allegedly refused to conduct negotiations for tribe-related gaming activities, the Seminole Tribe filed suit against Florida.<sup>213</sup>

The case hinged on two issues: first, whether Congress abrogated state immunity through the IGRA, and second, whether Congress acted pursuant to a valid exercise of power.<sup>214</sup> Since the language abrogating state immunity was clear, the Court focused on the constitutional issue of whether Congress has power to abrogate state immunity.

Writing for a five-to-four majority, Justice Rehnquist argued that state immunity has its roots in the common law of England and in the “fundamental ‘jurisprudence of all civilized nations.’”<sup>215</sup> The majority found that congressional abrogation of immunity had been upheld in only one case, *Union Gas Co.*, which the Court characterized as a “solitary departure from established law.”<sup>216</sup> The Court held that Article I does not give Congress power to abrogate state immunity, and as the Fourteenth Amendment was ratified after the Eleventh Amendment, Congress may only abrogate state immunity to the extent necessary to protect rights guaranteed under the Fourteenth Amendment.<sup>217</sup>

In an extraordinarily lengthy dissent, Justice Souter was not persuaded that the Framers intended federal law to be subordinate to state sovereign immunity. Rather, states would be part of a system, and power would be divided between the states and the Nation, with “the

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208. 25 U.S.C. § 2710(d) (1988).

209. U.S. CONST. art. I, § 8, cl. 3.

210. 11 U.S.C. § 2710(d)(1)(C).

211. *Id.* § 2710(d)(3)(A).

212. *Id.* § 2710(d)(7)(B).

213. *Seminole Tribe of Fla. v. Florida*, 517 U.S. 44, 45 (1996).

214. *Id.* at 57–58.

215. *Id.* at 69 (citing *Hans v. Louisiana*, 134 U.S. 1, 17 (1889)).

216. *Id.* at 66.

217. *Id.* at 59. There was extensive criticism of the case among commentators. A measured critique of *Seminole Tribe* is found in Leonard G. Gershon, *A Bankruptcy Exception to Eleventh Amendment Immunity: Limiting the Seminole Tribe Doctrine*, 74 AM. BANKR. L.J. 2 (2000).

[Nation] to be invested with its own judicial power and the right to prevail against the States whenever their respective substantive laws might be in conflict.”<sup>218</sup>

Before *Katz*, most bankruptcy courts followed this rule from *Seminole Tribe*.<sup>219</sup> Several bankruptcy courts creatively endeavored to find that the Code was enacted pursuant to the Fourteenth Amendment,<sup>220</sup> but this was clearly a minority position.<sup>221</sup>

## 6. *Alden v. Maine*

A discussion on the Eleventh Amendment and bankruptcy jurisdiction would be incomplete without a review of *Alden v. Maine*.<sup>222</sup> Coming on the heels of *Seminole Tribe*, and not long before *Katz*, the case shows just how deeply entrenched the opposing camps had become.

In *Alden*, a group of probation officers filed suit against their employer, the State of Maine, for violating the Fair Labor Standards Act of 1938 (“FLSA”). After being dismissed on the grounds of sovereign immunity from federal court, the officers then filed the same action in state court, which likewise dismissed the suit on the basis of sovereign immunity.<sup>223</sup> The Maine Supreme Court upheld the lower court’s decision.<sup>224</sup> In a five-to-four ruling, the Supreme Court affirmed.<sup>225</sup>

For the majority in *Alden*, state sovereign immunity is inherent in the Constitution and does not arise from the Eleventh Amendment.<sup>226</sup> Well before the Constitution was drafted, the Framers assumed that states naturally possessed “residual and inviolable sovereignty.”<sup>227</sup> Thus, the majority in *Alden* concluded,

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218. *Seminole Tribe*, 517 U.S. at 104 (Souter, J., dissenting).

219. *Techs. Int’l Holdings, Inc. v. Kentucky* (*In re Technologies Int’l Holdings, Inc.*), Nos. 99-50867, 99-50868, 99-50869, 2003 Bankr. LEXIS 1541, at \*30 (Bankr. E.D. Ky. Nov. 24, 2003) (citing *Seminole Tribe* in ruling that bankruptcy debtor suit against Kentucky barred by the Eleventh Amendment as only the Fourteenth Amendment, and not the Bankruptcy Code, validly abrogated state immunity).

220. *In re Willis*, 230 B.R. 619 (Bankr. E.D. Okla. 1999); *In re Straight*, 209 B.R. 540 (Bankr. D. Wyo. 1997); *In re Headrick*, 203 B.R. 805 (Bankr. S.D. Ga. 1996).

221. See *Techs. Int’l Holdings*, 2003 Bankr. LEXIS 1541, at \*30, and cases cited therein.

222. 527 U.S. 706 (1999). Whereas *Seminole Tribe* dealt with the authority of a federal court to hear citizen suits against a state agency, *Alden* addressed whether a state court had jurisdiction to hear citizen suits against state agencies. *Id.* at 711–12.

223. *Id.* at 711–12.

224. *Id.*

225. *Id.* at 712.

226. *Id.* at 713.

227. THE FEDERALIST NO. 39, at 245 (James Madison) (Clinton Rossiter ed., 1961).

[T]he sovereign immunity of the States neither derives from, nor is limited by, the terms of the Eleventh Amendment. Rather, as the Constitution's structure, its history, and the authoritative interpretations by this Court make clear, the States' immunity from suit is a fundamental aspect of the sovereignty which the States enjoyed before the ratification of the Constitution, and which they retain today . . . except as altered by the plan of the Constitution or certain constitutional Amendments.<sup>228</sup>

The minority in *Alden*, however, could find no evidence that state immunity was immutable to the Framers. The dearth of notes or debate on the issue among the Framers,<sup>229</sup> and the fact that two of the four-justice plurality in *Chisholm* were participants in the Constitutional Convention (as was Chisholm's attorney, Edmund Randolph),<sup>230</sup> led the dissent to conclude that state sovereign immunity was anything but sacrosanct. Pre-Constitution, some states did not even consider themselves to be immune from suit, while other states were ambivalent.<sup>231</sup> Moreover, there was at least some popular sentiment at the time that no sovereign should be immune from suit by citizens.<sup>232</sup> The dissent concluded that sovereign immunity was considered by the Framers to be, at most, a right under common law, not natural law.<sup>233</sup> Such a right was not properly amenable to contemporary circumstances, which were unlike anything that existed at the time of the Framers.<sup>234</sup>

### 7. *Ex Parte Young* Meets Bankruptcy: *In re Dairy Mart*

*In re Dairy Mart*<sup>235</sup> extended *Ex parte Young*'s sovereign immunity exception. Dairy Mart operated a chain of convenience stores, some of which sold gasoline.<sup>236</sup> The gasoline was stored under the gas pumps in underground tanks, which were subject to the Resource Conservation and Recovery Act<sup>237</sup> ("RCRA"). The State of Kentucky administered a fund to assist owners of underground tanks to comply

228. *Alden*, 527 U.S. at 713.

229. *Id.* at 772–73.

230. *Id.* at 789.

231. *Id.* at 769–70, 772.

232. *Id.* at 784–85.

233. *Id.* at 774–78.

234. *Id.* at 807.

235. *Dairy Mart Convenience Stores, Inc. v. Nickel (In re Dairy Mart)*, 411 F.3d 367 (2d Cir. 2005).

236. *Id.* at 369.

237. 42 U.S.C. §§ 6901–6992k (2000).

with RCRA cleanup requirements, but the fund program had a strict claim application deadline of October 12, 2001.<sup>238</sup>

Dairy Mart filed for chapter 11 bankruptcy reorganization on September 24, 2001 in the Southern District of New York.<sup>239</sup> Twenty-two of its Kentucky stores were eligible for assistance under the fund, but Dairy Mart missed the claim deadline by four days, and its claims were denied.<sup>240</sup> Dairy Mart asserted that its claims should be approved because section 108(b) of the Code automatically extends any nonbankruptcy claim filing deadline for an additional sixty days from the initial bankruptcy filing date.<sup>241</sup> That would have given Dairy Mart until November 24, 2001 to file its claims.

Dairy Mart brought an adversary proceeding to compel payment of the claims.<sup>242</sup> Kentucky state officials filed a motion to dismiss on the grounds of sovereign immunity, arguing that the remedy sought by Dairy Mart went beyond the *Ex parte Young* rule of allowing suits to enjoin unconstitutional conduct. The state officials argued that the effect of allowing the bankruptcy court to rule on the injunction would be to require the State of Kentucky to pay money to plaintiffs from the state treasury.<sup>243</sup> Thus, the action was directed, not just towards state officials, but the State of Kentucky itself. The bankruptcy court denied the motion on the grounds that the suit sought injunctive relief to enjoin violation of federal law, thereby falling within the *Ex parte Young* exception to Eleventh Amendment sovereign immunity.<sup>244</sup> The district court affirmed.<sup>245</sup>

The Second Circuit found that the Eleventh Amendment was not absolute. “In tension with the immunity of the states is the supremacy of the Union and its Constitution.”<sup>246</sup> The Second Circuit noted that payment of state funds, an “ancillary effect” of proper injunctive relief,

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238. *Dairy Mart*, 411 F.3d at 370.

239. *Id.* at 368.

240. *Id.* at 370.

241. Section 108(b) provides as follows:

[I]f applicable nonbankruptcy law . . . fixes a period within which the debtor . . . may file any pleading, demand, notice, or proof of claim or loss . . . and such period has not expired before the date of the filing of the petition, the trustee may . . . file, cure, or perform, as the case may be . . . 60 days after the order for relief.

11 U.S.C. § 108(b) 2000.

242. *Dairy Mart*, 411 F.3d at 370.

243. *Id.* at 375.

244. *Id.*

245. *Id.*

246. *Id.* at 371.

was “a permissible and often an inevitable consequence” of the *Ex parte Young* doctrine.<sup>247</sup> In this case, eligibility for the state funds was entirely within the purview of state law—ordering injunctive relief that the claim be accepted was not an order that the State of Kentucky pay money.<sup>248</sup> It could still refuse to pay the claims, if allowed under state law.<sup>249</sup> The Second Circuit concluded that “the Supremacy Clause demands that any rights of Dairy Mart under the bankruptcy code must be equitably met, and the payment is simply an ancillary effect of a properly issued injunction.”<sup>250</sup>

The court in *Dairy Mart* did not actually abrogate state immunity—Kentucky had already provided for payment of the funds to eligible citizens. Rather, the court invoked its bankruptcy powers against Kentucky to restore the debtor’s eligibility for the funds. This is conceptually different from a case in which a bankruptcy court orders a state to restore a preferential payment. In the latter situation, the debtor’s interest only exists because of the Code. The result, however, is the same: state money is paid to a citizen as a consequence of the exercise of bankruptcy jurisdiction. It is almost certain that the *Seminole Tribe* majority would not have approved of this outcome if they had reviewed the case.

### III. Conflict at the Border: *Central Virginia Community College v. Katz*

#### A. Bankruptcy Opinions Leading up to *Katz*

The road leading to *Katz* is a study in judicial progression and shifting court majorities. It mirrors the judicial gyrations of the Eleventh Amendment.

##### 1. *Hoffman v. Connecticut Department of Income Maintenance*

The Court’s decision in *Hoffman v. Connecticut Department of Income Maintenance*<sup>251</sup> shows the Court’s tentative approach to state abrogation of immunity. In *Hoffman*, a chapter 7 trustee in a bankruptcy case filed two unrelated adversarial proceedings against the State of Connecticut.<sup>252</sup> One proceeding, filed pursuant to section 542(b) of

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247. *Id.* at 375 (citing *Edelman v. Jordan*, 415 U.S. 651, 668 (1974)).

248. *Id.* at 375–76.

249. *See id.* at 376.

250. *Id.*

251. 492 U.S. 96 (1989).

252. *Id.* at 99.

the Code,<sup>253</sup> demanded “turnover” of Medicare payments made for services performed by a bankrupt nursing home.<sup>254</sup> The other action was brought pursuant to section 547 of the Code to recover a “preferential” transfer of funds paid for state taxes, interest, and penalties within ninety days before the bankruptcy filing.<sup>255</sup> Connecticut filed a motion to dismiss both complaints on the grounds of sovereign immunity.<sup>256</sup>

The bankruptcy court ruled that by enacting section 106(c) of the Code, Congress abrogated state sovereign immunity in bankruptcy litigation for turnover and preference actions.<sup>257</sup> The district court reversed,<sup>258</sup> and the court of appeals affirmed, holding that section 106(c) abrogates state immunity to the extent necessary to determine a state’s right in property of the estate, but not to the extent of recovering a money judgment or other property from a state.<sup>259</sup> The Supreme Court affirmed the lower court decision, but without deciding the constitutional validity of section 106.<sup>260</sup> Instead, after minutely explicating the language of section 106(a) and (b), the Court concluded that it was “unlikely” that Congress intended “broad abrogation” of the Eleventh Amendment.<sup>261</sup> Rather, section 106(c) was “more indicative of declaratory and injunctive relief than of monetary recovery.”<sup>262</sup> In cases involving possible abrogation of the Eleventh Amendment, Congress’s intent to do so must be “unmistakably clear in the language of the statute.”<sup>263</sup>

Such was the five-to-four majority opinion. However, in their concurring opinions, both Justices Scalia and O’Connor flatly asserted that Congress had no power under the Bankruptcy Clause to abrogate the states’ Eleventh Amendment immunity.<sup>264</sup> Justice Scalia would have affirmed the Second Circuit decision “without the necessity of considering whether Congress intended to exercise a power it did not

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253. 11 U.S.C. § 542(b) (2000).

254. *Hoffman*, 492 U.S. at 99.

255. *Id.*

256. *Id.*

257. *Id.*

258. Conn. Dep’t of Income Maint. v. Hoffman (*In re* Willington Convalescent Home), 72 B.R. 1002 (Bankr. D. Conn. 1987), *aff’d*, 850 F.2d 50, 55 (2d Cir. 1988), *aff’d* 492 U.S. 96 (1989).

259. Hoffman v. Conn. Dep’t of Income Maint. (*In re* Willington Convalescent Home), 850 F.2d 50, 55 (2d Cir. 1988), *aff’d* 492 U.S. 96 (1989).

260. *Hoffman*, 492 U.S. at 104.

261. *Id.* at 101.

262. *Id.* at 102.

263. *Id.* at 101 (citing *Atascadero State Hosp. v. Scanlon*, 473 U.S. 234, 242 (1985)).

264. *Id.* at 105 (O’Connor, J. & Scalia, J., concurring).

possess.”<sup>265</sup> In contrast, Justice Stevens wrote in his dissenting opinion that the legislative history showed that the drafters of the Code were “well aware of the value to the bankruptcy administration process of a waiver of federal and state sovereign immunity.”<sup>266</sup>

Congress responded to this decision,<sup>267</sup> by strengthening the language of section 106(c) to more clearly express the intent to abrogate state sovereignty in bankruptcy litigation.<sup>268</sup>

## 2. *Tennessee Student Assistance Corporation v. Hood*

The case of *Tennessee Student Assistance Corp. v. Hood*,<sup>269</sup> a seven-to-two decision, was a critical stepping-stone to *Katz*, although decided upon far narrower grounds. In *Hood*, a bankruptcy debtor owed student loans to a Tennessee state student loan agency.<sup>270</sup> Ordinarily, government-guaranteed student loans are not dischargeable in bankruptcy unless the debtor can demonstrate that the debtor and any dependents would suffer “undue hardship” if required to repay the loans.<sup>271</sup> The debtor filed a complaint against the state agency seeking a hardship discharge, and the agency moved to dismiss the complaint for lack of jurisdiction.<sup>272</sup> The bankruptcy court denied the motion, holding that, pursuant to section 106(a) of the Code, the Bankruptcy Clause gave Congress the power to abrogate state sovereignty.<sup>273</sup> The district courts and Sixth Circuit affirmed.<sup>274</sup>

The Supreme Court also affirmed, but on different grounds.<sup>275</sup> Justice Rehnquist, writing for the majority, reasoned that the dis-

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265. *Id.* (Scalia, J., concurring).

266. *Id.* at 111 (Stevens, J., dissenting).

267. This was also a response to a similar decision in *United States v. Nordic Village, Inc.*, 503 U.S. 30 (1992).

268. 11 U.S.C. § 106(b) (2000).

269. 541 U.S. 440 (2004).

270. *Id.* at 444.

271. 11 U.S.C. § 523(a)(8). This is a difficult showing to make. Many courts have adopted the three-prong test used in *Brunner v. New York Higher Education Services Corp.*, 831 F.2d 395 (2d Cir. 1987): present dire financial circumstances, likelihood of condition continuing in the future, and the debtor’s good faith attempt to repay the loan. *See id.* at 396.

272. *Brunner*, 831 F.2d at 444–45. Federal bankruptcy procedures require the debtor seeking a student loan discharge to file a complaint and serve the complaint with a summons upon a representative of the lender. FED. R. BANKR. PROC. 7001(6), 7003, 7004.

273. *Brunner*, 831 F.2d at 445.

274. *Hood v. Tenn. Student Assistance Corp. (In re Hood)*, 319 F.3d 755 (6th Cir. 2003).

275. Later, several bankruptcy courts continued to cite the Sixth Circuit opinion in *Hood* in holding that section 106 validly abrogated state immunity. *See, e.g.*, *Quality Stores, Inc. v. Vt. Dep’t of Taxes (In re Quality Stores, Inc.)*, 324 B.R. 631, 635 (Bankr. M.D. Mich. 2005) (holding that adversary proceeding for turnover of funds held by Vermont Depart-

charge of a debt by a bankruptcy court is an in rem proceeding, and that a bankruptcy court has exclusive jurisdiction over a debtor's property, wherever located.<sup>276</sup> Because the court's jurisdiction is premised upon the res, a nonparticipating creditor cannot be subjected to personal liability.<sup>277</sup> Thus, a debtor is not seeking money damages or other affirmative relief by filing a complaint for discharge of a student debt—he seeks only the discharge of the debt.<sup>278</sup> The fact that Federal Bankruptcy Rules<sup>279</sup> require a bankruptcy court to issue process was not an “indignity to the sovereignty of a State” because it was only a procedural modus to bring the issue before the bankruptcy court.<sup>280</sup> For the dissent, even an adjudication of discharge of a state debt violated the Eleventh Amendment, because “the State is compelled to either subject itself to the Bankruptcy Court's jurisdiction or to forfeit its rights.”<sup>281</sup>

Numerous bankruptcy courts followed the ruling in *Hood*.<sup>282</sup> In *Flores v. Illinois Department of Public Health*,<sup>283</sup> a chapter 7 debtor filed an adversary proceeding to determine the dischargeability of a scholarship obligation owed to Vermont.<sup>284</sup> Vermont filed a motion to dismiss based on sovereign immunity.<sup>285</sup> The bankruptcy court denied the motion, pursuant to *Hood*, and suggested that the Supreme Court in *Seminole Tribe* “painted its picture of sovereign immunity . . . with an overly broad brush.”<sup>286</sup>

In *Florida Furniture Industries, Inc. v. Maheffey (In re Florida Furniture Industries, Inc.)*,<sup>287</sup> the court denied the motion of a taxing authority to dismiss a complaint for determination of a tax liability.<sup>288</sup> Citing

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ment of Revenue could proceed since section 106(a) was a valid abrogation of state immunity).

276. *Hood*, 541 U.S. at 448.

277. *Id.*

278. *Id.* at 450.

279. FED. R. BANKR. PROC. 7001(b), 7003.

280. *Hood*, 541 U.S. at 452.

281. *Id.* at 458 (Thomas, J., dissenting).

282. See, e.g., *Texas v. Davis (In re Davis)*, 340 B.R. 767, 771 (Bankr. E.D. Tex. 2006) (holding that discharge of debt owed to state by bail bond operator not in violation of the Eleventh Amendment); *Gray v. Fla. State Univ. (In re Dehon)*, 327 B.R. 38, 58 (Bankr. D. Mass. 2006) (“[T]he Framers intended that the Constitution would alienate state's sovereign immunity with regard to bankruptcy matters upon ratification.”).

283. 300 B.R. 599 (Bankr. Vt. 2003).

284. *Id.* at 600.

285. *Id.* at 601.

286. *Id.* at 602.

287. 342 B.R. 838 (Bankr. M.D. Fla. 2005).

288. *Id.* at 841.

*Hood*, the court ruled that since the res at issue in the case—a tax liability—is not in possession of the state, the court’s action would not require in personam jurisdiction against the state.<sup>289</sup>

The bankruptcy court in *Georgia Higher Education Assistance Corp. v. Crow (In re Crow)*<sup>290</sup> drew a distinction between adjudicating rights to a res in the debtor’s possession, and ordering affirmative relief for money damages against a state. In *In re Crow*, the court rejected a motion by a state agency to dismiss the debtor’s student discharge complaint, but dismissed the debtor’s count for wrongful damages for collection efforts instead.<sup>291</sup> “Because count two seeks affirmative relief from the state through a coercive judicial process, the bankruptcy court’s jurisdiction over it is premised on the persona of the state, not on the res of the debtor’s property. Because jurisdiction is *in personam*, Eleventh Amendment concerns are not obviated by *Hood*.”<sup>292</sup>

### 3. *Official Committee v. Public Utilities Commission (In re 360networks (USA), Inc.)*

In *Official Committee v. Public Utilities Commission (In re 360networks (USA), Inc.)*,<sup>293</sup> the court considered whether the New York Public Utilities Commission (“NYPUC”) was subject to a lawsuit for the return of a preferential transfer under the preference avoidance provisions of section 547.<sup>294</sup> The bankruptcy court, citing *Hood*, ruled that its in rem jurisdiction allowed it to “determine all claims that anyone . . . has to the property or thing in question” and that an in rem proceeding is “one against the world . . . to establish an unquestionable title to the res.”<sup>295</sup> The court did not exercise in personam jurisdiction against New York or its agencies or officials, since they were not compelled to appear, and no personal liability would be created.<sup>296</sup>

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289. *Id.*

290. 394 F.3d 918 (11th Cir. 2004).

291. *Id.* at 921.

292. *Id.*

293. 316 B.R. 797 (Bankr. S.D.N.Y. 2004).

294. Bankruptcy Code section 547 is one of the sections enumerated in section 106(a) and allows a bankruptcy trustee or its representative (in this case, the creditors’ committee) to demand return of funds paid by the debtor to a creditor for a pre-bankruptcy debt within ninety days before the filing of the bankruptcy. 11 U.S.C. § 547 (2000). There are defenses set forth under section 547 which may well have been available to NYPUC, but the threshold issue in *360networks* was whether the trustee could sue NYPUC, a state agency, for preference in the first place. See *360networks*, 316 B.R. at 799.

295. *360networks*, 316 B.R. at 803 (internal citations omitted). A bankruptcy court has “exclusive jurisdiction” of all property of the debtor and the debtor’s estate “wherever located.” *Id.* at 803 (citing *Begier v. IRS*, 496 U.S. 53, 58 (1990)).

296. *Id.*

Rather, “the power of the court [was] limited . . . to the disposition of the property.”<sup>297</sup> Therefore, since the bankruptcy court has in rem jurisdiction over the property of the debtor, “it has *in rem* jurisdiction to decide issues involving that property, notwithstanding a State’s sovereign immunity.”<sup>298</sup> Since there was no pending motion under section 550 to compel return of the money, the bankruptcy court could rule that the transfer was avoidable without ruling at the same time that New York had to return the money.<sup>299</sup>

*360networks* was not the first case in which a court confronted the difference between the authority to declare the status of property of the estate, and the authority to enforce its declaration against a state. In *Suhar v. Burns (In re Burns)*,<sup>300</sup> the court stated, “The fact that avoidance and recovery are distinct does not mean that avoidance cannot trigger recovery, but it does suggest that avoidance need not always trigger recovery.”<sup>301</sup> Similarly, in *United States Lines, Inc. v. United States (In re McLean Industries, Inc.)*,<sup>302</sup> the court stated that a bankruptcy court has power to determine that a transfer is avoidable under section 547, even if it lacks power to order affirmative relief.<sup>303</sup> The bank-

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297. *Id.* (internal citations omitted). A preference claim falls within the bankruptcy court’s in rem jurisdiction because property subject to a preference action is “best understood as that property that would have been part of the estate had it not been transferred before the commencement of the bankruptcy.” *Id.*; see also *In re Bullion Reserve of N. Am.*, 836 F.2d 1214, 1217 (9th Cir. 1988), *cert. denied*, 486 U.S. 1056 (1988) (“[P]roperty belongs to the debtor for purposes of section 547 if its transfer will deprive the bankruptcy estate of something which could otherwise be used to satisfy the claims of creditors.”); cf. *FDIC v. Hirsch (In re Colonial Realty Co.)*, 980 F.2d 125, 131 (2d Cir. 1992) (holding that in a preference action, property transferred does not become property of the estate until it is recovered).

298. *360networks*, 316 B.R. at 803, 804; see also *Gardner v. New Jersey*, 329 U.S. 565, 577 (1947) (holding that a bankruptcy court’s in rem jurisdiction over a debtor’s property “is not limited to the prevention of interference with the use of the debtor’s property . . . but it extends also to the adjudication of questions respecting title”); *In re N.C. Technical Dev. Authority, Inc.*, No. 03-83278C-7D, 2005 Bankr. LEXIS 1087, at \*11 (Bankr. M.D.N.C. Mar. 30, 2005) (debtor’s adversary proceeding to set aside state corrective deed was solely an in rem proceeding and not an affront to the sovereignty of the state).

299. *360networks*, 316 B.R. at 805.

300. 322 F.3d 421 (6th Cir. 2003).

301. *Id.* at 427.

302. 196 B.R. 670 (Bankr. S.D.N.Y. 1996).

303. *Id.* at 677. The bankruptcy court in *Sticka v. Oregon State Lottery Commission (In re Judy A. Moore)*, 323 B.R. 752 (Bankr. D. Or. 2005), confronted almost identical facts as the court in *360networks* and reached a different conclusion. As in *360networks*, a chapter 7 trustee filed an adversary proceeding against the Oregon State Lottery Commission to avoid an alleged preferential transfer. *360networks*, 316 B.R. at 754. There were two issues: first, whether section 106(a) was a valid exercise of constitutional authority; and second, whether the trustee’s preference claim could be used to set off a claim for income taxes filed by the lottery commission against the debtor’s estate. *Id.* at 754–55. As to the first

ruptcy court in *Bliemeister v. Industrial Commission of Arizona (In re Bliemeister)*,<sup>304</sup> however, foresaw the arguments to be made in *Katz* and concluded that the states had surrendered their sovereignty to bankruptcy jurisdiction when they ratified the Bankruptcy Clause.

### B. *Central Virginia Community College v. Katz*

When confronted with the ominous prospect of having to order the NYPUC to actually do something (pay back the debtor's money) the bankruptcy court in *360networks* did what any courageous federal court would do when faced with a challenge—it left the question for another court to decide. The issue appeared again two years later in *Katz*. Partisans of expanded bankruptcy powers saw a victory for their view.

Wallace's Bookstores, Inc. ("WBI") is an American saga. The business was founded by Wallace G. Wilkinson, who dropped out of college in 1960 to start a used bookstore.<sup>305</sup> WBI ultimately grew into one of the nation's largest retailers of new and used college textbooks, with more than ninety-one locations on sixty college campuses around the country.<sup>306</sup> In 1987, Wilkinson, then a political unknown, used his

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issue, the bankruptcy court noted that since *Hood* had avoided the issue of whether section 106(a) was constitutional, and the Ninth Circuit had previously held that section 106(a) was unconstitutional as applied to states, the trustee had no authority to bring a preference avoidance action against the state. *Id.* As for the setoff claim under section 502(d), the bankruptcy court found that immunity did not apply, for two reasons. First, setoff is part of the bankruptcy claims process, a strictly in rem proceeding that does not offend state sovereignty. *Id.* at 756–57. Second, section 502(d) includes a waiver provision whereby if a state files a proof of claim as a creditor in a bankruptcy case, it waives immunity with respect to adjudication of that proof of claim, including any defenses or objections to the claim. *Id.* at 757. Some courts were in agreement with this conclusion. *Schlossbera v. Maryland (In re Creative Goldsmith of D.C., Inc.)*, 119 F.3d 1140, 1147 (4th Cir. 1997) ("Congress' effort to abrogate the states' Eleventh Amendment immunity through its 1994 enactment of 11 U.S.C. § 106(a) is unconstitutional and ineffective."); *Heritage Associates v. Maryland (In re Heritage Associates)*, 336 B.R. 255 (Bankr. Md. 2006) (finding an avoidance complaint filed by chapter 11 debtor's plan committee against state agency was barred under the Eleventh Amendment). Other courts were not in such agreement. *Quality Stores, Inc. v. Vt. Dep't of Taxes (In re Quality Stores, Inc.)* 324 B.R. 631, 635 (Bankr. M.D. Mich. 2005) (noting a split among the circuits on this issue, adopted the Sixth Circuit rule in *Hood v. Tennessee Student Assistance Corp. (In re Hood)*, 319 F.3d 755 (6th Cir. 2003), to find that section 106 represented a valid abrogation of state immunity).

304. 251 B.R. 383 (Bankr. D. Az. 2000), *aff'd on other grounds*, 296 F.3d 858 (9th Cir. 2002).

305. *W.G. Wilkinson, 60, Kentucky Governor Who Faced Scandals*, N.Y. TIMES, July 6, 2002, <http://query.nytimes.com/gst/fullpage.html?res=9A03E7DA1131F935A35754C0A9649C8B63>.

306. *Id.*; John L. Pulley, *Court Divides Up a Bankruptcy Chain of College Bookstores*, CHRON. HIGHER EDUC., May 4, 2001, <http://chronicle.com/weekly/v47/i34/34a03001.htm>.

considerable financial resources to fund his candidacy in the Democratic primary for governor of Kentucky, including hiring political consultant James Carville.<sup>307</sup> His plan to introduce a state lottery was popular with voters, and after winning the primary against a field that included two former Kentucky governors and a former lieutenant governor, Wilkinson went on to defeat the Republican nominee in the fall election by a landslide.<sup>308</sup>

Ethics concerns, however, soon dogged his administration, which saw investigations of his overseas business dealings (culminating in an audit by Italian tax police), state contracts awarded to companies contributing to his wife's political war chest, charges that a company he owned conspired to buy stolen books, and prison time for his nephew on corruption charges.<sup>309</sup> At that time, the Kentucky Constitution prohibited a governor from serving consecutive terms.<sup>310</sup> Not gauging the political winds very astutely, Wilkinson pushed for an amendment to allow gubernatorial succession, grandfathered to include him.<sup>311</sup> When the General Assembly refused to pass the proposed amendment, Wilkinson's wife, Martha Wilkinson, announced her candidacy for the 1991 Democratic nomination to replace him, but she withdrew from the primary.<sup>312</sup> Diagnosed with lymphoma, Wallace Wilkinson retired from public life at the end of his term. He died in 2002.<sup>313</sup>

WBI suffered a similar fall from grace. Once valued at up to \$450 million, creditors of the company filed an involuntary chapter 7 bankruptcy petition against WBI on February 5, 2001, seeking immediate liquidation of the assets of WBI and affiliated companies.<sup>314</sup> Two weeks later, WBI and its subsidiaries filed to convert the cases to voluntary chapter 11 cases, jointly administered in the Bankruptcy Court for the Eastern District of Kentucky.<sup>315</sup> A plan of liquidation was approved a year later, and the bankruptcy court appointed Bernard

307. WALLACE GLENN WILKINSON, *YOU CAN'T DO THAT, GOVERNOR!* 24 (1995).

308. Howard Wilkinson & Howard Wolfe, *Wallace Wilkinson Dead at 60*, CINCINNATI ENQUIRER, July 6, 2002, [http://www.enquirer.com/editions/2002/07/06/loc\\_wallace\\_wilkinson.html](http://www.enquirer.com/editions/2002/07/06/loc_wallace_wilkinson.html).

309. Kakie Urch, *Scandals Beset Kentucky Governors*, CINCINNATI ENQUIRER, Sept. 29, 2002, [http://www.enquirer.com/editions/2002/09/29/loc\\_scandals\\_beset\\_ky.html](http://www.enquirer.com/editions/2002/09/29/loc_scandals_beset_ky.html).

310. Wilkinson & Wolfe, *supra* note 308.

311. *Id.*

312. *Id.*

313. *Id.*

314. *Creditors Question Wilkinson About Bankruptcy*, CINCINNATI ENQUIRER, Mar. 18, 2001, [http://www.enquirer.com/editions/2001/03/18/loc\\_creditors\\_question.html](http://www.enquirer.com/editions/2001/03/18/loc_creditors_question.html).

315. *In re Wallace's Bookstores, Inc.*, Nos. 01-50545-01-50606, 01-51059-01-51065 (Bankr. E.D. Ky. Feb. 28, 2001) (on file with author).

Katz, an accountant, to serve as liquidating supervisor to oversee the orderly liquidation of assets.<sup>316</sup>

One of Mr. Katz's duties as trustee was to investigate and recover all "preferential transfers" made by WBI to creditors within the ninety days immediately preceding the bankruptcy filing. Several hundred of these "preference" actions were ultimately filed in the case. One of these was *Katz v. Central Virginia Community College*, filed on February 12, 2003.<sup>317</sup> The complaint alleged that the debtors made preferential transfers to the college in the amount of \$63,387.<sup>318</sup> The complaint demanded that the transfers be avoided pursuant to section 547 of the Code and recovered by the trustee pursuant to section 550.<sup>319</sup>

Central Virginia Community College ("CVCC") filed a motion to dismiss the adversary complaint.<sup>320</sup> CVCC argued that under the rule of *Seminole Tribe*, section 106 was unconstitutional as a violation of state sovereignty, to which the State of Virginia never consented.<sup>321</sup>

The bankruptcy court denied CVCC's motion to dismiss, and the district court and Sixth Circuit affirmed, all on the basis of the Sixth Circuit's decision in *Hood*.<sup>322</sup> The Court granted certiorari in *Katz* in order to consider the question left open in *Hood*: whether Congress's attempt to abrogate state sovereign immunity in section 106(a) was valid.<sup>323</sup>

In the same way that *Seminole Tribe* and *Alden* were premised upon detailed historical grounds, the majority in *Katz* took pains to promulgate its own careful version of the history of the Bankruptcy Clause and state immunity. The Court began by noting that bankruptcy jurisdiction "at its core, is *in rem*."<sup>324</sup> Such jurisdiction "does not implicate States' sovereignty to nearly the same degree as other kinds of jurisdiction."<sup>325</sup> Still, in modern times as well as in the eighteenth century, the jurisdiction of courts in adjudicating rights to property of a bank-

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316. Order Confirming Second Amended Joint Consolidated Plan of Liquidation of Wallace's Bookstores, Inc., *In re* Wallace's Bookstores, Inc., No. 01-50545 (Bankr. E.D. Ky. filed Mar. 20, 2002) (on file with author).

317. Complaint for Damages, *Katz v. Cent. Va. Cmty. Coll.*, 546 U.S. 356 (2006) (No. 01-50545) (on file with author).

318. *Id.* at 5.

319. *Id.*

320. Motion to Dismiss Adversary Complaint, *Katz*, 546 U.S. 356 (2006) (No. 01-50545) (on file with author).

321. *Id.* at 3-4.

322. *Katz*, 546 U.S. at 356 (2006).

323. *Id.*

324. *Id.* at 362 (citing *Gardner v. New Jersey*, 329 U.S. 565, 574 (1947)).

325. *Id.* at 361 (citing *Tennessee v. Hood*, 541 U.S. 440, 450-51 (2004)).

rupt estate must naturally include “the power to issue compulsory orders to facilitate the administration and distribution of the res.”<sup>326</sup>

The Court presumed that the Framers were familiar with the contemporary legal context at the time they adopted the Bankruptcy Clause,<sup>327</sup> and that the Framers drafted the Bankruptcy Clause with full knowledge of what was necessary to create an effective national bankruptcy regime. Thus, the Court concluded that in ratifying the Constitution, the States abrogated their sovereign immunity to the extent necessary to implement that regime.<sup>328</sup>

The Court then surveyed the status of bankruptcy before the Constitution to support its interpretation that the Framers intended to imbue the Bankruptcy Clause with broad powers in order to effectuate a national bankruptcy regime. For example, the Court noted the disparate results of *James v. Allen*<sup>329</sup> and *Millar v. Hall*,<sup>330</sup> which posed a genuine impediment to travel and commerce in the early republic.<sup>331</sup>

It was against this backdrop that the Framers agreed that Congress should have the power to establish “uniform Laws on the subject of Bankruptcies.”<sup>332</sup> Although the Framers’ immediate interest may have been to avoid unjust imprisonment for debt and to make federal bankruptcy discharge enforceable in every state, “the power granted to Congress by that Clause is a unitary concept rather than an amalgam of discrete segments.”<sup>333</sup> Thus, the Framers realized that an effective bankruptcy regime would require more than “simple adjudications of rights in the res.”<sup>334</sup> English law, for example, as well as the first United States bankruptcy law, gave courts and commissioners the power to force third parties to turn over property of the estate and to issue writs of habeas corpus directing states to release debtors from prison.<sup>335</sup> Accordingly, “those who crafted the Bankruptcy Clause would have understood it to give Congress the power to authorize courts to avoid preferential transfers and to recover the transferred property.”<sup>336</sup> To the extent that such powers ancillary to the

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326. *Id.* at 362.

327. *Id.*

328. *Id.* at 362–63.

329. 1 U.S. (1 Dall.) 188 (Pa. Ct. Com. Pl. 1786).

330. 1 U.S. (1 Dall.) 229 (Pa. 1788).

331. *See supra* notes 17–21 and accompanying text.

332. *Katz*, 546 U.S. at 370.

333. *Id.*

334. *Id.*

335. *Id.* at 372.

336. *Id.*

bankruptcy court's in rem jurisdiction may infringe upon state sovereign immunity, "the States agreed in the plan of the Convention not to assert that immunity."<sup>337</sup>

As further proof that the states consented to broad abrogation of immunity under the Bankruptcy Clause, the Court noted that the Act of 1800, the country's first bankruptcy law, included a provision granting federal courts the power to issue habeas corpus writs directing states to release imprisoned debtors.<sup>338</sup> This was extremely significant since Congress passed the Act of 1800 just five years after the ratification of the Eleventh Amendment in 1798, when national sentiment was strongly in favor of states' rights. Yet there was no objection to the bankruptcy legislation or grant of habeas corpus based upon infringement of sovereign immunity. In addition, section 62 of the Act of 1800 specifically exempted debts owed to the United States, "or to any of them" from bankruptcy discharge.<sup>339</sup> The fact that the statute had to expressly carve out this exemption in favor of states suggests that states were otherwise assumed to be fully subject to the Act of 1800.<sup>340</sup> Taken together, the Court reached the "ineluctable conclusion" that "States acquiesced in a subordination of whatever sovereign immunity they might otherwise have asserted in proceedings necessary to effectuate the *in rem* jurisdiction of the bankruptcy courts."<sup>341</sup> In light of this history, the enactment of section 106(a) "was not necessary to authorize the Bankruptcy Court's jurisdiction over these preference avoidance proceedings."<sup>342</sup>

The Court endeavored to clarify that the decision does "not mean to suggest that every law labeled a 'bankruptcy law' could, consistent with the Bankruptcy Clause, properly impinge upon state sovereign immunity."<sup>343</sup> Presumably, the door was open for review of bankruptcy laws in the future. The Court's decision was that under the authority of the Bankruptcy Clause, Congress could determine whether states should be amenable to such proceedings.<sup>344</sup>

In dissent, Justice Thomas argued that nothing in Article I indicates an intention to abrogate state sovereignty.<sup>345</sup> Citing *Seminole*

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337. *Id.*

338. *Id.* at 375.

339. *Id.*

340. *Id.* at 375-77.

341. *Id.* at 377-78.

342. *Id.* at 362.

343. *Id.* at 378 n.15.

344. *Id.* at 362.

345. *Id.* at 381.

*Tribe* and *Alden*, he found no reason to override “settled doctrine” that Article I “cannot be used to circumvent the constitutional limitations placed upon federal jurisdiction.”<sup>346</sup> Judge Thomas also found fault with the Court’s historical review, opining that the scant attention paid to bankruptcy language in adopting the Constitution, and the twelve-year delay in passing the first national bankruptcy law after the Constitution was ratified, indicate that there was very little concern in the early republic for a national bankruptcy law.<sup>347</sup> As for uniformity, the remedy intended by the Framers to redress the refusal of one state to recognize a bankruptcy discharge from another state is the Full Faith and Credit Clause,<sup>348</sup> not the authorization of private suits against the States.<sup>349</sup> Finally, Justice Thomas found disingenuous the Court’s determination that recovery of assets under section 550 was properly ancillary to in rem authority.<sup>350</sup> For Thomas, the result of *Katz* was to effectively overrule *Seminole Tribe*. “That would be wrong,” he concluded, “but at least the terms of our disagreement would be transparent.”<sup>351</sup>

*Katz* is not a direct refutation of *Seminole Tribe*. *Seminole Tribe* held that sovereign immunity is abrogated if a state consents to suit or if Congress abrogates it by an express statement made pursuant to a valid grant of congressional power.<sup>352</sup> Rather than moor its decision on a finding that section 106 is constitutionally valid, the *Katz* Court found that Florida had consented to suit under the Code through ratification of the Bankruptcy Clause.<sup>353</sup>

The *Katz* decision has been followed in subsequent cases. In *Chattanooga State Technical Community College v. Johnson (In re North American Royalties, Inc.)*,<sup>354</sup> the bankruptcy court denied a motion to dismiss a bankruptcy preference claim, finding that as determined in *Katz*, the state of Tennessee gave up its right to assert sovereign immunity to preference suits when it ratified the Bankruptcy Clause.<sup>355</sup> In *Florida Department of Revenue v. Omine (In re Omine)*,<sup>356</sup> the district court af-

346. *Id.* at 381 (Thomas, J., dissenting).

347. *Id.* at 385–86.

348. U.S. CONST. art. IV, § 1.

349. *Katz*, 546 U.S. at 390–91.

350. *Id.* at 393.

351. *Id.*

352. *Seminole Tribe of Fla. v. Florida*, 517 U.S. 44, 54–55 (1996).

353. *Katz*, 546 U.S. at 375–77.

354. No. 1:05-cv-91, 2006 U.S. Dist. LEXIS 13034 (E.D. Tenn. Mar. 10, 2006).

355. *Id.* at \*10–\*11.

356. No. 6:05-cv-1633-Orl-31DAB, 2006 U.S. Dist. LEXIS 8396 (M.D. Fla. Feb. 10, 2006).

firmed the bankruptcy court award of damages and sanctions against the Florida Department of Revenue (“DOR”), after the DOR repeatedly violated the automatic stay by attempting to collect a debt for repayment of public assistance money paid to the debtor’s ex-wife and children.<sup>357</sup> As sanctions for its violation of the stay, however, the bankruptcy court discharged the remainder of the debt owed to the DOR and ordered it to pay the debtor \$1000 in fines and \$1600 for his attorneys fees.<sup>358</sup> Citing *Katz*, the district court held that actions to force a creditor to honor the automatic stay are necessary to enforce the bankruptcy court’s in rem jurisdiction.<sup>359</sup>

#### IV. Conclusion: What Will *Katz* Drag In? The Future of State Sovereignty in Bankruptcy

State law will continue to act as the primary substantive law of bankruptcy, both because as a practical matter, there is little federal common law, and because many provisions of the Code expressly incorporate state substantive law. In this sense, state sovereignty largely prevails. State authority, however, gives way to bankruptcy jurisdiction in three situations: (1) when federal bankruptcy law preempts state insolvency law under the Supremacy Clause; (2) when a state law that is not specifically a bankruptcy law has the effect of preempting federal bankruptcy law; and (3) when state sovereignty is abrogated because it conflicts with provisions of federal bankruptcy law. Under the present Code, the restrictions on state sovereignty are set forth in section 106.<sup>360</sup> The rationale behind these restrictions is to eliminate the difference between state and non-state actors for purposes of defining property of the bankruptcy estate and administering the estate.

The first two elements are firmly established in American constitutional law. However, given the debate within the Court, as characterized by the opposing—and slim—majorities in *Seminole Tribe* and *Katz*, abrogation of state immunity under the Bankruptcy Clause is clearly not as established under the law. For the majority in *Seminole Tribe* (and like-minded jurists), the boundary between state sovereignty and federal bankruptcy jurisdiction is fixed—the reach of bankruptcy law ends where the state becomes subject to suit for any reason, whether in bankruptcy court or elsewhere, except pursuant to the Fourteenth

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357. *Id.* at \*8.

358. *Id.*

359. *Id.*

360. 11 U.S.C. § 106 (2000).

Amendment.<sup>361</sup> In contrast, the majority in *Katz* concluded that states surrendered their sovereign immunity when they ratified the Bankruptcy Clause. The *Katz* decision suggests that in the future, any exercise of bankruptcy jurisdiction over the state can be defended upon the principal that such jurisdiction is ancillary to the purposes of the bankruptcy power.

*Katz* abrogates state immunity as to the process of bankruptcy. This very fact is itself abhorrent to the majority in *Seminole Tribe*. The rule in *Katz*, however, is not likely to cause a fundamental change in the process or substance of bankruptcy. *Katz* does not create any new rights under state law. For example, by filing bankruptcy, a debtor does not suddenly gain the right to sue a state for a tort liability that would otherwise be barred by sovereign immunity under nonbankruptcy law. Where a cause of action arises solely under state law, it does not offend the preemption doctrine to bar suits against state actors.

A tort, or any other state-based cause of action, is fundamentally different from a cause of action that exists only in bankruptcy and would not exist but for bankruptcy, such as preference avoidance actions, turnover proceedings, or discharge litigation. Where the jurisdictional basis is bankruptcy law, the rule from *Katz* is that sovereign immunity cannot be used to differentiate a state actor from a non-state actor.<sup>362</sup> Thus, *Katz* will most heavily impact the procedural aspects of bankruptcy, and not the substantive aspects.

To be sure, *Katz* is radical because it sweeps away a state's defense to a bankruptcy action. It establishes a fundamental exception to the Eleventh Amendment, similar to *Ex parte Young*,<sup>363</sup> and one that will be used far more frequently. But no substantive rights will be created by *Katz*. The case of *Dairy Mart*<sup>364</sup> is an example of this. The right to an environmental clean-up subsidy from the State of Kentucky was strictly a state-law right—it was not a right that arose because of the debtor's bankruptcy, nor was it a cause of action created by any surrender of state sovereignty. The law of Kentucky already provided the subsidy—the debtor was merely late in filing for it under the state law.<sup>365</sup> Bankruptcy law intervened only to enforce the Code provision of tolling a

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361. U.S. CONST. amend. XIV.

362. See *supra* note 237 and accompanying text.

363. See *supra* notes 173–82 and accompanying text.

364. See *supra* notes 235–50 and accompanying text.

365. See *supra* note 240 and accompanying text.

regulatory statute for sixty days.<sup>366</sup> The decision in *Dairy Mart* did not create an interest that would otherwise not have existed.

Nor is the *Katz* decision at odds with the thoughtful opinion of Justice Sutherland in *Continental Bank v. Rock Island Railway Co.*,<sup>367</sup> who reviewed the several bankruptcy acts and codes enacted since the ratification of the Constitution, and concluded:

Taken altogether, they demonstrate in a very striking way the capacity of the bankruptcy clause to meet new conditions as they have been disclosed as a result of the tremendous growth of business and development of human activities from 1800 to the present day. And these acts, far-reaching though they be, have not gone beyond the limit of congressional power; but rather have constituted extensions into a field whose boundaries may not yet be fully revealed.<sup>368</sup>

*Katz*, monumental as it is, is just a part of that “revealing” process. Moreover, given the disparity in views regarding the limits of sovereignty when confronted by bankruptcy law, it is certainly not the last extension into this uncertain and controversial field.

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366. See *supra* note 241 and accompanying text.

367. 294 U.S. 648 (1935).

368. *Id.* at 671.