AMERICAN BANKRUPTCY INSTITUTE

2017 Midwest Regional Bankruptcy Seminar

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Interaction Between State and Bankruptcy Courts

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CONCURRENT SESSION

2017

Res Judicata & Collateral Estoppel
or
Claim Preclusion & Issue Preclusion

by: Stephen Milner, Esq.[1]

I. What Are We Talking About When We Talk About Res Judicata?

A. The Prevailing View – Res Judicata (Claim Preclusion) is Distinct from Collateral Estoppel (Issue Preclusion).

The term res judicata is generally thought of as distinct from the related issue of collateral estoppel / issue preclusion.

> Res judicata and collateral estoppel are not the same. Res judicata, or claim preclusion as it is more helpfully termed, is the doctrine, simply stated, by which a final judgment on the merits in an action precludes a party from bringing a subsequent lawsuit on the same claim or cause of action or raising a new defense to defeat a prior judgment. *See generally* J. Friedenthal, M. Kane & A. Miller, Civil Procedure at 607–09 (1985). It precludes not only relitigating a claim or cause of action previously adjudicated, it also precludes litigating a claim or defense that should have been raised, but was not, in a claim or cause of action previously adjudicated. This last variation was formerly known as the rule against splitting a cause of action. *Id.* at 607.
>
> Collateral estoppel, or issue preclusion as it is better termed, precludes relitigation of issues of fact or law actually litigated and decided in a prior action between the same parties and necessary to the judgment, even if decided as part of a different claim or cause of action. *Id.*
>
> *Gargallo v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 918 F.2d 658, 660-61 (6th Cir. 1990).

Lawyers and judges are not always careful distinguishing between the use of res judicata in a general sense and in the more limited doctrine of claim preclusion. Practitioners should proceed with caution, particularly when reviewing older cases discussing res judicata.

[1] Stephen Milner was formerly a law clerk for the Hon. Gregory R. Schaaf, United States Bankruptcy Court, Eastern District of Kentucky. The following analysis is not intended to express the opinions of the Court, but merely to outline the issues and arguments raised by various courts and commentators.

"'Res judicata' has been used in this section as a general term referring to all of the ways in which one judgment will have a binding effect on another. That usage is and doubtless will continue to be common, but it lumps under a single name two quite different effects of judgments. The first is the effect of foreclosing any litigation of matters that never have been litigated, because of the determination that they should have been advanced in an earlier suit. The second is the effect of foreclosing relitigation of matters that have once been litigated and decided. The first of these, preclusion of matters that were never litigated, has gone under the name, 'true res judicata,' or the names, 'merger' and 'bar.' The second doctrine, preclusion of matters that have once been decided, has usually been called 'collateral estoppel.' Professor Allan Vestal has long argued for the use of the names 'claim preclusion' and 'issue preclusion' for these two doctrines [Vestal, *Rationale of Preclusion*, 9 St. Louis U. L.J. 29 (1964)], and this usage is increasingly employed by the courts as it is by Restatement Second of Judgments." Charles Alan Wright, *The Law of Federal Courts* § 100A, at 722–23 (5th ed. 1994).

RES JUDICATA, Black's Law Dictionary (10th ed. 2014) (form altered from original).

B. Alternatively, the Doctrine of Res Judicata is Sometimes Used to Refer to Both the Concepts of Issue Preclusion and Claim Preclusion.

Some jurisdictions, including Kentucky and Ohio, seem to use the term res judicata in a more general sense, as an umbrella concept that encompasses the doctrines of claim preclusion and issue preclusion.

1. Kentucky.

The rule of res judicata is an affirmative defense which operates to bar repetitious suits involving the same cause of action. The doctrine of res judicata is formed by two subparts: 1) claim preclusion and 2) issue preclusion.[2]

[2] In this opinion we employ the term claim preclusion to refer to the doctrine which bars subsequent litigation of a cause of action which has previously been adjudicated. The term issue preclusion is employed to refer to the doctrine which prohibits issues which were adjudicated in a previous lawsuit from being relitigated in a subsequent lawsuit. Res judicata is the Latin term which encompasses both issue and claim preclusion and is not to be used as synonymous with either individually, but rather equally with both. Collateral estoppel is a term used by some to refer to issue preclusion, but for simplicity's sake, we shall not use it in this opinion.

Yeoman v. Commonwealth, Health Policy Bd., 983 S.W.2d 459, 464-65 n.2 (Ky. 1998).

2. Ohio.

> The doctrine of res judicata encompasses the two related concepts of claim preclusion, also known as res judicata or estoppel by judgment, and issue preclusion, also known as collateral estoppel.
>
> *O'Nesti v. DeBartolo Realty Corp.*, 2007-Ohio-1102, ¶ 6, 113 Ohio St. 3d 59, 61, 862 N.E.2d 803, 806 (citing *Grava v. Parkman Twp.* (1995), 73 Ohio St.3d 379, 381, 653 N.E.2d 226).

II. Why Should a Federal Court Care About a State Court Judgment?

A. The Full Faith & Credit Statute, 28 U.S.C. § 173.

> The Acts of the legislature of any State, Territory, or Possession of the United States, or copies thereof, shall be authenticated by affixing the seal of such State, Territory or Possession thereto.
>
> The records and judicial proceedings of any court of any such State, Territory or Possession, or copies thereof, shall be proved or admitted in other courts within the United States and its Territories and Possessions by the attestation of the clerk and seal of the court annexed, if a seal exists, together with a certificate of a judge of the court that the said attestation is in proper form.
>
> **Such Acts, records and judicial proceedings or copies thereof, so authenticated, shall have the same full faith and credit in every court within the United States and its Territories and Possessions as they have by law or usage in the courts of such State, Territory or Possession from which they are taken.**

III. What Rules Apply?

Determining that a prior judgment is preclusive is a two-step analysis:

(1) consider the law of the judgment state to determine its preclusive effect; and
(2) if state law would give the judgment preclusive effect, consider whether an exception applies pursuant to federal law.

As the United States Supreme Court has noted in the context of issue and claim preclusion:

[The Full Faith and Credit Statute] directs a federal court to refer to the preclusion law of the State in which judgment was rendered. "It has long been established that § 1738 does not allow federal courts to employ their own rules ... in determining the effect of state judgments. Rather, it goes beyond the common law and commands a federal court to accept the rules chosen by the State from which the judgment is taken."

Marrese v. American Academy of Orthopaedic Surgeons, 470 U.S. 373, 380, 105 S.Ct. 1327, 1332, 84 L.Ed.2d 274 (1985)(quoting *Kremer v. Chemical Constr. Corp.,* 456 U.S. 461, 481–82, 102 S.Ct. 1883, 1898, 72 L.Ed.2d 262 (1982)).

In *Marrese,* the Supreme Court, in accordance with the Full Faith and Credit Statute, instructed lower federal courts faced with the question of whether to give full faith and credit to a state court default judgment to "consider first the law of the State in which the judgment was rendered to determine its preclusive effect." *Marrese* at 375, 105 S.Ct. at 1329. If the state court would not give preclusive effect to a default judgment, the analysis is complete. If, however, the state would accord the judgment preclusive effect, *Marrese* instructs that the federal court give preclusive effect to the judgment unless Congress has expressly or impliedly created an exception to § 1738 which ought to apply to the facts before the federal court. *Marrese* at 386, 105 S.Ct. at 1334–35.

In re Calvert, 105 F.3d 315, 317 (6th Cir. 1997)

IV. How are the Doctrines Distinct?

A. Claim Preclusion (Res Judicata).

1. Definition.

res judicata (rays joo-di-kay-tə *or* -kah-tə) [Latin "a thing adjudicated"] (17c)

1. An issue that has been definitively settled by judicial decision.

2. An affirmative defense barring the same parties from litigating a second lawsuit on the same claim, or any other claim arising from the same transaction or series of transactions and that could have been — but was not — raised in the first suit. • The three essential elements are (1) an earlier decision on the issue, (2) a final judgment on the merits, and (3) the involvement of the same parties, or parties in privity with the original parties. Restatement (Second) of Judgments §§ 17, 24 (1982).

— Also termed *former adjudication*; *res adjudicata*; *claim preclusion*; *doctrine of res judicata.*

RES JUDICATA, Black's Law Dictionary (10th ed. 2014) (form altered)

2. State-Specific Case Law.

The elements required to show that claim preclusion applies are largely consistent from jurisdiction to jurisdiction.

i. Kentucky.

> For claim preclusion to bar further litigation, certain elements must be present. First, there must be identity of the parties. *Newman v. Newman,* Ky., 451 S.W.2d 417, 419 (1970). Second, there must be identity of the causes of action. *Id.* Third, the action must have been resolved on the merits. *Id.* The rule that issues which have been once litigated cannot be the subject matter of a later action is not only salutary, but necessary to the speedy and efficient administration of justice.
>
> *Yeoman v. Commonwealth, Health Policy Bd.*, 983 S.W.2d 459, 465 (Ky. 1998)

***See also Coomer v. CSX Transportation, Inc.,* 319 S.W.3d 366, 371 (Ky. 2010) (citing Yeoman v. Com., Health Policy Bd., 393 S.W.2d 459, 465) (discussing the rule against splitting causes of action); *Miller v. Administrative Office of Courts*, 361 S.W.3d 867, 872 (Ky. 2011) (citing *Harrod v. Irvine*, 283 S.W.3d 246, 250 (Ky.App.2009).).

ii. Ohio.

> "Claim preclusion," the concept pertinent here, "prevents subsequent actions, by the same parties or their privies, based upon any claim arising out of a transaction that was the subject matter of a previous action." *Id.* Thus, "a valid, final judgment rendered upon the merits bars all subsequent actions based upon any claim arising out of the transaction or occurrence that was the subject matter of the previous action." *Grava v. Parkman Twp.*, 73 Ohio St.3d 379, 653 N.E.2d 226, 229 (1995).
>
> We have distilled this doctrine down to four elements:
>
> (1) a prior final, valid decision on the merits by a court of competent jurisdiction; (2) a second action involving the same parties, or their privies, as the first; (3) a second action raising claims that were or could have been litigated in the first action; and (4) a second action arising out of the same transaction or occurrence that was the subject matter of the previous action.
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> *Boggs*, 655 F.3d at 520 (citation omitted).
>
> *Stolmayer v. McCarthy*, 673 Fed. Appx. 467, 469 (6th Cir. 2016)

B. Issue Preclusion (Collateral Estoppel).

1. Definition.

collateral estoppel (e-stop-əl) (1941)

1. The binding effect of a judgment as to matters actually litigated and determined in one action on later controversies between the parties involving a different claim from that on which the original judgment was based.

2. A doctrine barring a party from relitigating an issue determined against that party in an earlier action, even if the second action differs significantly from the first one.

— Also termed *issue preclusion*; *issue estoppel*; *direct estoppel*; *estoppel by judgment*; *estoppel by record*; *estoppel by verdict*; *cause-of-action estoppel*; *technical estoppel*; *estoppel per rem judicatam.*

COLLATERAL ESTOPPEL, Black's Law Dictionary (10th ed. 2014) (form altered)

2. State-Specific Case Law.

i. Kentucky.

> For issue preclusion to operate as a bar to further litigation, certain elements must be found to be present. First, the issue in the second case must be the same as the issue in the first case. *Restatement (Second) of Judgments* § 27 (1982). Second, the issue must have been actually litigated *Id.* Third, even if an issue was actually litigated in a prior action, issue preclusion will not bar subsequent litigation unless the issue was actually decided in that action. *Id.* Fourth, for issue preclusion to operate as a bar, the decision on the issue in the prior action must have been necessary to the court's judgment. *Id.*
>
> *Yeoman v. Commonwealth, Health Policy Bd.*, 983 S.W.2d 459, 465 (Ky. 1998)

***See also Moore v. Commonwealth*, 954 S.W.2d 317, 319 (Ky. 1997) (relying on *Sedley v. City of West Buechel*, Ky., 461 S.W.2d 556, 559 (Ky. 1970)).

ii. Ohio.

> In comparison, "[i]ssue preclusion refers to the effect of a judgment in foreclosing relitigation of a matter that has been actually litigated and decided." *In re Fordu,* 201 F.3d at 703 (citing *Migra,* 465 U.S. at 77 n. 1, 104 S.Ct. 892). Under Ohio law, the doctrine of issue preclusion has four elements:
>
> 1) A final judgment on the merits in the previous case after a full and fair opportunity to litigate the issue;
> 2) The issue must have been actually and directly litigated in the prior suit and must have been necessary to the final judgment;
> 3) The issue in the present suit must have been identical to the issue in the prior suit;
> 4) The party against whom estoppel is sought was a party or in privity with the party to the prior action.
>
> *Sill v. Sweeney (In re Sweeney),* 276 B.R. 186, 189 (6th Cir. BAP 2002) (citations omitted).
>
> *In re Henkel*, 490 B.R. 759, 771 (Bankr. S.D. Ohio 2013) (form altered).

3. Miscellaneous Issues.

i. The "actually litigated" requirement when considering the issue-preclusive effect of a default judgment.

Jurisdictions vary regarding whether they treat default judgments as preclusive. Typically resolution of this issue depends on whether a default judgment can satisfy the "actually litigated" requirement notwithstanding the entry of default.

ii. Are Kentucky default judgments entitled to preclusive effect? An open question.

a) *Davis v. Tuggle's Administrator*, 297 Ky. 376, 178 S.W.2d 979 (1944) (giving "res adjudicata" effect to issues decided in an uncontested declaratory judgment action in a subsequent fraudulent conveyance action).

Though it afforded issue-preclusive effect to the prior case, *Tuggle's* was decided before Kentucky distinguished between the separate doctrines of claim preclusion and issue preclusion. *See Sedley v. City of West Beuchel*, 461 S.W.2d 556 (Ky. 1970). And it did not consider whether the uncontested underlying action satisfied the modern test that an issue be "actually litigated." *See, e.g., Yeoman v. Commonwealth*, 983 S.W.2d 459, 465 (Ky. 1998). Notably, *Yeoman* relied on the Restatement (Second) of

Judgments, which notes in comments that a default judgment is, by definition, not actually litigated. This may leave *Tuggle's* on shaky ground.

b) The Kentucky Court of Appeals has afforded a default judgment issue-preclusive effect, though it did so by applying a "full and fair opportunity to litigate" standard as opposed to the more stringent "actually litigated" standard that now applies. *See Jellinick v. Capitol Indem. Corp.*, 210 S.W.3d 168, 172-73 (Ky. Ct. App. 2006).

c) Recent cases, inconsistent results…

1) *West Am. Ins. Co. v. Morris (In re Morris)*, 229 B.R. 683, 685 (Bankr. E.D. Ky. 1999) (holding that "Kentucky gives preclusive effect to default judgments."; citing *Tuggle's*).

2) *Savage v. Murphy (In re Murphy)*, 471 B.R. 190, 193 (Bankr. W.D. Ky. 2012) (holding that "Kentucky does indeed give preclusive effect to default judgments."; citing *Tuggle's* and *Morris*.

3) *Daniels v. Miller (In re Miller)*, Adv. No. 10-5024, 2010 WL 3724780, at *2 (Bankr. E.D. Ky. Sept. 17, 2010) (holding that the only default judgments to be afforded preclusive effect are those that contain express findings of fact and conclusions of law).

4) *Morris v. Brown (In re Brown)*, Case No. 6:11-cv-00002, ECF No. 9 at 6 (E.D. Ky. Aug. 5, 2011) (holding in an appeal of a bankruptcy nondischargeability action that under "Kentucky law . . . [u]nless the default judgment contains 'express findings of fact and conclusions of law,' it will not be given preclusive effect in subsequent litigation."; quoting *Miller*).

5) *Columbia Gas Transmission v. The Raven Co*., Civil No. 12-72, 2014 WL 2711943 (E.D. Ky. June 13, 2014) (affording the decision of a state administrative agency acting in a judicial capacity preclusive effect, based in part on a conclusion that Kentucky would treats default judgments as issue-preclusive).

d) These cases suggest that, while there is some indication that the Kentucky Supreme Court would afford default judgments issue-preclusive effect, that claim has never been squarely presented for determination. This has resulted in inconsistent decisions that are difficult, if not impossible to harmonize.

V. How Do These Issues Arise in Bankruptcy?

A. Nondischargeability Proceedings.

Adversary proceedings seeking to have a debt declared nondischargeable often present issues regarding the preclusive effects of prepetition state-court judgments. These situations typically involve questions regarding issue preclusion because decisions regarding the dischargeability of a debt are the exclusive province of the bankruptcy courts.

> The United States Supreme Court has held that issue preclusion principles are applicable to dischargeability proceedings in bankruptcy cases. *Grogan v. Garner,* 498 U.S. 279, 284 n. 11, 111 S.Ct. 654, 112 L.Ed.2d 755 (1991) ("[C]ollateral estoppel principles do indeed apply in discharge exception proceedings pursuant to § 523(a).").
>
> *In re Bodrick*, 534 B.R. 738, 742 (Bankr. S.D. Ohio 2015).

***See also In re Trost*, Bankruptcy Appellate Panel of the Sixth Circuit, Case No. 16-8024 (June 28, 2017).

B. Claims Allowance? Not so fast…

Challenges to a creditor's claim may give rise to preclusion issues. But the preclusive effect of a state-law judgment sometimes has a more limited effect because the claims allowance process depends on the application of federal bankruptcy law.

> A Texas court would find that the debtor's liability to Voltz under the lease has been determined, together with the total amount of the debt.[5] Those findings are entitled to preclusive effect in this court.
>
> That is, however, the extent to which the judgment is entitled to preclusive effect. **With liability and the amount of the debt established by state law, the second issue—the amount of the claim that should be allowed in the bankruptcy case—is decided under federal bankruptcy law.** Voltz argues that the doctrine of res judicata bars this result. It does not.
>
> Res judicata (claim preclusion) "prevents litigation of all grounds for, or defenses to, recovery that were previously available to the parties, regardless of whether they were asserted or determined in the prior proceeding." *Brown v. Felsen,* 442 U.S. 127, 131, 99 S.Ct. 2205, 60 L.Ed.2d 767 (1979). Bankruptcy courts have exclusive jurisdiction over the claims allowance process. *See Canal Corp. v. Finnman (In re Johnson),* 960 F.2d 396, 404 (4th Cir.1992) ("[T]he existence of a claim is controlled by state law, [but] the allowance or disallowance of a claim in bankruptcy is a matter of federal law left to the bankruptcy court's exercise of its equitable powers.").[6] The issue of the § 502(b)(6) cap was not available to the

> parties in the state court litigation because the Texas state court did not have jurisdiction over the claims allowance process. Res judicata does not apply under these circumstances.[7]
>
> *In re ProCare Automotive Service Sols., LLC*, 359 B.R. 653, 657 (Bankr. N.D. Ohio 2007) (emphasis supplied).

VI. A Case Study – Collateral Estoppel / Issue Preclusion in Practice.

Fisher v. Anderson (In re Anderson), Case No. 13-60469, Adv. No. 13-6021, 2014 WL 98691 (Bankr. E.D. Ky. Jan. 10, 2014), *aff'd* 520 B.R. 89 (B.A.P. 6th Cir. 2014).

A. Issue.

Whether a Tennessee penalty default judgment was entitled to preclusive effect based on the Full Faith and Credit Statute and the doctrine of collateral estoppel (issue preclusion) in a nondischargeability case under § 523(a) of the Bankruptcy Code.

B. Facts.

1. Tennessee state court lawsuit against the Debtors was filed prior to bankruptcy, alleging claims of fraud, misrepresentation, and deceit, stemming from Plaintiffs dealings with the Debtors related to a real estate development.

2. Debtors took 8 months to answer the state court complaint and refused to comply with orders requiring them to participate in discovery.

3. Tennessee state court issued a penalty default judgment against the Debtors, citing their repeated refusals to comply with discovery orders.

4. Debtors filed Chapter 7 bankruptcy petition just days before the Tennessee court was scheduled to hold hearings to determine the damages stemming from the State Court Judgment.

5. State court plaintiffs filed adversary proceeding, alleging non-dischargeability on grounds of fraud, misrepresentation, and deceit.

C. Analysis.

1. Full Faith and Credit Statute requires a bankruptcy court to give full faith and credit to state court judgments.

2. "The doctrine of collateral estoppel applies in dischargeability actions under 11 U.S.C. § 523(a)" *Rally Hill Prods. v. Bursack (In re Bursack)*, 65 F.3d 51, 53 (6th Cir. 1995) (citing *Grogan v. Garner (In re Garner)*, 498

U.S. 279, 284 n.11112 L.Ed.2d 755 111 S.Ct. 654 (1991)).

3. "A federal court will grant collateral estoppel effect to a state court judgment "if a state court judgment would receive preclusive effect in the state where it was rendered." *Bursack,* 65 F.3d at 53 (citing *Marrese v. American Academy of Orthopedic Surgeons,* 470 U.S. 373, 386, 84 L.Ed.2d 274, 105 S.Ct. 1327 (1985)).

4. Under Tennessee law, "collateral estoppel bars relitigation of an issue if it was raised in an earlier case between the same parties, actually litigated, and necessary to the judgment of the earlier case." *See Bursack,* 65 F.3d at 54 (citing *Massengill v. Scott,* 738 S.W.2d 629, 632 (Tenn.1987)). *Id.* at *4.

5. The elements underlying the plaintiffs' state court fraud claims are consistent with those a creditor must prove to establish a claim of nondischargeability based on fraud. And the plaintiffs' state court complaint alleged sufficient facts to support their fraud claims.

6. The fraud claims were actually litigated in the Tennessee state court.

7. Even a default judgment satisfies Tennessee's "actually litigated" requirement:

> A judgment taken by default is conclusive by way of estoppel in respect to all such matters and facts as are well pleaded and properly raised, and material to the case made by declaration or other pleadings, and such issues cannot be relitigated in any subsequent action between the parties and their privies.
>
> *Bursack*, 65 F.3d at 54 (quoting *Lawhorn v. Wellford*, 179 Tenn. 625, 168 S.W.2d 790, 792 (1943)).

Id. at *6–7.

8. The fact that this was a penalty default judgment makes no difference regarding the actually litigated requirements. Other jurisdictions have given collateral estoppel effect to prior penalty default judgments.

9. Where a party has substantially participated in an action in which he had a full and fair opportunity to defend on the merits, but subsequently chooses not to do so, and even attempts to frustrate the effort to bring the action to judgment, it is not an abuse of discretion for a district court to apply the

doctrine of collateral estoppel to prevent further litigation of the issues resolved by the default judgment in the prior action.

10. *Bush v. Balfour Beatty Bahamas, Ltd. (In re Bush)*, 62 F.3d 1319, 1325 (11th Cir.1995) (holding that a penalty judgment met the "actually litigated" requirement) (internal footnote omitted). *Id.* at *8.

11. The Fraud Claims were Necessary to the State Court Judgment.

12. In affirming the case, the B.A.P. noted that the Debtors seemed to be confusing the issues of claim preclusion and collateral estoppel (issue preclusion). *See* 520 B.R. at 94 n.4.

See also Panther Petroleum, LLC v. Couch (In re Couch), Case No. 16-8009, 2017 WL 444644 at *1 (B.A.P. 6th Cir. Feb. 2, 2017) for a more recent discussion of *Bursack* and *Fisher*.

REMOVAL AND REMAND OF CLAIMS RELATED TO BANKRUPTCY CASES

by: Holly N. Lankster, Esq.[1]

I. Statutory Authority.

A. General Removal Statute - 28 U.S.C. § 1441.

(a) Generally.--Except as otherwise expressly provided by Act of Congress, any civil action brought in a State court of which the district courts of the United States have original jurisdiction, may be removed by the defendant or the defendants, to the district court of the United States for the district and division embracing the place where such action is pending.

(b) Removal based on diversity of citizenship.—

(1) In determining whether a civil action is removable on the basis of the jurisdiction under section 1332(a) of this title, the citizenship of defendants sued under fictitious names shall be disregarded.

(2) A civil action otherwise removable solely on the basis of the jurisdiction under section 1332(a) of this title may not be removed if any of the parties in interest properly joined and served as defendants is a citizen of the State in which such action is brought.

(c) Joinder of Federal law claims and State law claims.—

(1) If a civil action includes--

(A) a claim arising under the Constitution, laws, or treaties of the United States (within the meaning of section 1331 of this title), and

(B) a claim not within the original or supplemental jurisdiction of the district court or a claim that has been made nonremovable by statute, the entire action may be removed if the action would be removable without the inclusion of the claim described in subparagraph (B).

[1] Holly N. Lankster is a law clerk for the Hon. Gregory R. Schaaf, United States Bankruptcy Court, Eastern District of Kentucky. The following analysis is not intended to express the opinions of the Court, but merely to outline the issues and arguments raised by various courts and commentators.

(2) Upon removal of an action described in paragraph (1), the district court shall sever from the action all claims described in paragraph (1)(B) and shall remand the severed claims to the State court from which the action was removed. Only defendants against whom a claim described in paragraph (1)(A) has been asserted are required to join in or consent to the removal under paragraph (1).

B. Bankruptcy Removal Statute - 28 U.S.C. § 1452.

(a) 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.

(b) The court to which such claim or cause of action is removed may remand such claim or cause of action on any equitable ground. An order entered under this subsection remanding a claim or cause of action, or a decision to not remand, is not reviewable by appeal or otherwise by the court of appeals under section 158(d), 1291, or 1292 of this title or by the Supreme Court of the United States under section 1254 of this title.

II. Harmonizing § 1441 and § 1452.

A. Who May Remove?

1. It is well established that removal under 1441 requires unanimous consent among the defendants.

2. But most courts hold a single party in a multiple defendant case is entitled to remove litigation under § 1452; unanimity of defendants is not required.
    i. Section 1441 refers to removal by "the defendant or the defendants," which has been interpreted as requiring unanimity of defendants to remove whereas § 1452 refers to the removal by "a party."
        a. *See In re Terry Mfg. Co. Inc*., 324 B.R. 147, 152 (Bankr. M.D. Ala. 2005) ("It now appears that the great weight of authority holds that unanimity is not required in a § 1452 removal."). *See contra Orion Refining Corp. v. Fluor Enterprises, Inc*., 319 B.R. 480, 486 (E.D. La. 2004)

(listing district and bankruptcy courts that require unanimity to remove under § 1452).

B. What May Be Removed?

1. The entire civil action may be removed pursuant to § 1441.

2. But § 1452 is claim-specific and party-specific. Thus a party may choose to remove particular claims and leave other claims in the original forum.
   i. Section 1452 refers to removal of a "claim or cause of action" whereas § 1441 refers to removal of a "civil action."
      a. *See, e.g., Orion Refining Corp. v. Fluor Enterprises, Inc*., 319 B.R. at 486 (distinguishing between removal of a single claim or cause of action permitted under § 1452 from removal of an entire civil action under § 1446).

   ii. What is removed depends on the removal petition.
      a. *See In re Princess Louise Corp*., 77 B.R. 766, 771 (Bankr. C.D. Cal. 1987) ("The Court holds that the scope of what is removed from state court to the bankruptcy court is determined by the removal petition. If the removal petition extends to the entire state court action, the entire state court action is removed to the bankruptcy court … If, on the other hand, the removal petition indicates that only specified claims or causes of action have been removed, the state court may proceed with what has not been removed.").

C. Where Can You Remove?

1. Section 1452 does not limit removal to actions that are pending in state court; removal is permitted from one federal court (such as the Court of Federal Claims) to another federal court.
   i. *See Quality Tooling, Inc. v. U.S*., 47 F.3d 1569, 1571–72 (Fed. Cir. 1995) ("In the government's view [§ 1452(a)] permits transfer only from state courts to a bankruptcy court, and a transfer from a federal court of nationwide jurisdiction to a district court is not authorized … But § 1452 does not refer to actions commenced in state courts. It states simply that '[a] party may remove any claim' to a district court sitting in bankruptcy.").

2. That said, most courts hold it is not proper to remove a case from district court to bankruptcy court in the same district. The proper procedural vehicle is through a transfer, not removal.

3. *See, e.g., Doyle v. Mellon Bank, N.A.*, 307 B.R. 462, 465 (E.D. Pa. 2004) ("Five bankruptcy courts and one district court have found no authority to support removal from a district court to a bankruptcy court."); *In re The Academy, Inc.*, 288 B.R. 286, 290 (Bankr. M.D. Fla. 2002) (action pending in district court cannot be removed to bankruptcy court; it must be referred to the bankruptcy court); *In re Mitchell*, 206 B.R. 204, 210 (Bankr. C.D. Cal. 1997), as amended, (May 30, 1997) ("This Court holds that the proper procedure for a party to use to request a district court to transfer a lawsuit pending in that district court to a bankruptcy judge of the same district is for the party seeking the transfer to move the district court to refer that lawsuit to the bankruptcy court for further handling, if there is some reason why it would make sense to have the bankruptcy court take over further handling of the lawsuit from the district court … This Court holds that 28 U.S.C.
§ 1452(a) cannot be used to remove a lawsuit pending in federal district court to the same district court where the lawsuit is already pending."); *In re Cornell & Co., Inc.*, 203 B.R. 585, 586 (Bankr. E.D. Pa. 1997) (court rejects the contention that "district court" in § 1452(a) could be read as embracing bankruptcy courts).

III. Removal Process and Procedure.

A. Time for Filing.

1. Civil Action Initiated Before Commencement of Bankruptcy Case.
   i. A party may file a Notice of Removal only within the longest of:
      a. 90 days after the order for relief in the case under the Code;
      b. 30 days after entry of an order terminating the stay, if the claim or cause of action in a civil action has been stayed pursuant to § 362; or
      c. 30 days after a trustee qualifies in a Chapter 11 reorganization case but not later than 180 days after the order for relief. FED. R. BANKR. P. 9027(a)(2).

2. Civil Action Initiated After Commencement of Bankruptcy Case.

i. A party may file a Notice of Removal with the clerk only within the shorter of:
   a. 30 days after receipt, through service or otherwise, of a copy of the initial pleading setting forth the claim or cause of action sought to be removed; or
   b. 30 days after receipt of the summons if the initial pleadings has been filed with the court but not served with the summons. FED. R. BANKR. P. 9027(a)(3).

B. Steps for Filing.

1. A party must file a Notice of Removal with the clerk of the court in the district and division where the state or federal court where the civil action is pending is located. FED. R. BANKR. P. 9027(a)(1).
   i. Virtually all courts interpret Rule 9027(a)(1) to mean the clerk of the bankruptcy court, not the clerk of the district court. FED. R. BANKR. P. 9001(3) (" 'Clerk' means bankruptcy clerk, if one has been appointed, otherwise clerk of the district court."); *see also Braden Partners, L.P. v. Hometech Medical Services, Inc*., Case No. C-02-5187 ECM, 2003 WL 223423 at *2 (N.D. Cal. Jan. 17, 2003) ("However, the majority view is stated in *In re Aztec Industries, Inc*., 84 B.R. 464 (Bankr. N.D. Ohio 1987), which … held that it was proper to remove to the bankruptcy court rather than the district court, noting, 'Notwithstanding the use of the term "District Court" in § 1452(a), the majority of Courts have allowed parties to file Petitions for Removal of state court cases with the Bankruptcy Court.'").
      a. If state court action is pending in a state different from that in which the bankruptcy case is pending, removal is filed in the bankruptcy court in the federal district where the state court action is pending. That bankruptcy court may then transfer the case to the bankruptcy court where the bankruptcy case is pending. *See Maitland v. Mitchell (In re Harris Pine Mills)*, 44 F.3d 1431, 1435 (9th Cir. 1995) ("Those matters falling under the heading of concurrent jurisdiction (i.e., civil actions involving claims that arise under or in or are related to Title 11 proceedings) may be filed originally in state court, then subsequently removed by one of the parties to federal district court. 28 U.S.C. § 1452(a). If the district court's local rules so provide, the

removed action will then be referred automatically to the bankruptcy court. 28 U.S.C. § 157(a)."); *In re Newport Creamery, Inc*., 275 B.R. 179, 182 (Bankr. D. R.I. 2002) (case could not be removed from the Mississippi state court to the bankruptcy court in Massachusetts; it first had to be removed to the federal district court where the state court litigation was pending).

ii. The Notice of Removal must be signed pursuant to Bankruptcy Rule 9011 but need not be sworn.

iii. The Notice of Removal must contain a short and plain statement of the facts that entitle the party filing the notice to remove.

iv. The Notice of Removal must contain a statement that upon removal of the claim or cause of action, the party filing the notice does or does not consent to entry of final orders or judgments by the bankruptcy court.

v. The Notice of Removal must be accompanied by a copy of all process and pleadings.

a. The court can require the removing party to provide copies of "all records and proceedings related to the claim or cause of action" as was available in the original court, not just those pleadings and process as part of the removal. FED. R. BANKR. P. 9027 (e)(2).

2. The party filing the Notice of Removal must "promptly" serve a copy of the Notice of Removal on all parties to the removed claim or cause of action. FED. R. BANKR. P. 9027(b).

3. The party filing the Notice of Removal must also "promptly" file a copy of the Notice of Removal with the clerk of the court from which the claim or cause of action is removed. FED. R. BANKR. P. 9027(c).

C. Effect of Filing.

1. Removal of the claim or cause of action occurs upon on the filing of a copy of the Notice of Removal in the non-bankruptcy court. FED. R. BANKR. P. 9027(c).

2. "The parties shall proceed no further in that court unless and until the claim or cause of action is remanded." *Id.*

D. Procedure After Removal.

1. The bankruptcy judge may issue all necessary orders and process to bring before it all proper parties whether served by process issued by the court form which the claim or cause of action was removed or otherwise. FED. R. BANKR. P. 9027(e)(1).

2. The bankruptcy judge can require filing of all records and proceedings. FED. R. BANKR. P. 9027(e)(2).

3. Any party other than the party that filed the notice of removal must file a statement that the party does or does not consent to entry of final orders or judgment by the bankruptcy court.
   i. The statement must be signed pursuant to Bankruptcy Rule 9011.
   ii. The statement must be filed not later than 14 days after the filing of the Notice of Removal.
   iii. The party filing the statement must mail a copy to every other party to the removed claim or cause of action. FED. R. BANKR. P. 9027(e)(3).

E. Applicability of Part VII of Federal Rules of Bankruptcy Procedure.

1. The Bankruptcy Rules in Part VII apply to a claim or cause of action removed. They further govern procedure after removal. FED. R. BANKR. P 9027(g).

2. Re-pleading is not necessary unless the court so orders. *Id.*

3. If the defendant(s) haven't answered, then the defendant(s) shall answer or present other defenses or objections available within Part VII within the longest of:
   i. 21 days following the receipt through service or otherwise of a copy of the initial pleading;
   ii. 21 days following the service of summons on such initial pleading; or
   iii. 7 days following the filing of the Notice of Removal. *Id*.

4. If service not properly perfected, service may be completed or new process issued pursuant to Part VII. FED. R. BANKR. P. 9027(f).

i. "This subdivision shall not deprive any defendant on whom process is served after removal of the defendant's right to move to remand the case." *Id*.

F. Post-*Stern* Amendments.

1. In 2016, subdivisions (a)(1) and (e)(3) of Bankruptcy Rule 9027 were amended to require a statement of consent to entry of final orders or judgment by the bankruptcy court.

2. This amendment was in response to so-called *Stern* claims that may satisfy the statutory definition of core proceedings pursuant to 28 U.S.C. § 157(b)(2) but remain beyond the constitutional power of the bankruptcy judge to finally adjudicate.

3. The amended Bankruptcy Rule 9027 calls for a statement regarding consent, regardless of whether or not a proceeding is termed "non-core."

4. If a party to the removed claim or cause of action has not filed a pleading prior to removal, there is no need to file a separate statement under subdivision (e)(3) because a statement regarding consent must be included in a responsive pleading filed pursuant to FED. R. BANKR. P. 7012(b).

5. Bankruptcy Rule 7016 governs the bankruptcy court's decision whether to hear and determine the proceeding, issue proposed findings of fact and conclusions of law, or take some other action in the proceeding.

IV. Exceptions to Removal.

A. Proceeding before the United States Tax Court.

1. A proceeding in the United State Tax Court is stayed by the filing of the petition. 11 U.S.C. § 362(a)(8).

2. A debtor is permitted to invoke the bankruptcy power to determine the tax indebtedness of the estate. 11 U.S.C. § 505.

3. But a proceeding before the U.S. Tax Court is not removable. 28 U.S.C. § 1478(a).

B. Civil Action by a Government Unit to Enforce a Regulatory or Police Power.

1. This kind of civil action is expressly exempted from the automatic stay. 11 U.S.C. § 362(b)(4).

C. Other Exceptions?

1. Even matters that are generally protected from removal can be removed under §1452(a) as the language of § 1452(a) may trump language in another federal statute that would prevent removal of that action to another court.
   i. *See, e.g., California Public Employees' Retirement System v. WorldCom, Inc*., 368 F.3d 86, 91–92 (2d Cir. 2004) (holding that the conflict between § 22(a) of the Securities Act and the bankruptcy removal statute is to be resolved in favor of bankruptcy removal).
   ii. *See contra Tennessee Consol. Retirement System v. Citigroup, Inc.*, Case No. 3:03-0128, 2003 WL 22190841 at *3 (M.D. Tenn. May 9, 2003) (a specific statute controls over a more generally worded statute, regardless of date of enactment; Securities Act mandated remand).

V. Remand.

A. 28 U.S.C. § 1452(b).

1. Section 1452(b) provides that a bankruptcy court may remand the claim or cause of action on any equitable ground.

2. The court may only remand the matter to the court from which the case originated; it may not remand to a stray court.
   i. *See, e.g., Allied Signal Recovery Trust v. Allied Signal, Inc*., 298 F.3d 263, 271 (3d Cir. 2002) (order permitting remand of case to state court other than that from which it had been removed was reviewable by mandamus).

B. FED. R. BANKR. P. 9014.

1. A motion for remand is governed by Bankruptcy Rule 9014 and served on the parties to the removed claim or cause of action. FED. R. BANKR. P.

9027(d).

C. Timing.

1. There is no time limitation to seeking a remand of the removed action.
   i. *See Billington v. Winograde (In re Hotel Mt. Lassen, Inc*.), 207 B.R. 935, 938–39 (Bankr. E.D. Cal. 1997):
   There being no specified deadline, any motion to remand under § 1452(b) and Rule 9027(d) is timely. The timing of the motion, however, counts as an equitable factor that is relevant to remand. Accordingly, unreasonable delay in making such a motion may weigh against remand when the court is deciding whether to remand on "any equitable ground."
   ii. *See also Unico Holdings, Inc. v. Nutramax Products, Inc*., 264 B.R. 779, 786 (Bankr. S.D. Fla. 2001) (a motion to remand need not be made within the 30-day time limits prescribed by § 1447(c)).

D. Factors to Consider.

1. Courts use different criteria to determine whether there are equitable grounds for remand.

2. In the case of *Sowell v. U.S. Bank Trust Nat. Ass'n*, 317 B.R. 319, 322-23 (E.D. N.C. 2004), the court considered the following:
   i. Effect of the action on the administration of the bankruptcy estate;
   ii. The extent to which issues of state law predominate;
   iii. Complexity of applicable state law;
   iv. Relatedness or remoteness of the action to the bankruptcy estate;
   v. Existence of the right to trial by jury; and
   vi. Prejudice to the party involuntarily removed from the state court.

3. In the case of *Shared Network Users Group, Inc. v. WorldCom Technologies, Inc*., 309 B.R. 446, 449 (E.D. Pa. 2004), the court considered:
   i. Judicial Economy;
   ii. Forum non conveniens;
   iii. Expertise of the original court; and
   iv. Possibility of inconsistent results.

E. Relationship with Abstention.

1. If a court is required to abstain under § 1334(c)(2) if the case had originally been commenced in bankruptcy court, it is also required to abstain and remand in a removed case.

2. Factors to consider are similar to those factors to consider in determining whether the matter should be remanded.
   i. *See In re Bradlees Stores, Inc*., 311 B.R. 29, 34 (Bankr. S.D. N.Y. 2004); *Kmart Creditor Trust v. Conaway* (*In re Kmart Corp*.), 307 B.R. 586, 590-91 (Bankr. E.D. Mich. 2004).

3. Factors considered when determining whether to abstain on a discretionary basis are applicable in determining whether to remand on an equitable basis.
   i. *See, e.g., Mountain State Carbon, LLC v. Central West Virginia* Energy Co., Civil Action No. 5:12-CV-87, 2012 WL 2415547 at *5 (N.D. W. Va. June 26, 2012) (considerations for permissive abstention are essentially identical to the factors to consider for equitable remand).

F. Appeal.

1. More general removal provisions and procedures found in § 1441 to § 1451 are applicable to cases removed from state courts based on diversity or federal question jurisdiction, including cases removed in bankruptcy.

2. Generally, § 1447(c) and (d) prevent review of an order granting a motion to remand by an appellate court or the United States Supreme Court.
   i. *Things Remembered, Inc. v. Petrarca*, 516 U.S. 124, 116 S. Ct. 494, 133 L.Ed.2d 461 (1995).
      a. The plaintiff filed a notice of removal both under § 1441 and § 1452(a) of Title 28 of an action pending in state court prior to the time the debtor filed its Chapter 11 petition.
      b. The bankruptcy court found the removal timely under § 1441 and §1446, but untimely under § 1452 and Bankruptcy Rule 9027.

c. On appeal the district court found the removal untimely under both and ordered remand.
d. The Sixth Circuit held that it was barred by both § 1447(d) and § 1452(b) from hearing the appeal from the district court decision.
e. The United States Supreme Court first held that the Sixth Circuit was correct in holding that appeal to the Sixth Circuit was barred by § 1447(d).
f. The Supreme Court recognized that, read together, § 1447(c) and (d) foreclose appellate review of an order to remand based on a defect in procedure or lack of subject matter jurisdiction.
g. The Supreme Court also said that the same conclusion would result if it were analyzing removal pursuant to § 1452(a) because § 1447(d) applies, not only to orders of remand made in cases removed under § 1441, but also to orders of remand made in cases removed under any other statutes.
h. Thus an order that remands a proceeding arising out of a bankruptcy case to state court because of a timeliness defect is not appealable beyond the district court or bankruptcy appellate panel, regardless whether it was removed under § 1441 or § 1452(b).

3. In spite of § 1452(b), a decision not to remand based on a lack of subject matter jurisdiction, rather than equitable grounds, may be subject to review by the court of appeals. *See, e.g., In re Bissonnet Investments LLC*, 320 F.3d 520, 525, (5th Cir. 2003) ("Because the district court decided not to remand for alleged lack of jurisdiction, § 1447(d) does not preclude this court's appellate jurisdiction. Because the district court decision was not based on equitable grounds, § 1452(b) does not preclude appellate review. As nothing prevents this Court from reviewing the district court's decision finding subject matter jurisdiction, we therefore review the decision de novo.").

INTERACTION BETWEEN STATE AND BANKRUPTCY COURTS

by: Holly N. Lankster, Esq.[1]

I. Automatic Stay.

A. 11 U.S.C. § 362(a).

B. Three Potential Situations:

1. The automatic stay legally enjoins a state court action and the state court complies with the stay;
   i. Automatic stay does not apply to actions brought by the debtor; it only applies to actions against the debtor.
   ii. Even so, there are still issues that may rise in litigation commenced by a debtor. To the extent that a creditor must file a compulsory counterclaim, the stay may prevent that action and the creditor must seek relief.

2. The automatic stay legally enjoins the state court action but the state court proceeds in violation of the stay;
   i. Such action is treated as void. *Easley v. Pettibone Michigan Corp.*, 990 F.2d 905 (6th Cir. 1993) (listing a majority of jurisdictions holding actions taken in violation of the automatic stay are void).
   ii. This results in a needless waste of judicial and private resources.
   iii. Such action raises the possibility of sanctions against the creditor who continues to pursue such action in violation of the stay. 11 U.S.C. § 362(k)(1) ("Except as provided in paragraph (2), an individual injured by any willful violation of a stay provided by this section shall recover actual damages, including costs and attorneys' fees, and, in appropriate circumstances, may recover punitive damages.").

[1] Holly N. Lankster is a law clerk for the Hon. Gregory R. Schaaf, United States Bankruptcy Court, Eastern District of Kentucky. The following analysis is not intended to express the opinions of the Court, but merely to outline the issues and arguments raised by various courts and commentators.

3. The state court misinterprets the legal effect of the stay and needlessly suspends or dismisses state actions.
    i. This action could prejudice the parties. Evidence may be difficult to preserve. Money spent in preparation may be irrevocably lost. Collectability of debts may be jeopardized.
    ii. Co-Debtors.
        a. With the exception of the co-debtor stay in Chapter 12 pursuant to § 1201 and Chapter 13 pursuant to § 1301, creditors are free to sue a debtor's co-obligor.
        b. The co-debtor stay in § 1201 and § 1301 do not apply to commercial debts or cases in which a co-obligor incurred its debt in the ordinary course of its business.
        c. The co-debtor stay will terminate within 20 days for relief from the co-debtor stay unless the debtor or another party in interest objects. § 1201(d); § 1301(d).

4. Examples of Explicit Exceptions to the Stay.
    i. Criminal Actions. Commencement or continuation of a criminal action or proceeding. § 362(b)(1).
    ii. Family Law Proceedings.
        a. Commencement or continuation of a civil action or proceeding for:
            i. The establishment of paternity;
            ii. For the establishment or modification of an order for domestic support obligations;
            iii. Concerning child custody or visitation;
            iv. For the dissolution of a marriage, except to the extent that such proceeding seeks determine the division of property that is property of the estate; or
            v. Regarding domestic violation.
        b. Collection of a domestic support obligation from property that is not property of the estate and with respect to the withholding of income that is property of the estate or property of the debtor for payment of a domestic support obligation under a judicial or administrative order or a statute. § 362(b)(2).
    iii. Police or Regulatory Power. Government actions to enforce both its criminal laws and its police powers (but not to enforce a money judgment even if obtained pursuant to such police powers). § 362(b)(4).

iv. Perfection of Interests. Permits the perfection, or the maintenance or continuation of perfection, of interests in property to the extent that the trustee's rights and powers are subject to such perfection under § 546(b) or such act is accomplished within the period provided by § 547(e)(2)(A). § 362(b)(3).

v. Eviction Proceedings of Nonresidential Property. Any act by a lessor to the debtor under a lease of nonresidential real property that has terminated by the expiration of the stated term of the lease before the commencement of or during a case under this title to obtain possession of such property. § 362(b)(10).

C. Three Potential Ways Around the Stay.

1. Relief. Grounds for stay relief are (a) for "cause;" or (b) upon proof that the debtor does not have equity in the property and the property is not reasonably necessary for an effective reorganization. § 362(d).

2. Abstention. The scope of mandatory abstention is narrow, but bankruptcy courts have discretion to abstain in the interest of justice and comity. 28 U.S.C. § 1334(c).

3. Dismissal. Bad faith in filing the petition or a chapter 13 plan is a common reason for dismissal.

II. Discharge

A. 11 U.S.C. § 524.

B. The state court has two important roles:

1. Determining if a debt has been discharged or is dischargeable; and

2. Ruling on the nature and character of a debt.

C. Issue of when a debt has been discharged or is dischargeable generally raised in state court as an affirmative defense.

1. Relatively easy to determine if the debtor received a general discharge, but may be difficult to determine whether a discharge applied to a

particular debt.

D. Creditors who want to object to the discharge of certain types of debts must do so in a bankruptcy proceeding.

1. No obligation to seek a determination of dischargeability in the bankruptcy proceeding.

2. Creditor may sue in state court on a debt it believes is nondischargeable.

3. In cases under chapters 7, 11 and 12, state courts have concurrent jurisdiction with the bankruptcy court to determine the dischargeability of a debt for exceptions under § 523(a) *other than* those arising under subsections §§ 523(a)(2), (4), and (6). 11 U.S.C. § 523(c)(1); *Hamilton v. Herr (In re Hamilton)*, 540 F.3d 367, 373 (6th Cir. 2008) (recognizing courts have interpreted § 1334(b) as granting concurrent jurisdiction to state courts to determine the nondischargeability of debts).
   i. Discharge exceptions pursuant to §§ 523(a)(2), (4), and (6) must be brought in the bankruptcy court while the bankruptcy case remains open. 11 U.S.C. § 523(c)(1).

4. Generally state court findings and judgments are given *res judicata/collateral estoppel* effect.
   i. A state court determination that a debt was not discharged is *res judicata*. *In re McGregor*, 233 B.R. 406 (Bankr. S.D. Ohio 1999).
   ii. The preclusive effect of state court findings can also impact a proceeding to determine dischargeability of a debt that was the result of a state court action. *See, e.g., In re Couch*, 544 B.R. 867 (Bankr. E.D. Ky. 2016).
   iii. But bankruptcy courts must keep in mind the impact of the *Rooker-Feldman* doctrine. The *Rooker–Feldman* doctrine forbids lower federal courts from hearing cases that "essentially invite [them] to review and reverse unfavorable state-court judgments." *Exxon Mobil Corp. v. Saudi Basic Indus. Corp.,* 544 U.S. 280, 283, 125 S.Ct. 1517, 161 L.Ed.2d 454 (2005). *Rooker–Feldman* ousts lower federal courts of subject-matter jurisdiction in "[1] cases brought by state-court losers [2] complaining of injuries caused by state-court judgments [3] rendered before the district court proceedings commenced [4] and inviting district court review and

rejection of those judgments." *Id.* at 284, 125 S.Ct. 1517.

5. Alternatively, while a bankruptcy proceeding is ongoing and before a discharge is granted, parties may obtain relief from the stay to have the state court adjudicate whether specific debts are dischargeable.

III. Access to and Benefits From State Courts.

A. Access to State Court Proceedings.

1. The Code does not "freeze" deadlines during the period of bankruptcy.

2. If a deadline fixed by nonbankruptcy law, orders in nonbankruptcy proceedings, or agreements has not expired at the time of the bankruptcy filing, then the deadline period does not expire until the later of (1) the end of such period, including any suspension of such period occurring on or after the commencement of the case, or (2) thirty days after notice or expiration of the stay. This provision includes deadlines fixed by nonbankruptcy law. § 108(c).

3. The Code further extends deadlines fixed by nonbankruptcy law, an order entered in a nonbankruptcy proceeding, or an agreement regarding certain actions for a debtor or a party protected by a co-obligor stay (such as filing a pleading, demand, notice, etc.) until the later of (1) the nonbankruptcy deadline, including any applicable suspension, or (2) sixty days after the filing of the bankruptcy petition. § 108(b).

4. Finally, § 108(a) extends deadlines regarding a debtor's right to commence an action.
   i. If a nonbankruptcy deadline has not expired by the date the bankruptcy petition is filed, the bankruptcy trustee (or, presumably, the debtor in possession) is allowed to file the action until the later of (1) the nonbankruptcy deadline, including any applicable suspension thereof, or (2) two years after the filing of the bankruptcy petition. § 108(a).
   ii. Nevertheless, although § 108(a) extends this deadline, it does not explicitly provide extra time for the debtor to act; rather, it states a trustee may file suit after the original deadline.

B. Effect on Rights Received Through State Courts.

1. A number of Code provisions allow a bankruptcy trustee or debtor-in-possession to avoid voluntary and involuntary transfers of interests in property and recover them for the benefit of the estate.
   i. Trustee as Lien Creditor - § 544.
   ii. Preferences - § 547.
   iii. Fraudulent Transfers and Obligations - § 548.
      a. A regularly conducted, non-collusive judicial foreclosure sale may not be attacked as a fraudulent transfer for lack of reasonably equivalent value under § 548. *BFP v. Resolution Trust Corp*., 511 U.S. 531, 114. S. Ct. 17557, 128 L. Ed. 2d 556 (1994).
   iv. Postpetition Transactions - § 549.
   v. Liability of Transferee of Avoided Transfer - § 550.

2. A judicial lien is avoidable if it impairs a debtor's exemption. § 522(f).
   i. A judicial lien is a "lien obtained by judgment, levy, sequestration, or other legal or equitable process or proceeding." § 101(36).
   ii. A judicial lien is not the same as a lien created by statute. A statutory lien is not avoidable under § 522(f). *In re Newton*, 402 B.R. 771 (Bankr. W.D. Ky. 2009); *In re Skinner*, 213 B.R. 335 (Bankr. W.D. Tenn. 1997) (the terms "judicial lien" and "statutory lien" are mutually exclusive).

IV. Marital Dissolutions.

A. Family Law and Bankruptcy Often Collide.

1. There is an ongoing tension between the desire to leave marital dissolution decisions to the state courts and the need to deal fairly with all creditors and ensure the debtor's fresh start.

2. This tension manifests in the treatment of domestic support obligations and the division of property in bankruptcy**.**

B. Domestic Support Obligations Defined - § 101(14A).

1. Section 101(14) defines "domestic support obligations as "a debt that accrues before, on, or after the date of the order for relief in a case under

this title, including interest that accrues on that debt as provided under applicable nonbankruptcy law notwithstanding any other provision of this title, that is--

(A) owed to or recoverable by:
(i) a spouse, former spouse, or child of the debtor or such child's parent, legal guardian, or responsible relative; or
(ii) a governmental unit;

(B) in the nature of alimony, maintenance, or support (including assistance provided by a governmental unit) of such spouse, former spouse, or child of the debtor or such child's parent, without regard to whether such debt is expressly so designated;

(C) established or subject to establishment before, on, or after the date of the order for relief in a case under this title, by reason of applicable provisions of--

(i) a separation agreement, divorce decree, or property settlement agreement;
(ii) an order of a court of record; or
(iii) a determination made in accordance with applicable nonbankruptcy law by a governmental unit; and

(D) not assigned to a nongovernmental entity, unless that obligation is assigned voluntarily by the spouse, former spouse, child of the debtor, or such child's parent, legal guardian, or responsible relative for the purpose of collecting the debt.

C. Automatic Stay – § 362(a).

1. The stay is inapplicable to paternity, support, custody, visitation, divorce or the collection of DSO from non-estate property. § 362(b)(2).

D. Priority - § 507(a)(1).

1. Because a DSO is entitled to priority status, it must be paid in full during the life of a debtor's chapter 13 plan. § 507(a)(1); § 1322(a)(2).

E. Confirmation - – § 1129(a)(14), § 1225(a)(7), § 1325(a)(8).

1. A debtor must be current on post-petition DSO payments as a condition to confirmation of chapter 11, 12, and 13 plans.

F. Dischargeability – § 523(a)(5) & (15).

1. Domestic support obligations such as alimony, maintenance, and support, are not dischargeable. § 523(a)(5).

2. Property settlement obligations, or debts "owed to a spouse, former spouse, or child of the debtor and not of the kind described in paragraph (5) that [are] incurred by the debtor in the course of a divorce or separation or in connection with a separation agreement, divorce decree or other order of a court of record, or a determination made in accordance with State or territorial law by a governmental unit," are not dischargeable. § 523(a)(15).
   i. The 2005 amendments to the bankruptcy code removed the type of debts described in § 523(a)(15) from the § 523(c)(1) list. The effect of this deletion is that bankruptcy courts and state courts now share concurrent jurisdiction to determine the dischargeability of § 523(a)(15) debts. *In re Lewis*, 423 B.R. 742, 755 (Bankr.W.D.Mich.2010); *In re Tinnel*, No. 14-11440, 2014 WL 2809727, at *2 (Bankr. E.D. Tenn. June 20, 2014); *In re Baer*, 2012 WL 1430934, No. 12–2009 (Bankr. E.D.Ky. Apr. 23, 2012).

3. DSOs and property settlement agreements are excepted from a chapter 11 and chapter 12 discharge. § 1141(d)(2) and § 1228(a)(2).

4. Only DSOs are excepted from discharge in a chapter 13. § 1328(a)(2).

ROOKER-FELDMAN DOCTRINE
by Michael A. Galasso, Esq.

"*Rooker* and *Feldman* are strange bedfellows. *Lance v. Dennis*, 546 U.S. 459, 467 (Stevens, J., dissenting).

Derived from two decisions, *Rooker v. Fidelity Trust Co.*, 263 U.S. 413 (1923) and *District of Columbia Ct. of App. v. Feldman*, 460 U.S. 462 (1983), stands for the principle that "lower federal courts lack subject matter jurisdiction to engage in appellate review of state court proceedings or to adjudicate claims 'inextricably intertwined' with issues decided in state court proceedings. *Stemler v. City of Florence*, 350 F.3d 578, 589 (6th Cir. 2003), *quoting Peterson Novelties, Inc. v. Berkley*, 305 F.3d 386, 390 (6th Cir. 2002). Rooker-Feldman prevents federal courts from exercising jurisdiction over cases challenging state court judgments. *ExxonMobil Corp. v. Saudi Basic Indus. Corp.*, 544 U.S. 280 (2005). Consistent with federalism and comity concerns, Rooker-Feldman raises a jurisdictional bar that prevents lower federal courts from second-guessing state court decisions. *Texaco, Inc. v. Pennzoil Co.*, 784 F.2d 1133, 1142 (2d Cir. 1986), *rev'd on other grounds*, 481 U.S. 1 (1987). The doctrine vests authority to review state court judgments solely in the Supreme Court.

When applicable, Rooker-Feldman may even extend to claims not raised in state court if they are closely enough related to a state court judgment. *Skykes v. Cook Cty. Cir. Ct. Prob. Div.*, 837 F.3d 736 (7th Cir. 2016); *Hoblock v. Albany Cty. Bd. of Elections*, 422 F.3d 77 (2d Cir. 2005) (claimant cannot avoid application of Rooker-Feldman by presenting legal theories in federal court not raised in state court).

As of 2005, Rooker-Feldman had never been applied by the Supreme Court aside from the two cases from which it takes its name. *ExxonMobil*, 544 U.S. 280 (2005). *ExxonMobil* noted that both cases involved a losing party in state court filing suit in district court after the state cases ended, complaining of an injury caused by the judgment and seeking review and rejection of the judgment by the federal court. The Supreme Court noted the "narrow" ground for the doctrine's application and noted the extension "far beyond the contours" of the two originating cases. *Id.* at 283.

In 2006, the Supreme Court reiterated the restriction of the doctrine to "state court losers." *Lance v. Dennis*, 546 U.S. 459, 460 (2006). Any doubt in the narrowing of the doctrine was dispelled by the Court's language: "[n]either *Rooker* nor *Feldman* elaborated a rationale for a wide-reaching bar on the jurisdiction of lower federal courts, and our cases since *Feldman* have tended to emphasize the narrowness of the *Rooker-Feldman* rule." *Id.* at 464 (internal citations omitted). Justice Stevens' dissent in *Lance* notes that the Supreme Court "finally interred" the doctrine in 2005 with *ExxonMobil* and the decision in *Lance* disapproves of the "resuscitation of a doctrine that has produced nothing but mischief for 23 years." *Id.*at 468.

A commonly employed test is whether the "source of the injury" upon which the federal claim is based is a state court judgment. *Lawrence v. Welch*, 531 F.3d 364, 368 (6th Cir. 2008); *McCormick v. Braverman*, 451 F.3d 382 (6th Cir. 2006). If the source of injury is something other than a state court judgment, the claim is independent and not within the scope of the

doctrine. *Id.* The test has also been stated as whether the federal claims are "inextricably intertwined" with the state court proceedings. *Peterson Novelties, Inc. v. Berkley*, 305 F.3d 386, 390 (6th Cir. 2002). Doubts are to be construed in favor of deference to state court actions. *Atlantic Coast Line R.R. Co. v. Brotherhood of Locomotive Engineers*, 398 U.S. 281 (1970).

The Second Circuit employs a four-part test of whether:

(1) claimant lost in state court;
(2) claims injuries caused by state court judgment;
(3) claim invites review and rejection of state court judgment; and
(4) state court judgment was rendered before federal proceedings commenced.

MacPherson v. State Street Bank and Trust Co., 452 F. Supp. 2d 133 (E.D.N.Y. 2006).

The doctrine is often confused with, but is distinct from, the doctrines of res judicata, collateral estoppel, claim preclusion and issue preclusion. Judgments from state courts are not afforded Full Faith and Credit from the Constitution. Rather, those doctrines are applicable to federal courts only through 28 U.S.C. Section 1738, the Full Faith and Credit Act. *Parsons Steel, Inc. v. First Ala. Bank*, 474 U.S. 518 (1986). Yet, distinguishing between Rooker-Feldman and these doctrines has proven difficult. *Zealy v. City of Waukesha*, 153 F. Supp. 2d 970, 980 (E.D. Wis. 2001), *citing Young v. Murphy*, 90 F.3d 1225 (7th Cir. 1996). Because the expansion of Rooker-Feldman would "tend to supplant" Congress' mandate under the Full Faith and Credit Act (which directs federal courts to look principally to state law in deciding what effect to give state court judgments) it has been limited. *Lance v. Dennis*, 546 U.S. 459, 466 (2006). The risk is that incorporating preclusion principles into Rooker-Feldman turns the limited doctrine into a uniform federal rule governing the preclusive effects of state courts judgments contrary to the Full Faith and Credit Act. *Id.*

In practice, the application of Rooker-Feldman is very limited:

- State court judgment must have been rendered before federal proceedings commenced. *ExxonMobil*, 544 U.S. at 284.

- Federal proceeding must be filed after state court proceeding "ended." *ExxonMobil*, 544 U.S. at 291. Some courts have construed "ended" to mean the conclusion of all appellate proceedings. *Green v. Jefferson Cty. Comm'n*, 563 F.3d 1243 (11th Cir. 2009); *Guttman v. G.T.S. Khalsa*, 446 F.3d 1027 (10th Cir. 2006); *Dornheim v. Sholes*, 430 F.3d 919 (8th Cir. 2005).

- Single action rule: requires commencement of two separate actions. *Motley v. Option One Mtg. Corp.*, 620 F. Supp. 2d 1297 (M.D. Ala. 2009). Removal of a state court action is a continuation of a single action and not a separate case. *Id.* at 1301 (internal citations omitted).

- It does not prevent a federal district court from reviewing a challenge to the constitutionality of the state law applied in the state court action. *Carter v. Burns*, 524 F.3d 796 (6th Cir. 2008).

- It has no application to the review of executive or administrative actions. *Lance v. Dennis*, 546 U.S. 459, 464 (2006).

- A "causal" relationship is required to invoke the doctrine between the complained of injury and the state court action. *McKithen v. Brown*, 481 F.3d 89, 97-98 (2d Cir. 2007). Causation is not present where the state court "simply ratified, acquiesced in, or left unpunished" the actions of a third party. *Hoblock v. Albany Cty. Bd. of Elections*, 422 F.3d 77, 88 (2d Cir. 2005).

- In the Sixth Circuit, is there is an exception to allow for review of a state court judgment procured by fraud? *See, In re Sun Valley Foods, Inc.*, 801 F.2d 186, 189 (6th Cir. 1986) (holding federal court may entertain attack on state court judgment procured through "fraud, deception, accident, or mistake."); *but see West v. Evergreen Highlands Ass'n*, 213 Fed. Appx. 670, 674 (10th Cir. 2007) (distinguishing *Sun Valley* as relying on a case addressing res judicata, not Rooker-Feldman); *see also Anctil v. Ally Fin. Inc.*, 998 F. Supp. 2d 127, 137 (S.D.N.Y. 2014), *aff'd in part, rev'd in part*, *Babb v. Capitalsource, Inc.*, 588 Fed. Appx. 66 (2d Cir. 2015), (noting fraud exception recognized in Sixth and Ninth Circuits, rejected in the Fourth and Eighth Circuits, with differing results in the Third Circuit, and not yet addressed in the Second Circuit).

While application of the doctrine is limited, one clear and consistent holding is that a federal district court will not act as an appellate tribunal for a state court judgment. *Kougasian v. TMSL, Inc.* 359 F.3d 1136, 1139 (9th Cir. 2004) (doctrine prevents review over action that is a "de facto appeal" from a state court judgment); *Hall v. Lake Cty. Bd. Commr's*, 408 F.3d 335, 336 (7th Cir. 2005).

And while very limited, Rooker-Feldman is not completely dead. In March, 2017, the Seventh Circuit Court of Appeals issued the decision in *Mains v. Citibank, N.A.*, 852 F.3d 669 (7th Cir. 2017) in which Mains filed suit in federal court against his former mortgage lender asserting a multitude of claims connected to alleged fraudulent activity. The court noted that "the state courts resolved these matters long before he turned to the federal court." Even though some of the claims asserted in federal court were not asserted in state court, the court noted that those claims may still be subject to Rooker-Feldman if they are "closely enough related" to the state court judgment. The court also held that, applying state law claim and issue preclusion, res judicata would still apply in the absence of Rooker-Feldman since the state court judgment is given deference under the Full Faith and Credit Act.

In *Spencer v. FHLMC*, 2017 WL 1187965, March 30, 2017 (W.D. Wis.), the district court affirmed the bankruptcy court's dismissal of a Chapter 13 debtor's adversary proceeding challenging standing to recover on a mortgage debt claim where the state court had already issued a judgment in the foreclosure action. The district court noted that the claim in the adversary proceeding was not an independent claim since it sought review of the state court

foreclosure judgment in the form of an order setting aside the state court judgment. Note that the district court did not decline to apply Rooker-Feldman in light of a pending appeal in state court of the foreclosure judgment.

What if the state court judgment is void, as opposed to merely incorrect? In *In re Gray*, 2017 WL 2484824, June 7, 2017 (Bankr. D. Kan.), the court addressed a situation where a state court judgment was taken in violation of the discharge injunction. Because the debt was void under 11 U.S.C. Section 524, the bankruptcy court held that it was not entitled to Rooker-Feldman preclusion.

The Bankruptcy Court for the Northern District of Ohio granted a motion for relief from judgment filed by a mortgage creditor in *In re Leigh*, No.12-10128 (Bankr. N.D. Ohio April 26, 2013, Doc. 85) that set aside a judgment in a Chapter 13 which sustained a claim objection and avoided a lien. The court found the judgment void under Rooker-Feldman because the history of the case showed that the judgment was the result of dissatisfaction with a state court judgment in a foreclosure case. Because the court did not have jurisdiction to review the state court judgment and to extinguish the lien, the judgment was void and set aside.

A recent case involving the *Hamilton* exception and a unique set of facts: *In re Isaacs*, No. 16-8041 (B.A.P. 6th Cir. July 3, 2017). The *Hamilton* exception come from the holding in *In re Hamilton*, 540 F.3d 367 (6th Cir. 2006) which held that a judgment where a state court construes the discharge order is permissible, but that a state court judgment which modifies the discharge order is void ab initio. The *Isaacs* opinion acknowledges the rare circumstances of the underlying case where:

(1) the borrowers/debtors executed a second lien HELOC mortgage in February, 2003 which states "[t]he lien of this Mortgage will attach on the date this Mortgage is recorded."

(2) the debtors filed a Chapter 7 petition in March, 2004 which scheduled the mortgage as secured.

(3) the mortgagee did not record the mortgage until June, 2004 (post-petition) and without relief from stay.

(4) the debtors never sought to avoid the mortgage in the Chapter 7 even after they later re-opened the case to avoid two judicial liens.

(5) the debtors received a discharge in the Chapter 7 case in August, 2004.

(6) in April, 2014 the mortgagee filed an in rem foreclosure in Kentucky state court and obtained a default judgment that determined the mortgage as a valid lien.

(7) prior to a judicial sale of the property, one of the two debtors filed a Chapter 13 petition and initiated an avoidance as to the mortgage.

The bankruptcy court granted summary judgment to the debtor finding the debt was unsecured because it was discharged in the Chapter 7 since the mortgage was not recorded pre-petition and

never attached to the property. Since the debt was unsecured, it was discharged. Thus, the state court order was void ab initio under the *Hamilton* exception to Rooker-Feldman since the foreclosure decree modified the discharge rather than construing it.
The BAP reversed on the grounds that the *Hamilton* exception did not apply and, therefore, Rooker-Feldman precluded avoidance of the state court foreclosure judgment. This conclusion was reached on the basis that, while the debtor's personal liability for the debt was discharged, the foreclosure action was in rem only and did not modify the discharge order. The two judge majority noted that "rarely" would an in rem action modify a discharge injunction.

To reach its conclusion, the majority opinion determined that the bankruptcy court incorrectly held that the mortgage was invalid. The opinion looked to a second provision in the mortgage which conveyed the mortgaged interest in the property and noted that the lien grant was effective as between the mortgagor and mortgagee, and that the recording requirement related only to the effectiveness of the lien as to third parties (validity versus priority). The court determined that the lien was effective as between the parties irrespective of whether the instrument was ambiguous and that this determination was further consistent with Kentucky law. Consequently, the mortgage was effective before, during and after the Chapter 7 case and the in rem foreclosure action did modify the discharge.

The concurring opinion agreed with the result but would have limited the holding with a rule that an in rem action does not violate the discharge injunction as a matter of law, ending the inquiry without further analysis. The concurrence pointed to the fact that *Hamilton* involved a case where the state court did assess personal liability in violation of the discharge injunction whereas the *Isaacs* case merely addressed the in rem validity of a lien stating "[t]he majority's reasoning suggests the bankruptcy courts can serve as an appellate court over every foreclosure action under the rationale that an otherwise permissible in rem action may violate the discharge injunction of the lien is deemed invalid." Thus, the exception would swallow the rule. The concurrence noted that the circumstances in the case did not leave the debtor without redress as remedies were available for a stay violation - but that federal court review of the in rem judgment was not available.

ABSTENTION

Pullman - Case presents federal constitutional issue that will be mooted or presented in a different posture by state court determination of state law. *Railroad Comm'n v. Pullman Co.*, 312 U.S. 496 (1941). Test: (1) unsettled issues of state law; and (2) possibility that state law determination will moot or present in different posture the federal constitutional issues raised.

Younger - A federal court should not enjoin a pending state criminal proceeding unless the danger of irreparable loss is both immediate and great. *Younger v. Harris*, 401 U.S. 37 (1971). Test: (1) state proceeding are ongoing; (2) proceedings implicate important state interests; and (3) state proceedings provide an adequate opportunity to litigate the federal constitutional claim. Very limited in civil cases.

Test: (1) state proceeding are ongoing; (2) proceedings implicate important state interests; and (3) state proceedings provide an adequate opportunity to litigate the federal constitutional claim.

Younger extended to non-criminal judicial proceedings by *Middlesex Cty. Ethics Comm. v. Garden State Bar Ass'n*, 457 U.S. 423 (1982) but limited to three exceptional circumstances by *Sprint Communications, Inc. v. Jacobs*, 134 S.Ct. 584 (2013): (1) ongoing state criminal prosecutions; (2) certain civil enforcement proceedings; and (3) civil proceedings in furtherance of the state court's ability to perform its judicial functions.

Colorado River - In "exceptional" circumstances involving contemporaneous exercise of concurrent jurisdiction, federal court may abstain where parallel state court litigation could result in comprehensive disposition of litigation, and abstention would conserve judicial resources. *Colorado River Water Conservation Dist. v. U.S.*, 424 U.S. 800 (1976). Six factors:

1. whether controversy involves a res over which one court has exercised jurisdiction;
2. whether the federal forum is less inconvenient than the other for the parties;
3. whether staying or dismissing the federal action will avoid piecemeal litigation;
4. the order in which the actions were filed and whether one has advanced more;
5. whether federal law governs substantively; and
6. whether the state procedures are adequate to protect plaintiff's federal rights.

Where any of the above factors is facially neutral, that is basis for retaining jurisdiction versus yielding it. *Woodford v. Community Action Agency of Greene Cty., Inc.*, 239 F.3d 517 (2d Cir. 2001).

In determining whether "exceptional" circumstances exist, court must determine whether actions are "parallel" which requires: (1) parties in both actions are identical; and (2) the state action will completely and promptly resolve the issues between the parties. *Vonrosenberg v. Lawrence*, 849 F.3d 163 (4th Cir. 2017).

Mandatory Abstention - Pursuant to 28 U.S.C. Section 1334(c) a bankruptcy court must abstain if the following five requirements are met: (1) the proceeding is based on a state law claim or cause of action; (2) the claim or cause of action is "related to" a case under Title 11, but does not "arise under" Title 11 and does not "arise in" a case under Title 11; (3) federal courts would not have jurisdiction over the claim but for its relation to a bankruptcy case; (4) an action "is commenced" in a state forum of appropriate jurisdiction; and (5) the action can be timely adjudicated in the state forum of appropriate jurisdiction. *Stoe v. Flaherty*, 436 F.3d 209, 212-13 (3d Cir. 2006).

Permissive Abstention - Permissive or discretionary abstention is governed by 28 U.S.C. Section 1334(c)(1) and allows the court to abstain from core and non-core matters when it is in the interest of justice, for judicial economy, or based upon respect for state law. *Telluride Asset Resolution, LLC v. Telluride Global Development, LLC*, 364 B.R. 390 (10th Cir. B.A.P. 2007). In other words, in a case where a court is not required to abstain, it may use its discretion to abstain where the interest of the bankruptcy court in adjudicating the matter is outweighed by other factors. *Lucre Mgmt. Grp., LLC v. Schempp Real Estate, LLC*, 303 B.R. 866 (Bankr. D. Colo. 2003).

Courts apply the following non-exclusive factors to a discretionary abstention analysis:

(1) The effect or lack thereof on the efficient administration of the estate if a court recommends abstention;

(2) The extent to which state law issues predominate over bankruptcy issues;

(3) The difficulty or unsettled nature of the applicable law;

(4) The presence of a related proceeding commenced in state court or other non-bankruptcy court;

(5) The jurisdictional basis, if any, other than 28 U.S.C. § 1334;

(6) The degree of relatedness or remoteness of the proceeding to the main bankruptcy case;

(7) The substance rather than the form of an asserted "core" proceeding;

(8) The feasibility of severing state law claims from core bankruptcy matters to allow judgments to be entered in state court with enforcement left to the bankruptcy court;

(9) The burden on the bankruptcy court's docket;

(10) The likelihood that the commencement of the proceeding in bankruptcy court involves forum shopping by one of the parties;

(11) The existence of a right to a jury trial; and

(12) The presence in the proceeding on non-debtor parties.

See, e.g., Harris v. J.K. Harris & Co., 331 B.R. 634, 645 (Bankr. E.D. Pa. 2005); *In re: Continental Holdings*, 158 B.R. 442, 446 (Bankr. N.D. Ohio 1993); *Matter of Hughes-Bechtol, Inc.*, 107 Bankr. 552, 559 (Bankr. S.D. Ohio 1989).

ANTI-INJUNCTION ACT

"A court of the United States may not grant an injunction to stay proceedings in a state court except as expressly authorized by Act of Congress, or where necessary in aid of its jurisdiction, or to protect or effectuate its judgments."

22 U.S.C. § 2283 (enacted 1948).

The United States Supreme Court explained the purpose of the Anti–Injunction Act:

> The Act, which has existed in some form since 1793, see Act of Mar. 2, 1793, ch. 22, § 5, 1 Stat. 335, is a necessary concomitant of the Framers' decision to authorize, and Congress' decision to implement, a dual system of federal and state courts. It represents Congress' considered judgment as to how to balance the tensions inherent in such a system. Prevention of frequent federal court intervention is important to make the dual system work effectively. By generally barring such intervention, the Act forestalls "the inevitable friction between the state and federal courts that ensues from the injunction of state judicial proceedings by a federal court." Vendo Co. v. Lektro–Vend Corp., 433 U.S. 623, 630–631, 97 S.Ct. 2881, 2887, 53 L.Ed.2d 1009 (1977) (plurality opinion). Due in no small part to the fundamental constitutional independence of the States, Congress adopted a general policy under which state proceedings "should normally be allowed to continue unimpaired by intervention of the lower federal courts, with relief from error, if any, through the state appellate courts and ultimately this Court."

Chick Kam Choo v. Exxon Corp., 486 U.S. 140, 146, 108 S.Ct. 1684, 1689, 100 L.Ed.2d 127 (1988) (quoting Atlantic Coast Line R.R. Co. v. Brotherhood of Locomotive Eng'rs, 398 U.S. 281, 287, 90 S.Ct. 1739, 1743, 26 L.Ed.2d 234 (1970)).

The Anti-Injunction Act ("AIA") imposes an absolute ban upon the issuance of a federal injunction against a pending state court proceeding unless an exception is applicable. *Mitchum v. Foster*, 407 U.S. 225 (1972). There are three exceptions to the AIA where the injunction:

1. is expressly authorized by Congress;
2. is necessary to aid of the federal court's jurisdiction; or
3. is necessary to protect or effectuate the federal court's judgment.

See Chick Kam Choo v. Exxon Corp., 486 U.S. 140, 146 (1988).

The second exception ("in aid of jurisdiction") typically arises: (i) where the case is removed from state court; or (ii) where the federal court acquires in rem or quasi in rem jurisdiction over real property before the state court. *Martingale, LLC v. City of Louisville*, 361 F.3d 297, 302 (6th Cir. 2004) (internal citations omitted). This exception has more recently been extended to class action litigation that has settled, or is close to settlement, where it would be intolerable to have conflicting orders from different courts. *Lorillard Tobacco Co. v. Chester, Wilcox & Saxbe*, 589 F.3d 835 (6th Cir. 2009).

The third exception ("relitigation excpetion") applies when: (1) the federal court's judgment was final on the merits; (2) the state suit involves the same parties; and (3) the state suit is based upon the same cause of action resolved by the federal court's final judgment. *In re MI Windows and Doors, Inc.*, No. 16-1146, 2017 WL 2636452, June 20, 2017 (4th Cir.).

Exceptions to the AIA are narrowly construed with any doubts being resolved in favor of permitting state courts to proceed in an orderly fashion to finally determine controversies. *Atlantic Coast Line R.R. Co. v. Brotherhood of Locomotive Engr's*, 398 U.S. 281 (1970).

The AIA bars a litigant from attempting to use a federal court as a means of avoiding an adverse state decision and, in effect, obtaining federal appellate review of the state decision. *Vernitron Corp. v. Benjamin*, 440 F.2d 105 (2d Cir. 1971).

EFFECTS OF A BANKRUPTCY PETITION ON STATE COURT APPOINTED RECEIVERS AND/OR CUSTODIANS:

By Stuart P. Brown, Esq.

The presence of a state court appointed receiver presents a unique set of considerations for debtors who are considering filing for bankruptcy protection. By way of demonstration, Federal Civil Rule 66 states that:

> These rules govern an action in which the appointment of a receiver is sought or a receiver sues or is sued. But the practice in administering an estate by a receiver or similar court-appointed officer must accord with the historical practice in federal courts or with a local rule1. An action in which a receiver has been appointed may only be dismissed by court order2.

But what exactly does 'accord with the historical practice in federal courts' mean? There is indeed a long history of federal court decision affecting receivers.

I. THE BARTON DOCTRINE

No discussion of the interplay between bankruptcy and state court appointed receivers would be complete without at least a quick mention of the Barton Doctrine. The so-called "Barton Doctrine" takes its name from the decision rendered in *Barton v. Barbour*, 104 U.S. 126 (1881). The Barton case involved an injury claim brought by Frances Barton against John Barbour. Mr. Barbour was an equity receiver appointed by a Virginia court and, in that capacity, he was operating Great Southern Railroad Company.3 The holding of the Supreme Court was that "before suit is brought against a receiver leave of court by which he was appointed must be

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The local rules of the United States Bankruptcy Courts for the Eastern District of Kentucky and the Southern District of Oho appear to have no mention of the word "receiver". By contrast, the United States Bankruptcy Court for the District of Colorado has specific rules regarding the disclosure of receiver held property.

A receiver does not necessarily need to return to the state court for termination of the receivership. When a state court action is removed to federal court, the federal court, and by extension, the bankruptcy court, is afforded with the authority to both dissolve and modify any previous order related to a receiver entered by the state court. 28 USC 1450. In re: Sundance Corp., Inc., 149 B.R. 641, 650 (Bankr. E.D. Wash 1993) which further stands for the proposition that if a bankruptcy court can order compensation for a receiver then it must also be able to discharge the receiver from further services.

The injuries claimed by Ms. Barton were indeed quite bad. She was riding as a passenger in a sleeper car on the rail line being operated by the Defendant as receiver. Due to a defective rail the sleeper car derailed and turned over down an embankment causing multiple injuries.

obtained" without which the other forum "had no jurisdiction to entertain the suit". The Court explained that:

> If the court below had entertained jurisdiction of this suit, it would have been an attempt to on its part of [sic] adjust charges and expenses incident to the administration by the court of another jurisdiction of trust property in its possession, and to enforce the payment of such charges and expenses out of the trust property without the leave of the court which was administering it, and without consideration of the rights and equities of other claimants thereto. It would have been an usurpation of the powers and duties which belonged exclusively to another court, and it would have made impossible of performance the duty of that court to distribute the trust assets to creditors equitably and according to their respective priorities.4

Despite the fact that Ms. Barton had been injured while riding a train provided by a common carrier, the Court did not allow her action to go forward without authorization from the receiver's appointing court. That is a harsh result by most any standard.

The Supreme Court wasted relatively little time in re-examining and further explaining their *Barton* decision. In *Porter v. Sabin*, 149 U.S. 473 (1893), the Court stated that "the possession of the receiver is the possession of the court; and the court itself holds and administers the estate through the receiver, as its officer, for the benefit of those whom the court shall ultimately adjudge to be entitled to it."5 The Supreme Court's wording sounds a whole lot like abstention. There are numerous later cases that touch on the issue of allowing receivers to remain in their state courts.

Congress has also had a longstanding interest in how courts and receivers interact. In 1887, in part in response to the Barton decision, Congress enacted statutes allowing receivers to be sued without leave of the appointing court regarding certain claims involving operating a business while undertaking their duties. The 1887 statute is the ancestor of the present version of 28 USC 959 which states:

Barton at 136.

Porter at 479.

> (a) Trustees, receivers or managers of any property, including debtors in possession, may be sued, without leave of the court appointing them, with respect to any of their actions or transactions in carrying on business connected with such property. Such actions shall be subject to the general equity power of such court so far as the same may be necessary to the ends of justice, but this shall not deprive a litigant of his right to trial by jury.

The current statute would appear to allow Ms. Barton's claim. But the 'historical practice in federal courts' is clearly rooted in the abstention shown in cases like Barton. These historical elements carry forward into bankruptcy court.

II. PROPERTY OF THE ESTATE OR PROPERTY OF THE ESTATE BUT NOT SUBJECT TO TURNOVER BY THE RECEIVER / CUSTODIAN.

Pursuant to 11 USC 541(a), the filing of a bankruptcy petition creates an estate comprised of the debtor's property. Property of the estate is defined broadly and encompasses all legal or equitable interests of the Debtor in property.6 Significant to this discussion is the fact that estate property is limited to those interests held by the debtor "as of the commencement of the case". Although what constitutes property of the estate is a question of federal law under 11 USC 541, state law determines whether the Debtor has an interest in property in the first instance.7

> 11 USC 543(b) mandates that a custodian is to:
>
> > Deliver to the trustee any property of the debtor held or transferred to such custodian, or proceeds, product, offspring, rents or profits of such property, that is in such custodian's possession, custody or control on the date that such custodian acquires knowledge of the commencement of the case.8

A state court appointed receiver is a "custodian" subject to 11 USC 543(b). See 11 USC 101(11)9 So, clearly the code requires turnover of property from a receiver, right? Not necessarily. 11 USC 543(d) states that:

See *United States v. Whiting Pools, Inc*., 462 U.S. 198, 204-205 (1983); In re: DiGregorio, 458 B.R. 436 (Bankr. N.D. Ill. 2011).

See *Barnhill v. Johnson*, 440 U.S. 48, 54-55 (1992); In re: Cannon 277 F.3d 838, 849 (6th Cir. 2002); and *FDIC v. AmFin Financial Corp*., 757 F.3d 530 (6th Cir. 2014).

Note that the wording of the statute rests on the receiver's awareness of the bankruptcy filing. A receiver who has sold property to a bonafide purchaser for value prior to acquiring actual knowledge of the bankruptcy filing has a good argument that the sale is valid despite a bankruptcy petition having been filed prior to the closing of the sale.

The term custodian means –

(d) After notice and hearing, the bankruptcy court –
(1) may excuse compliance with subsection (a), (b), or (c) of this section if the interests of creditors and, if the debtor is not insolvent, of equity security holders would be better served by permitting a custodian to continue in possession, custody, or control of such property, and
(2) shall excuse compliance with subsections (a) and (b)(1) of this section if the custodian is an assignee for the benefit of the Debtor's creditors that was appointed or took possession more than 120 days before the date of the filing of the petition, unless compliance with such subsections is necessary to prevent fraud or injustice.

This section reinforces the general abstention policy found in 11 USC 305 by permitting the bankruptcy court to authorize the receivership / custodianship to proceed pursuant to the order of the state court.10 So we see from the code that the initial presumption is in favor of the turnover of property unless after notice and hearing, the receiver/custodian is able to show good cause favoring the continuation of the state court role. Under section (d)(2), a custodian in place for 120 days is given a strong basis for retaining the position. It should be noted that a receiver/custodian bears the burden of establishing, by a preponderance of the evidence that compliance under 11 USC 543(b) should be waived pursuant to 11 USC 543(d)11.

Among the factors that courts must weigh in order to determine if the interests of creditors would be better served by permitting a receiver to continue in possession, custody or control of the debtor's property are:

(1) The likelihood of reorganization;
(2) The probability that funds required for reorganization will be available;
(3) Whether there are instances of mismanagement by the debtor;
(4) Whether the turnover would be injurious to creditors;
(5) Whether the Debtor will use the turned over property for the benefit of its creditors;

(A) Receiver or trustee of any of the property of the debtor, appointed in a case or proceeding not under this title;
(B) Assignee under a general assignment for the benefit of the debtor's creditors; or
(C) Trustee, receiver, or agent under applicable law, or under a contract, that is appointed or authorized to take charge of property of the debtor for the purpose of enforcing a lien against such property, or for the purpose of general administration of such property for the benefit of the debtor's creditors.

See *In re: Northgate Terrace Apartments, Ltd*., 117 B.R. 328, 333 (Bankr. S.D. Ohio 1990).

See *Matter of Willows of Coventry, Ltd P'ship*, 154 B.R. 959 , 967 (Bankr. N.D. Ind. 1993).

(6) Whether or not there are avoidance issues raised with respect to property retained by a receiver, because a receiver does not possess avoiding powers for the benefit of the estate; and
(7) The fact that the bankruptcy automatic stay has deactivated the state court receivership action.12

Receivers and creditors should do a deep and thorough review of these factors prior to approaching a bankruptcy court seeking to be excused from turning over property in their possession. The factors noted above carry a heavy degree of discretion for the Court. In *Szwak v. Earwood*, 592 F.3d 664 (5th Cir. 2009), the Court found that Dale Earwood, a state-law liquidator, was not entitled to compensation under 11 USC 543(c)(2) finding instead that the services claimed were not of "benefit to the estate" under 11 USC 503. Id. At 673. In so holding, the 5th Circuit criticized the claim of attorney fees expended in opposing the bankruptcy and criticized the failure to relinquish control of the estate property until ordered to do so by the district court. Id. At 672. There is clearly a path through bankruptcy court to a state court receiver maintaining property and continuing the state court process. However, creditors and receivers are advised to take a long look at their decision to oppose turning over property of the bankruptcy estate.

See Dill v. Dime Sav. Bank (In re: Dill), 163 B.R. 221, 225 (E.D.N.Y. 1994); In re: Poplar Springs Apartments, 103 B.R. 146, 150 (Bankr. S.D. Ohio 1989).