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Who Decides Whether Bankruptcy Jurisdiction Exists after Removal from State Court?

By Regan Loper January 2017

Imagine that while a bankruptcy case is pending, the debtor-in-possession or bankruptcy trustee files a state law claim against one of the estate's creditors. Presumably, if the debtor wins its state law claim, that recovery augments the bankruptcy estate and increases the amount available to pay the debtor's creditors.[1] The creditor, seeking to avoid litigating the action in the debtor's home state court, timely removes the lawsuit to federal court as permitted under 28 U.S.C. § 1452(a).[2] The creditor argues that the case should proceed in federal bankruptcy court because that court has bankruptcy jurisdiction over the matter under 28 U.S.C. § 1334(b).[3] That provision says that bankruptcy jurisdiction exists over all proceedings "related to cases under title 11."[4] The debtor responds by arguing that the state law claims have nothing to do with bankruptcy. Even if they did, the bankruptcy court should abstain and allow the state court to hear the lawsuit.[5]

At first glance, the creditor appears to be right: the bankruptcy judge has jurisdiction over the claim. According to the vast majority of case law, the debtor's state law claim appears to "relate to" the debtor's underlying bankruptcy case under 28 U.S.C. § 1334(b) because it meets the standard for "related to" jurisdiction – the outcome "could conceivably have an effect on the estate being administered in bankruptcy."[6] Moreover, all of the district courts in the United States have Reference Orders providing that all proceedings arising under title 11 or arising in or related to a case under title 11 shall be referred to the bankruptcy judge for that district.[7] Given that the bankruptcy judge appears to have "related to" jurisdiction over the debtor's claims in this scenario, it appears that the bankruptcy judge has jurisdiction over the case barring the judge's decision to abstain.

The real question in this scenario is who gets to decide whether bankruptcy jurisdiction exists under 28 U.S.C. § 1334 and whether to abstain. Is it the federal district court judge, where the case is

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[1] For simplicity, assume that the state law claim arose pre-petition.

[2] 28 U.S.C. § 1452(a) states that a "party may remove any claim or cause of action in a civil action other than a proceeding before the United States Tax Court or a civil action by a governmental unit to enforce such governmental unit's police or regulatory power, to the district court for the district where such civil action is pending, if such district court has jurisdiction of such claim or cause of action under section 1334 of this title." In turn, 28 U.S.C. § 1334 grants the district courts jurisdiction over "all cases under title 11" and over "all civil proceedings arising under title 11, or arising in or related to cases under title 11."

[3] 28 U.S.C. § 1334(b).

[4] *Id.*

[5] 28 U.S.C. § 1334(c) allows the district court to abstain from hearing a case, for example if it would be in the interest of comity with state courts.

[6] *Matter of Lemco Gypsum, Inc.*, 910 F.2d 784, 788 (11th Cir. 1990); *see also Pacor, Inc. v. Higgins*, 743 F.2d 984, 994 (3d Cir. 1984); *In re Pegasus Gold Corp.*, 394 F.3d 1189, 1193 (9th Cir. 2005); *Celotex Corp. v. Edwards*, 514 U.S. 300, 308 & n.6 (1995); *Nuveen Mun. Trust ex rel. Nuveen High Yield Mun. Bond Fund v. WithumSmith Brown, P.C.*, 692 F.3d 283, 293-94 (3d Cir. 2012).

[7] 28 U.S.C. § 157(a) permits each United States district court to refer "any or all cases under title 11 and any or all proceedings arising under title 11 or arising in or related to a case under title 11" to the bankruptcy judge for that district. Every district court has taken advantage of that opportunity and published Reference Orders to that effect.

located after removal? Or is it the bankruptcy judge, who arguably should have the case automatically referred to him or her pursuant to the Reference Order?

On the one hand, 28 U.S.C. § 1334(b) clearly grants *the district courts* jurisdiction over proceedings arising in or related to a bankruptcy case.[8] If the district court doesn't have bankruptcy jurisdiction, there's nothing to refer to the bankruptcy judge. And 28 U.S.C. § 1452(a), the removal statute for claims related to bankruptcy cases, clearly says the party may remove the claim "to the district court," not the bankruptcy court. On the other hand, each district court's Reference Order automatically refers claims related to a bankruptcy to the bankruptcy judge. Moreover, the bankruptcy judge would likely be in the best position to determine whether bankruptcy jurisdiction exists given his expertise in the field.

The Majority Approach – the District Court Decides

The majority of courts facing this issue have found that the District Court "must confirm its own jurisdiction before sending it to bankruptcy."[9] In *McKinstry v. Sergent*, the United States District Court for the Eastern District of Kentucky gave the following rationale for its decision:

> *The bankruptcy court itself has no jurisdiction unless this Court has jurisdiction first: Congress has vested bankruptcy jurisdiction in the district courts—saying "the district courts shall have original and exclusive jurisdiction of all cases under title 11" and that "the district courts shall have original but not exclusive jurisdiction of all civil proceedings arising under title 11, or arising in or related to cases under title 11.*[10]

A number of other cases agree with this rule, reasoning that the bankruptcy court has no jurisdiction (and nothing to be referred) unless the District Court first determines it has bankruptcy jurisdiction under section 1334.[11] This reasoning makes sense given the fact that bankruptcy judges, who lack the Article III powers granted to district court judges, should not be given any more authority than specifically granted by Congress.

The Minority Approach – the Bankruptcy Court Decides

The minority approach is to automatically refer claims to the bankruptcy court if the removal is based on federal jurisdiction under section 1334.[12] Courts have taken this approach in part based on the theory that bankruptcy courts already make an initial determination about whether a case is "core"

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[8] 28 U.S.C. § 1334(b).

[9] *McKinstry v. Sergent*, 442 B.R. 567, 570 (E.D. Ky. 2011).

[10] *Id.*

[11] *Muratore v. Darr*, 375 F.3d 140, 147-148 (1st Cir. 2004); *Marotta Gund Budd & Dzera, LLC v. Costa*, 340 B.R. 661, 663 (D.N.H. 2006) (concluding that because the local referral rule authorized "referring [only those] cases which meet the standard for subject matter jurisdiction under section 1334(b)," the district court must decide jurisdiction first); *Hutchins v. Shatz, Schwartz & Fentin, P.C.*, 494 B.R. 108, 117 (D. Mass. 2013); *Regions Bank v. JP Realty Partners, Ltd.*, 912 F. Supp. 2d 604, 613 (M.D. Tenn. 2012).

[12] *See, e.g., Mkt. St. Props. Palm Beach, LLC v. Nola Dev. Partners, LLC*, No. 10–00951, 2010 WL 2696848, at *1–2 (E.D. La. July 1, 2010); *Jenkins v. Oakhurst Dev., LLC*, No. 09–00282, 2009 WL 1473960, at * 1–2 (S.D.W. Va. May 22, 2009); *Consol. Lewis Inv. Corp. v. First Nat. Bank of Jefferson Parish*, 74 B.R. 648 (E.D. La. 1987).

or "non-core" under 28 U.S.C. § 157(b)(3).[13] In deciding whether to remand, the argument goes, the decision whether the claim is "core" or "non-core" is a necessary first step.[14] These opinions have also reasoned that "[q]uestions of permissive abstention and equitable remand are also better left to the bankruptcy court," given the bankruptcy court's familiarity with the underlying bankruptcy case and bankruptcy law.[15]

While the minority approach potentially conflates the "core" versus "non-core" determination with subject matter jurisdiction (not every "non-core" proceeding should necessarily be remanded), it appears to reach the more favorable result. The majority line of cases is correct that the bankruptcy court only has jurisdiction if the district court has it first, but the bankruptcy judge already has the proper expertise to rule on the issue, as the *MD Acquisition, LLC* opinion suggests.[16] The bankruptcy court has an in-depth understanding of the debtor's bankruptcy case and the practical relationship that the debtor's state law claim has to that bankruptcy. The district court, however, would have to start from square one learning the facts and issues of the bankruptcy case to understand the state law claim in the context of the bankruptcy. Therefore, while the majority approach correctly reads the Bankruptcy Code to require the district court to decide bankruptcy jurisdiction first, the minority approach reaches a more effective rule by relying on the role and expertise the bankruptcy judge already exercises.

If you would like more information, please contact:

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[13] *Mkt. St. Props.*, 2010 WL 2696848 at *1; *MD Acquisition, LLC v. Myers*, No. 08–494, 2009 WL 466383, at *4–5 (S.D. Ohio Feb.23, 2009).

[14] The court in *McKinstry*, in arguing against the minority approach and against this very point, makes the strong argument that requiring a bankruptcy judge to determine whether a proceeding is "core" is a different matter than requiring him to determine whether it has jurisdiction over section 1334. After all, the bankruptcy judge could find that the claim is "non-core" but still have bankruptcy jurisdiction under section 1334.

[15] *MD Acquisition, LLC*, 2009 WL 466383, at *5.

[16] There remains the issue of whether an Article I bankruptcy judge should determine jurisdiction when not specifically authorized by statute, but that issue should be counteracted in part by the fact that the bankruptcy judge's determination on the jurisdictional issue should be appealable to the district court.