STATE SOVEREIGN IMMUNITY IN BANKRUPTCY AFTER SEMINOLE TRIBE OF FLORIDA V. FLORIDA

A recent Supreme Court decision—in a case not involving bankruptcy—will continue to have a significant impact on the role states play in bankruptcy cases. In *Seminole*, Chief Justice Rehnquist wrote the opinion, joined by Justices O’Connor, Scalia, Kennedy and Thomas. Justice Stevens filed a dissenting opinion, as did Justice Souter, joined by Justices Ginsburg and Breyer.

*Seminole*, at 1131-32 (“Even when the Constitution vests in Congress complete lawmaking authority over a particular area, the Eleventh Amendment prevents congressional authorization of suits by private parties against nonconsenting States. The Eleventh Amendment restricts the judicial power under Article III and Article I cannot be used to circumvent the constitutional limitations placed upon federal jurisdiction.”). *Seminole* overruled an earlier Supreme Court case that had endorsed Congress’ power to abrogate a state’s sovereign immunity under the Commerce Clause in Article I of the Constitution. Accordingly, *Seminole* calls into question whether Congress may

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2304 *Seminole*, 116 S. Ct. at 1131-32 (“Even when the Constitution vests in Congress complete lawmaking authority over a particular area, the Eleventh Amendment prevents congressional authorization of suits by private parties against nonconsenting States. The Eleventh Amendment restricts the judicial power under Article III and Article I cannot be used to circumvent the constitutional limitations placed upon federal jurisdiction.”). *Seminole* overruled an earlier Supreme Court case that had endorsed Congress’ power to abrogate a state’s sovereign immunity under the Commerce Clause in Article I. *See* Pa. v. Union Gas Co., 491 U.S. 1 (1989).

2305 *Seminole*, at 1131-32. For a discussion of the controversy and confusion arising from the Supreme Court’s opinion, see Laura M. Herpers, Note, *State Sovereign Immunity: Myth or Reality after Seminole Tribes of Florida v. Florida*, 46 CATH. U. L. REV. 1005, 1018 (1997) (arguing that *Seminole* will “create both federalism and separation of powers problems, as well as confusion in the lower courts.”).

abrogate a state’s sovereign immunity under its Article I plenary bankruptcy powers. The Court briefly mentioned the potential impact of its opinion on bankruptcy cases, noting in a footnote that “[a]lthough the copyright and bankruptcy laws have existed practically since our nation’s inception . . . , there is no established tradition in the lower federal courts of allowing enforcement of those federal statutes against the States.”

Since the decision in *Seminole*, a number of courts have found that the bankruptcy court does not have jurisdiction over states because of the Eleventh Amendment. The Commission discussed the *Seminole* decision and its inevitable

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*Seminoles*, 116 S. Ct. at 1132 n.16. In his dissent, Justice Stevens argued that Article III permits enforcement of federal question actions against states in federal court. Id. at 1137 (Stevens, J., dissenting).

See, e.g., Department of Transp. and Dev. v. PNL Asset Management Co. (*In re Fernandez*), No. 96-31013, 1997 WL 570353, at *5 (5th Cir. Sept. 15, 1997) (“Section 106(a) of the Bankruptcy Code is unconstitutional. Congress cannot locate the authority claimed here to abrogate sovereign immunity in either the Bankruptcy Clause or in Section 5 of the Fourteenth Amendment.); Schlossberg v. Maryland (*In re Creative Goldsmiths of Wash., D.C., Inc.*), 119 F.3d 1140 (4th Cir. 1997) (dismissing trustee’s preference action against state under *Seminole*; state did not waive its sovereign immunity under section 106(b) by filing proof of claim for sales and withholding taxes unrelated to preference action); AER-Aerotron, Inc. v. Texas Dep’t of Transp., 104 F.3d 677, 680-81 (4th Cir. 1997) (stating in *dicta* that “perhaps the handwriting is on the wall that the abrogation provisions of the Bankruptcy Reform Act will suffer the same fate as the statutes involved in *Seminole*.”); Light v. State Bar of Cal., 1996 WL 341112 (9th Cir. 1996) (dismissing automatic stay action against state bar association); Kish v. Verniero, No. 97-1405, 1997 WL 471911 (D.N.J. Aug. 18, 1997) (holding that state department of motor vehicles was immune from debtor’s dischargeability action; Congress does not have authority to abrogate state sovereign immunity under bankruptcy clause and no indication section 106 was enacted pursuant to Fourteenth Amendment); Sacred Heart Hosp. of Norristown v. Pennsylvania Dep’t of Pub. Welfare (*In re Sacred Heart Hosp. of Norristown*), 204 B.R. 132 (E.D. Pa. 1997) (dismissing debtor’s action to recover for services provided under medical assistance program; court had no jurisdiction over state agency); see also *In re NVR*, LP, 206 B.R. 831 (Bankr. E.D. Va. 1997); *In re Charter Oak Assoc.*, 203 B.R. 17 (Bankr. D. Conn. 1996);
effect on the bankruptcy process in both plenary and working group sessions. The Commission is not proposing a specific recommendation in this area -- given the constitutional basis of the decision, there may be no statutory change to recommend. Nevertheless, Seminole’s impact as well as a variety of related bankruptcy policy considerations cannot be ignored. The effect of Seminole on a state’s role in bankruptcy should be weighed as part of any amendment to the substantive provisions of the Bankruptcy Code.\textsuperscript{2309}

In the 1994 amendments to the Bankruptcy Code, Congress substantially revised the sovereign immunity provisions in 11 U.S.C. § 106.\textsuperscript{2310} As amended, section 106(a)(1) explicitly abrogates a state’s sovereign immunity with respect to a wide variety of Bankruptcy Code protections including the automatic stay, avoidance, and turnover proceedings.\textsuperscript{2311} Now in the wake of Seminole, lower courts have held


\textsuperscript{2309} One commentator described the effect of Seminole on bankruptcy litigation against states:

If you represent a state, it may be one of the best things that ever happened in bankruptcy law. If you believe the dissent, it may seriously impair the bankruptcy system. If you believe the majority’s response, it won’t necessarily mean that much. . . . It is clear, though, that there will be many dramatic changes in how the federal courts relate to the states in the bankruptcy courts and elsewhere — and that we won’t know all of the changes for many months to come. Karen Cordry, \textit{A Tale of Two Sovereigns: Will the Bankruptcy Code Survive Seminole?}, \textit{5 NORTON BANKR. L. ADV.} 1, (May 1996). “‘There is grave concern that Seminole will act as precedent for lack of jurisdiction by the bankruptcy court to deal with any issue involving the state except in situations where the state consents to jurisdiction.’” \textit{Seminole: What it Means/Possible Defenses}, \textit{29 BANKR. CT. DECISIONS} A1, August 13, 1996 (quoting Phil Hendel); see Thomas Patterson & Russell L. Dees, \textit{State Dealings in Bankruptcy Are in for Some Changes}, \textit{BANKR. STRATEGIST} 5, 1996.


\textsuperscript{2311} See 11 U.S.C. § 106(a)(1) (1994). Section 106(a)(1) provides that “[n]otwithstanding an assertion of sovereign immunity, sovereign immunity is abrogated as to a governmental unit to the extent set forth in this section with respect to the following . . . .” Section 106(a)(1) then lists virtually every substantive section of the Bankruptcy Code, including section 105, the automatic stay, and avoidance actions.

When Congress enacted section 106(a) in 1994, it was acting in complete accordance with the then current Eleventh Amendment view. The clear congressional abrogation language in 1994 was in response to the Supreme Court’s decision in \textit{Hoffman} and \textit{Nordic Village}, which held that congressional intent to abrogate sovereign immunity must be stated unequivocally. \textit{See} Hoffman v.
that section 106(a)(1) is invalid because it purports to abrogate a nonconsenting state’s sovereign immunity by subjecting it to the jurisdiction of the bankruptcy court under a variety of substantive Bankruptcy Code provisions. The conflict between the holding in Seminole and the language of section 106(a) has almost uniformly been resolved in favor of Seminole and Eleventh Amendment sovereign immunity.

Prior to Seminole, it was widely believed that Congress was empowered by the Fourteenth Amendment and by Article I to abrogate expressly a state’s sovereign immunity to suit in federal court as provided by the Eleventh Amendment. Following Seminole, however, Eleventh Amendment sovereign immunity arguably insulates a state from bankruptcy court jurisdiction. Thus, Seminole may well have invalidated Congress’ express abrogation of the sovereign immunity of states and state agencies, which otherwise permitted private parties to engage states without their consent in bankruptcy court.

A. Bankruptcy Policy Before and After Seminole

Bankruptcy is a collective proceeding, providing a single forum for the resolution of claims against a debtor’s property “wherever located.” Accordingly,

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See cases cited supra note 2308; see also Elizabeth Gibson, Sovereign Immunity in Bankruptcy: The Next Chapter, 70 AM. BANKR. L.J. 195, 201 (1996).

See cases cited supra note 2308; but see In re Straight, 209 B.R. 540 (D. Wyo. 1997) (abrogation of state sovereign immunity under bankruptcy clause was valid exercise of power under fourteenth amendment); Headrick v. Georgia (In re Headrick), 200 B.R. 963, 967 (Bankr. S.D. Ga. 1996) (same).

In Pennsylvania v. Union Gas Co., 491 U.S. 1 (1989) (plurality opinion) overruled by Seminole Tribe of Florida v. Florida, 116 S. Ct. 1114 (1996), the Supreme Court held that Congress had the power under the Interstate Commerce Clause (and more generally under Article I) to abrogate a state’s Eleventh Amendment immunity. Union Gas, at 23. The Court found that Congress must clearly express an intent to abrogate a state’s immunity and render it liable in federal court. Id. at 8 (citing Atascadero State Hosp. v. Scanlon, 473 U.S. 234, 242 (1985)). In the bankruptcy context prior to Seminole, courts found that section 106 was a clear congressional abrogation of a state’s sovereign immunity. See, e.g., In re Merchants Grain, 59 F.3d 630 (7th Cir. 1995), vacated and remanded sub nom., Ohio Agric. Commodity Depositors Fund v. Mahern, 116 S. Ct. 1411 (1996) (remanded in light of Court’s decision in Seminole); In re Crook, 966 F.2d 539 (10th Cir.), cert. denied, 506 U.S. 985 (1992) (finding that mortgage held by state agency could be restructured by a bankruptcy court despite Eleventh Amendment).

28 U.S.C. § 1334(e) (1994) (“The district court in which a case under title 11 is commenced or is pending shall have exclusive jurisdiction of all of the property, wherever located,
all creditors who seek to assert a claim against property of the estate must assert their claims in the bankruptcy court where the debtor’s case is pending. By providing a single forum governed by a single set of procedural rules, the bankruptcy process ensures uniform procedural treatment for every type of claimant, including secured creditors, unsecured trade creditors, priority tax claimants, environmental claimants, child support claimants, employee and pension claimants, tort victims, bondholders, and equity security holders. A single bankruptcy forum also advances a variety of fundamental policy goals, including, equal distribution and treatment for similarly-situated creditors, promotion of a cost-effective and speedy process to minimize the cost to creditors, and the rehabilitation of individuals as well as business entities. Determining creditors’ rights in the debtor’s estate is a fundamental role of the bankruptcy court. A single forum for the resolution of claims against a bankruptcy estate is a critical component of the court’s responsibility for a number of reasons.

First, multiple proceedings in different courts may result in conflicting determinations of rights in a debtor’s estate. Two separate courts arriving at divergent determinations of the rights in a piece of the debtor’s property leads to further litigation between the parties seeking to enforce those rights. Moreover, separate treatment in multiple courts may also result in unequal treatment of similarly-situated creditors. A creditor that is able to enforce its rights in a separate forum without consideration of other possible claims in the property will benefit to the detriment of other creditors.

Second, the ability of a bankruptcy court to quickly restructure a debtor’s obligations enhances the likelihood of saving a business or giving a family a fresh start and increasing the distribution to creditors. The bankruptcy court has the ability to give notice to all parties with an interest in the debtor’s property and to bring those persons or entities into the bankruptcy court for a final, binding determination of the rights in the property. The ability to obtain this determination in the bankruptcy court may be lost if all parties with a claim against the debtor are not required to enforce their claims in the same court.

Third, a single forum reduces the cost of collection for creditors. Creditors often have overlapping interests in the debtor’s estate and multiple proceedings would require creditors to participate in each proceeding to protect their interests, greatly increasing their cost of collection. Creditors are already bearing the cost of administering the bankruptcy estate because a trustee or other professionals retained by the estate are paid before any distribution is made to unsecured creditors. The additional costs of enforcing a claim in a separate forum place creditors at a distinct disadvantage.
Fourth, Chapter 11 of the Bankruptcy Code favors the reorganization of debtors in an effort to preserve going-concern value, retain jobs, and promote the efficient use of capital. A bankruptcy court that does not control all critical aspects of a debtor’s business will be unable to achieve a reorganization. These fundamental policies underlie the importance of a single bankruptcy forum to determine all claims by and against a debtor.

Because the Eleventh Amendment protects only the states, the ability to bring actions against federal and municipal agencies remains unaffected by the *Seminole* decision. For example, if a federal agency obtained possession of property of the estate in violation of the automatic stay, a debtor could seek to recover this property on an expedited basis in the bankruptcy court. However, unless a state waives its sovereign immunity, it may not be possible to bring that same action in the bankruptcy court against a state agency. As a result, states must be treated differently from all other creditors and parties in interest (including the federal government) in the bankruptcy process.

States play an important role in the bankruptcy process, appearing in many bankruptcy cases in a myriad of roles -- as priority tax creditor, secured creditor, unsecured creditor, police and regulatory authority, environmental creditor, landlord, guarantor, bondholder, leaseholder, and equity interest holder. Similarly, a debtor may have a number of potential actions against a state, including a stay violation, preferences, turnover of property, and lien avoidance. The different treatment accorded states under *Seminole* may result in fewer proceedings against them within the bankruptcy process due to the increased costs required to seek a recovery against a state, including sanctions for violation of the automatic stay.

As one commentator has observed:

> From a bankruptcy perspective, the unfortunate result of this partial invalidation of section 106 is the asymmetry it creates. Of all the parties who might be involved in a bankruptcy case, only state governments are given the special shield of immunity. Other creditors, including other governmental units, are subject to suit in the bankruptcy court to recover preferences or to answer for violating the automatic stay or to determine the validity and priority of liens. But state governmental units are immune from such suits. Presumably the Supreme Court would opine that this lack of equality is the price we must pay for the Constitution’s continuing recognition of the sovereignty of the states.


In addition to authorizing the recovery of property, the Bankruptcy Code entitles debtors to bring motions for sanctions or contempt for willful violations of the automatic stay against governmental entities that pursue actions outside of the scope of the police and regulatory exception in section 362(b)(4) without seeking permission from the bankruptcy court. However, the ability to obtain damages for stay violations by states may be substantially limited under *Seminole* although
of state entities will alter the statutory equilibrium struck in the Bankruptcy Code that balances the rights of creditors against each other as well as against the rights of the debtor.

The Bankruptcy Code carefully balances the rights of the debtor and all creditors, including states. State interests are protected in a number of ways in bankruptcy. An exception to the automatic stay is codified in section 362(b)(4) and (5), which recognizes the need for a state to enforce its police and regulatory

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it may be possible for a state court (not the bankruptcy court) to grant damages to the debtor under section 362(h).

Whether a state court could decline to adjudicate a federal cause of action because of a nondiscriminatory (equally applicable to state and federal actions) state law sovereign immunity doctrine is unclear. See Felder v. Casey, 487 U.S. 131 (1988) (though state notice statute applied equally to state and federal cause of action, notice statute impermissibly discriminated against federal cause of action under section 1983); General Oil Co. v. Crain, 209 U.S. 211, 226 (1908) (retaining appellate review of state supreme court decision that found no jurisdiction to enjoin state action; “[i]f a suit against state officers is precluded in the national courts by the Eleventh Amendment to the Constitution, and may be forbidden by a state to its courts, . . . without power of review by this court, . . . an easy way is open to prevent the enforcement of many provisions of the Constitution and the Fourteenth Amendment, which is directed at state action, could be nullified as to much of its operation.”). For a thorough discussion of enforcing federal causes of action in state court, see R. FALLO, D. MELTZER & D. SHAPIRO, HART & WECHSLER’S THE FEDERAL COURTS AND THE FEDERAL SYSTEM, 469-478 (4th ed.).

A recent case is illustrative. In Tri-City Turf Club, Inc. v. Kentucky Racing Commission, the debtor sued the state racing commission for violating the stay when the commission revoked the debtor’s operating license to conduct live horse races and intertrack betting. 203 B.R. 617 (Bankr. E.D. Ky. 1996). The court found that the state’s actions violated the stay and awarded attorneys’ fees, but reserved the amount of the damages until the fee hearings. Id. In the interim, the Supreme Court issued the Seminole decision. The Tri-City court found that, under Seminole, it had no jurisdiction over the state commission to award damages remedying a present violation, and therefore lacked jurisdiction to hear the debtor’s adversary proceeding against the state. Id. Thus, the debtor’s only option to recover property wrongfully taken was to delay the bankruptcy proceeding and to sue the state commission in state court.
power. Similarly, state tax claims are given priority treatment. Thus, the Bankruptcy Code generally recognizes the interests of governmental units and accords them special treatment where necessary while balancing the interests of other creditors as well as the debtor. Seminole’s interpretation of the Eleventh Amendment, as applied by the lower courts, has begun to alter this delicate balance by removing states from the jurisdiction of the bankruptcy court unless they consent to that jurisdiction.

B. Bankruptcy Litigation Involving States After Seminole

Given the fundamental need for a single binding bankruptcy proceeding, there are a number of possible alternatives to an action against a state in bankruptcy court. Assuming that a nonconsenting state is not subject to suit in the bankruptcy court, a debtor may be able to seek an Ex parte Young injunction against an individual state official (not the state itself) in federal court. Alternatively, the debtor could bring a suit against the state in state court. If the state has filed a proof of claim, the debtor may be able to show that the state waived its sovereign immunity under section 106(b), although a recent Court of Appeals decision suggests this type of waiver may be limited. In addition, a debtor may be able to assert an in rem action to recover property of the estate. While a few courts have upheld section 106(a) in light of Seminole, finding that section 106 was enacted as a proper exercise of Congressional power.

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2318 “The filing of a petition . . . does not operate as a stay under subsection (a)(1) of this section, of the commencement or continuation of an action or proceeding by a governmental unit to enforce such governmental unit’s police or regulatory power.” 11 U.S.C. § 362(b)(4) (1994); see also Board of Governors of the Fed. Reserve Sys. v. MCorp Fin., Inc., 502 U.S. 32 (1991) (Federal Reserve Board’s administrative proceedings against debtor are excepted from automatic stay by section 362(b)(4)). The Supreme Court in MCorp was “not persuaded . . . that the automatic stay provisions have any application to ongoing, nonfinal administrative proceedings.” Id. at 37. Similarly, section 362(b)(5) permits the enforcement of a prepetition nonmonetary judgment obtained in a police or regulatory action against the debtor or against property of the estate. 11 U.S.C. § 362(b)(5) (1994).


2320 The Seminole court noted that “several avenues remain open for ensuring state compliance with federal law.” 116 S. Ct. at 1131. These include consent of the state to federal jurisdiction, an Ex parte Young injunction, and suit in state court.

2321 Schlossberg v. Maryland (In re Creative Goldsmiths of Wash., D.C., Inc.), 119 F.3d 1140 (4th Cir. 1997) (holding that waiver of Eleventh Amendment sovereign immunity applied to only compulsory counterclaims to state’s proof of claim for sales and withholding taxes and not to trustee’s preference action; trustee failed to seek a setoff in preference action for amount of proof of claim and court never reached the issue of whether state had waived sovereign immunity to extent of setoff).
power under section 5 of the Fourteenth Amendment, this argument has been undercut recently by the Supreme Court. Finally, the U.S. trustee could be empowered to sue states on behalf of debtors in federal court to enforce states’ compliance with the Bankruptcy Code.

1. **Ex parte Young Injunction**

While a state may be immune under the Eleventh Amendment, individual state officials nonetheless may still be subject to federal injunctive relief from ongoing Bankruptcy Code violations. Before a state official actually has completed an act of wrongfully obtaining property, a debtor may be able to use an *Ex parte Young* injunction to enjoin the state official from completing the seizure. An *Ex parte Young* injunction operates on the theory that an individual state official who is about to act or is acting in violation of federal law is not protected by the state’s sovereign immunity. Once the state has obtained the property, the federal violation may no longer be ongoing and this option would no longer be available. At least one commentator believes that the ability to obtain *Ex parte Young* relief against state officials means that “little has changed” after the *Seminole* decision.

A recent Supreme Court case, however, limited the application of an *Ex parte Young* injunction to another suit brought by an Indian Tribe. In *Idaho v. Coeur d’Alene Tribe of Idaho*, a plurality of the Supreme Court held that *Ex parte Young* injunctive relief was unavailable in a suit against state officials seeking to establish

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2323 *City of Boerne v. Flores*, 1997 WL 345322, at *12 (U.S., June 25, 1997) (“Any suggestion that Congress has a substantive non-remedial power under the Fourteenth Amendment is not supported by our case law.”).

2324 209 U.S. 123 (1908). An *Ex parte Young* injunction can only be issued against a state officer to prevent an ongoing constitutional rights violation for which money damages will not suffice. Once the state has acted, an *Ex parte Young* injunction is not a viable option. *See Edelman v. Jordan*, 415 U.S. 651 (1974) (*Young* permits prospective relief only).


2326 Henry Paul Monaghan, *The Sovereign Immunity “Exception,”* 110 HARV. L. REV. 102 (1996) (arguing that because of the continuing vitality of the *Ex Parte Young* rule, “sovereign immunity has become a rare exception to the otherwise prevailing system of state governmental accountability in federal court for violations of federal law, an exception that many, including this author, find difficult to justify.”).
ownership of a lake bed as part of the tribe’s reservation. The Court held that the Tribe’s request for injunctive relief to recover ownership of the lake bed was essentially a quiet title action “in that substantially all benefits of ownership and control would shift from the state to the Tribe.”

A trustee’s ability to bring an Ex parte Young action to enjoin the fixing of a lien or to recover property of the estate actually held by the state may be limited if the Court’s quiet title language is interpreted literally. The facts in Cour d’Alene may be distinguishable, however, as applying to cases only where the state would lose regulatory control as a result of the Ex parte Young action. These circumstances would rarely, if ever, be present in bankruptcy.

2. State Court Action

A state’s Eleventh Amendment immunity only protects it from suit in federal court. As a result, a state court action may be brought to enforce a state’s compliance with the Bankruptcy Code. In the event of a wrongful seizure by a state of property of the estate, for example, the debtor may be able to commence a state court action to recover the property. State civil litigation, with its concomitant delays, might not provide an adequate substitute for the expedited hearing that otherwise would have been available in the bankruptcy court. There is also some question, in

2327 Idaho v. Cœur d’Alene Tribe of Idaho, 117 S. Ct. 2028, 2040 (1997) (“An allegation of an on-going violation of federal law where the requested relief is prospective is ordinarily sufficient to invoke the Young fiction. However, this case is unusual in that the Tribe’s suit is the functional equivalent of a quiet title action which implicates special sovereignty interests.”).

2328 Id.

2329 The Court in Seminole alluded to the fact that a state court action may be blocked by the state’s own sovereign immunity. Seminole, 116 S. Ct. 1114, 1131 n.14 (“this Court is empowered to review a question of federal law arising from a state court decision where a State has consented to suit” citing Cohens v. Virginia, 19 U.S. (6 Wheat.) 264 (1821) (emphasis added)).

2330 The Eleventh Amendment does not apply to claims brought in state court. See Hilton v. S.C. Pub. Rys. Comm’n, 502 U.S. 197, 205 (1991). Commentators debate, however, whether the Eleventh Amendment provides a state with complete immunity from suit or simply directs suits against states to state court. Compare Carlos Manuel Vazquez, What is Eleventh Amendment Immunity?, 106 YALE L.J. 1683, 1723 (1997) (discussing the “diversity interpretation” and the “immunity from liability” interpretation; “there appears to be no evidence that the Framers ‘intended’ to establish the forum-allocation principle that some regard the Eleventh Amendment as embodying.”) with Vicki C. Jackson, Seminole Tribe, the Eleventh Amendment, and the Potential Evisceration of Ex parte Young, 72 N.Y.U. L. REV. 495, 546 n.176 (1997) (disagreeing with Professor Vazquez’s assertion that a state may be immune from all liability because of the Eleventh Amendment and sovereign immunity under state law).
light of the comprehensive federal bankruptcy scheme, whether a state court would enforce federal relief.\textsuperscript{2331}

Assuming that a state court would enforce federal bankruptcy law, dual proceedings are not without other risks. In such a circumstance, a state seizure of property of the estate could have the practical and virtually immediate effect of unraveling a Chapter 11 case, shutting down the business, and potentially undercutting the interests of creditors and employees of the debtor. For example, a state asserting its police and regulatory power may revoke the debtor’s operating license for failure to pay state licensing fees.\textsuperscript{2332} Without an operating license, the debtor’s business would have to shut down until a determination could be made that the state was acting pursuant to a valid police and regulatory power (permitted notwithstanding the automatic stay) and was not merely seeking to satisfy a monetary action (not permitted under the automatic stay). Under these circumstances, a debtor would not be able to seek an expedited review in the bankruptcy court, but would have to seek review in state court. The debtor’s business could well be closed until a favorable determination had been made in state court.

Another complication may result from the issue preclusive and claim preclusive effect of a state court determination. If a debtor litigates its claims against a state in state court “with a full and fair opportunity” to litigate other related issues, the debtor may be precluded from asserting those claims in another context in the bankruptcy court.\textsuperscript{2333} The facts in a recent Fourth Circuit Court of Appeals decision

\textsuperscript{2331} See, e.g., Smith v. Mitchell Constr. Co., 481 S.E.2d 558, 561 (Ga. App. 1997) (dismissing state-law action for violation of the stay; bankruptcy law preempts state law and “creditors should be held to a uniform standard of conduct when dealing with bankruptcy debtors, and the bankruptcy courts are the only courts capable of fashioning such a uniform standard.”); Jeffrey A. Stoops, Monetary Awards to the Debtor for Violations of the Automatic Stay, 11 FL. ST. UNIV. L. REV. 423, 427 (1983) (“State courts seem unsure of their ability to deal with cases so closely related to a pending bankruptcy case and most would likely abstain.”).

\textsuperscript{2332} See, e.g., Tri-City Turf Club, Inc. v. Kentucky Racing Comm’n., 203 B.R. 617 (Bankr. E.D. Ky. 1996) (the debtor sued the state racing commission for violating the stay when the commission revoked the debtor’s operating license to conduct live horse races and intertrack betting).

\textsuperscript{2333} Allen v. McCurry, 449 U.S. 90 (1980). In Allen, the Supreme Court applied the doctrine of collateral estoppel to preclude a section 1983 action in federal court. The Allen criminal defendant (after his state law conviction) sued the officers arresting him under 42 U.S.C. § 1983 for violating his constitutional rights. The Court failed to find any congressional intent in enacting section 1983 to “deny binding effect to a state-court judgment or decision when the state court, acting within its proper jurisdiction, has given the parties a full and fair opportunity to litigate federal claims, and thereby has shown itself willing and able to protect federal rights.” Id.
provide a good example of how complicated this may become. In Creative Goldsmiths, the trustee filed an action against the State of Maryland Comptroller of the Treasury to avoid an income tax payment as a preference because it was made to the state within ninety days of the petition date. The State of Maryland had also filed a proof of claim in the bankruptcy case for sales taxes and withholding taxes owed by the debtor. The Fourth Circuit held that the bankruptcy court did not have jurisdiction over the state in the preference action under the Eleventh Amendment.

If the Creative Goldsmiths debtor were to litigate the preference claim against the state in state court, the debtor also may be required to assert any defenses it may have to the state’s proof of claim for sales and withholding taxes despite the fact that the state “waived” its sovereign immunity with respect to those taxes in the bankruptcy court under section 106(b) by filing a proof of claim. The claims are related because the debtor has a permissive counterclaim to setoff the state’s tax claim from its preference claim. What remains unclear is whether the debtor will later be estopped in bankruptcy court from asserting defenses to a claim that it had a “full and fair opportunity” to litigate in state court. Each time the debtor litigates with a state in state court, the bankruptcy court will have to determine the effect of the state court judgment. This will delay the bankruptcy process and may result in prejudice to other creditors if the debtor is estopped from asserting legitimate defenses to a claim.

3. State Waiver of Eleventh Amendment Sovereign Immunity

Eleventh Amendment immunity is not absolute; a state may waive its own immunity. A state’s Eleventh Amendment waiver must be specific and must be “stated by the most express language.” The Bankruptcy Code also provides for

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2335 Id. at 1142.

2336 Id. at 1143.

2337 Id.

2338 Id. at 1149.

a waiver of sovereign immunity under certain circumstances. Section 106(b) provides that a “governmental unit” that has filed a proof of claim has waived its sovereign immunity with respect “to a claim . . . that is property of the estate and that arose out of the same transaction or occurrence” in which the government’s claim arose.2340 The same principle is applied more generally outside the Eleventh Amendment context; creditors who file proofs of claim against a debtor’s estate are subject to the equitable jurisdiction of the bankruptcy court.2341

The Creative Goldsmiths decision, however, calls the constitutionality of section 106(b) into question in light of Seminole.2342 In Creative Goldsmiths, the trustee filed an action against the State of Maryland Comptroller of the Treasury to avoid an income tax payment as a preference because it was made to the state within 90 days of the petition date.2343 The State of Maryland had also filed a proof of claim for sales taxes and withholding taxes owed by the debtor.2344 In the preference action, the bankruptcy court held and the district court agreed that the payment to the state had been made in the ordinary course of the debtor’s business and was therefore not avoidable as a preference.2345 On appeal, the State of Maryland raised the Eleventh Amendment immunity issue for the first time.2346 The trustee argued, among other things, that the state had waived its Eleventh Amendment immunity pursuant to section 106(b) by filing a proof of claim in the bankruptcy case.2347

N.D. Ga. 1996) (attorney general’s Eleventh Amendment immunity waiver not binding unless state statute explicitly authorized attorney general to consent to waiver).


Id. at 1142.

Id. at 1143.

Id.

Id.

Id.
The Fourth Circuit rejected this argument, finding that the “deemed waived” language in section 106(b) “amounts to language of abrogation” in violation of *Seminole*.2348 The court went on to conclude that a waiver of a state’s Eleventh Amendment immunity is wholly within the particular state’s power.

While 11 U.S.C. § 106(b) may correctly describe those actions that, as a matter of constitutional law, constitute a state’s waiver of the Eleventh Amendment, it is nevertheless not within Congress’ power to abrogate such immunity by “deeming” a waiver. Rather, in the absence of a constitutional authorization, it lies solely within a state’s sovereign power to waive its immunity voluntarily and to consent to federal jurisdiction. Only if it waives such immunity may a private citizen sue the state in federal court.2349

To determine whether the State of Maryland had waived its sovereign immunity, the Fourth Circuit looked to Maryland state law.2350 Under the rationale in *Creative Goldsmiths*, Congress does not have the power to “deem” when a state has waived its Eleventh Amendment immunity.2351 Thus, the Fourth Circuit found that section 106(b) was rendered unconstitutional by *Seminole*. Interestingly, however, the Fourth Circuit also examined the factual basis of the trustee’s claim and the state’s proof of claim, finding that because they were unrelated they did not satisfy the compulsory counterclaim provisions of the Bankruptcy Rules.2352 The Fourth Circuit did not discuss the fact that the “same transaction or occurrence” test under the Bankruptcy Rules is also required for waiver under section 106(b).

At least one commentator has suggested that the Bankruptcy Code could condition a state’s very participation in the bankruptcy process on its waiver of sovereign immunity.2353 “For example, [Congress] may condition state claim tax priority on a state’s voluntary waiver of its immunity.”2354 Whether a waiver of this

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2348 *Id.* at 1147.

2349 *Id.*

2350 *Id.* Under Maryland state law, the Fourth Circuit found that the state had not waived its Eleventh Amendment immunity.

2351 *Id.* at 1147.

2352 *Id.*


2354 *Id.* at 24.
type would withstand Supreme Court scrutiny remains in some doubt, however, state action in order to participate in a related federal program has been upheld in other circumstances.

5. **In Rem** Proceeding in Bankruptcy Court

Another possible post-*Seminole* alternative is to frame a debtor’s claim against a state as an *in rem* proceeding against property of the estate. Since *Seminole*, one court has found that a trustee’s turnover action was an *in rem* proceeding against the property and not a “suit” against the state in violation of the Eleventh Amendment. In *Zywiczynski*, the trustee sought the turnover of a certificate of deposit bought by the debtor to secure environmental reclamation obligations that might arise out of debtor’s construction business. The state disputed the turnover proceeding commenced by the trustee on the ground that it was immune from suit in the bankruptcy court under the Eleventh Amendment. The *Zywiczynski* court found that it could make a summary inquiry into whether property is property of the estate and subject to turnover consistent with the Eleventh Amendment and the fundamental policy of the Bankruptcy Code to “obtain[] and maintain[] control of the property of the estate.”

A close statutory analogy to this type of suit is a civil forfeiture action. An *in rem* suit against property is similar to a civil forfeiture *in rem* action for remedial civil sanctions. Under the civil forfeiture laws, federal and state statutes authorize

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2355 *Id.* at 26.


2358 *Id.* The certificate of deposit was held by the issuing bank and was not in the physical possession of the state. The trustee named the state agency in the turnover complaint, but the state refused to submit to the jurisdiction of the bankruptcy court under the Eleventh Amendment.

2359 *Id.*

2360 *Id.* at 925. Under section 1334(e), the district court, and by referral the bankruptcy court, has “exclusive jurisdiction of all of the property, wherever located, of the debtor as of the commencement of such case, and of property of the estate.” 28 U.S.C. § 1334(e) (1994).

2361 *Zywiczynski*, at n.16.

government agents to seize property, including fungible property, and the government entity initiates a civil forfeiture proceeding. A forfeiture judgment is a final adjudication of all rights of all claimants to the property and establishes the government’s unencumbered title to the property. The government’s title to the property ultimately relates back to the date of the original offense although relation back does not occur until the final adjudication proceeding. Many forfeiture statutes enable co-owners and lienholders to file claims in the forfeiture action. However, not all statutes authorizing forfeitures have such “innocent owner” defenses. In addition, there generally is no formal recognition of claims of unsecured creditors in judicial forfeiture proceedings.

An admiralty action is a close common law analogy to this type of in rem proceeding. The Supreme Court has held that actual title to property may not be affected in an in rem proceeding consistent with the Eleventh Amendment. Only possession of the property at issue but not the title to the property may be resolved by a federal court. In the bankruptcy context, an in rem proceeding to recover a critical piece of the debtor’s property from a state may be sufficient to enable a debtor to continue operations (to the benefit of all creditors) pending a state court determination of the title to the property.

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2363 See 18 U.S.C. § 984 (1995) (authorizing forfeiture of fungible property, such as cash or monetary instruments).


2365 See, e.g., Bennis v. Michigan, 116 S. Ct. 994 (1996) (upholding Michigan statute allowing car to be forfeited as abatable nuisance after man engaged services of prostitute in car, notwithstanding state’s failure to reimburse the man’s wife for her part ownership interest).


2367 Florida Dep’t of State v. Treasure Salvors, Inc., 458 U.S. 670 (1982). In Treasure Salvors, a private party sought a warrant against artifacts held by the State of Florida. The State was not named as a party to the action and the complaint sought only to recover possession of the artifacts. The Supreme Court affirmed the portion of the Fifth Circuit’s determination that returned possession of the artifacts to the private party but reversed the portion of the Fifth Circuit’s holding that determined the state’s ownership of the artifacts as violative of the Eleventh Amendment. Id. at 700.

2368 Id. at 699 (“The Eleventh Amendment thus did not bar the process issued by the District Court to secure possession of artifacts of the Atocha held by the named state officials. The proper resolution of this issue, however, does not require -- or permit -- a determination of the state’s ownership of the artifacts.”).

2369 The use of an in rem proceeding against property of the estate held by a state is consistent with the Supreme Court’s narrowing of the use of an Ex parte Young action essentially
6. Congress’ Power Under the Fourteenth Amendment

Seminole does not necessarily eliminate all avenues of congressional power to abrogate a state’s Eleventh Amendment immunity. The Seminole Court recognized a valid exercise of congressional abrogation of Eleventh Amendment immunity under Section 5 of the Fourteenth Amendment.\textsuperscript{2370} The Fourteenth Amendment provides that “... No state shall make or enforce any law which shall abridge the privileges and immunities of citizens of the United States; nor shall any State deprive any person of life, liberty, or property without due process of law; nor deny to any person within its jurisdiction the equal protection of the law.”\textsuperscript{2371} Section 5 empowers the federal government to enforce the Fourteenth Amendment’s provisions.\textsuperscript{2372}

In upholding congressional abrogation power, the Court relied on the fact that the Fourteenth Amendment “expand[ed] federal power at the expense of state autonomy, [and] fundamentally altered the balance of state and federal power struck by the Constitution.”\textsuperscript{2373} A few courts now have used the Seminole rationale to find that section 106 was enacted as a “valid exercise of power under the Fourteenth Amendment.”\textsuperscript{2374} One court held that

\[\text{[t]he Bankruptcy Code is intended to provide all American citizens with the following: the privilege of efficient liquidation or other use and ratable distribution of a debtor’s assets, or (to put it another way)}\]

to quiet title in a dispute with the state. It is important to note that the court in Idaho v. Cœur d’Alene Tribe of Idaho distinguished its holding in Treasure Salvors by stating “[w]e do not think Treasure Salvors is helpful to the Tribe because the state officials there were acting beyond the authority conferred upon them by the State.” 117 S. Ct. 2028, 2040 (1997). It is unclear whether the Supreme Court would find that Eleventh Amendment immunity is not applicable in an in rem proceeding.

\textsuperscript{2370} In so holding, the Seminole court upheld its opinion in Fitzpatrick v. Bitzer, 427 U.S. 445 (1976) (authorizing abrogation of a state’s Eleventh Amendment immunity under the Enforcement Clause of the Fourteenth Amendment). In Fitzpatrick, male state employees sued the state for title VII sex discrimination in federal court, and the state argued immunity under the Eleventh Amendment.

\textsuperscript{2371} U.S. CONST. amend. XIV, § 1.

\textsuperscript{2372} Id. at § 5 (“The Congress shall have the power to enforce, by appropriate legislation, the provisions of this article.”).

\textsuperscript{2373} Seminole, 116 S. Ct. at 1125.

with immunity from the inefficient liquidation or use and inequitable distribution of a debtor’s assets which may obtain under State laws; the privilege of discharge, or (to put it another way) with immunity from oppressive debt collection which may obtain under State laws; liberty from economic bondage, and protection against undue loss of value of property in exigent financial circumstances; and fair and efficient determination of all of the above, according to the process due in a national court of equitable jurisdiction, without regard to persons or to any special privileges save those considered by Congress to be justified as a matter of policy.\textsuperscript{2375}

The court in \textit{Straight} thus found that, despite \textit{Seminole}, section 106(a) was a valid exercise of congressional abrogation power under the Fourteenth Amendment.

The Supreme Court, however, has questioned nonremedial legislation under the Fourteenth Amendment.\textsuperscript{2376} \textit{In City of Boerne}, the Court held that the Religious Freedom Restoration Act of 1993 (“RFRA”) exceeded Congress’ power under Section 5 of the Fourteenth Amendment.\textsuperscript{2377} Specifically, the Court found that Congress has the power to enforce the constitutional right to the free exercise of religion but that its Section 5 power “to enforce” the Fourteenth Amendment is only preventative or remedial in nature.\textsuperscript{2378} The RFRA was not a remedial statute because it was not enacted in response to offensive state statutes.\textsuperscript{2379} Similarly, section 106 was not revised to remedy an inequity under state law, but rather in response to the Supreme Court’s ruling in \textit{Hoffman v. Conn. Dep’t of Income Maintenance}, which held that former section 106(c) was not a clear congressional abrogation of Eleventh Amendment state sovereign immunity.\textsuperscript{2380} Despite this legislative history, whether section 106 could still be considered a “remedial” provision is unclear. It may be argued that section 106 was enacted to preserve the property rights protected under the Bankruptcy Code and to avoid the results under state law. In this regard, section 106 may be a remedial measure for purposes of abrogating a state’s Eleventh Amendment sovereign immunity.

\textsuperscript{2375} \textit{In re Straight}, 209 B.R. at *13.

\textsuperscript{2376} \textit{City of Boerne} v. Flores, 117 S. Ct. 2157, 2167 (1997) (“Any suggestion that Congress has a substantive non-remedial power under the Fourteenth Amendment is not supported by our case law.”).

\textsuperscript{2377} \textit{Id.} at 2158.

\textsuperscript{2378} \textit{Id.} at 2158.

\textsuperscript{2379} \textit{Id.} at 2166.

\textsuperscript{2380} 492 U.S. 96 (1989) (holding that former section 106(c) was not a clear abrogation of state Eleventh Amendment sovereign immunity).
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Amendment sovereign immunity. Re-enactment of section 106(a) under Section 5 of the Fourteenth Amendment may, however, exceed the Section 5 bounds set by the Court in City of Boerne.\footnote{City of Boerne, 117 S. Ct. at 2169. (“If Congress could define its own powers by altering the Fourteenth Amendment’s meaning, no longer would the Constitution be ‘superior paramount law, unchangeable by ordinary means.’ It would be ‘on a level with ordinary legislative acts, and, like other acts, . . . alterable when the legislature shall please to alter it.’” (quoting Marbury v. Madison, 5 U.S. (1 Cranch) 137, 177 (1803)).}

7. Empowering the U.S. Trustee to Sue States in Bankruptcy Court

The Eleventh Amendment does not bar suits against states in federal court as long as those suits are commenced by the federal government rather than private parties.\footnote{West Virginia v. United States, 479 U.S. 305, 311-12 & n.4 (1987) (“States have no sovereign immunity as against the Federal Government.”); Employees v. Dep’t of Pub. Health and Welfare, 411 U.S. 279, 286 (1973) (“[N]othing in . . . any . . . provision of the Constitution prevents or has ever been seriously supposed to prevent a State’s being sued by the United States.”).} Under the Bankruptcy Code, the U.S. trustee has standing to raise, appear, and be heard on any issue in any case or proceeding in bankruptcy with certain limitations.\footnote{Authorization to sue states in bankruptcy court must be explicitly stated in order for the U.S. trustee to assume the mantle of the federal government under the Eleventh Amendment. See Department of Transp. and Dev. v. PNL Asset Management Co. (In re Fernandez), No. 96-31013, 1997 WL 570353, *4 (5th Cir. Sept. 15, 1997) (“...the FDIC, as an agency of the national government, does not enjoy the status accorded the national government for Eleventh Amendment purposes. It follows that there must be a clear expression of purpose to abrogate the Eleventh Amendment in the grant of agency status for the purpose of jurisdiction.”).} As a consequence, the U.S. trustee could be empowered to commence suits in the bankruptcy court against states to enforce compliance with the Bankruptcy Code.\footnote{Daniel Meltzer, The Seminole Decision and State Sovereign Immunity, 1996 SUP. CT. REVIEW 1, 56-57; JOSEPH F. RIGA, STATE IMMUNITY IN BANKRUPTCY AFTER SEMINOLE TRIBE OF FLORIDA V. FLORIDA 21 (1997) (unpublished manuscript) (citing Jonathan R. Siegel, The Hidden Source of Congress’s Power to Abrogate State Sovereign Immunity, 73 TEX. L. REV. 539 (1995)).} A few commentators have supported using similar measures to seek relief against a state in federal court.\footnote{Private trustees are automatically appointed to serve in cases commenced under chapters 7, 12 and 13. Trustees are appointed to serve less often in cases commenced under Chapter 11.} Specifically with regard to the U.S. Trustee Program, this alternative would be more expeditious if the U.S. trustee acted as the case trustee.\footnote{Private trustees are automatically appointed to serve in cases commenced under chapters 7, 12 and 13. Trustees are appointed to serve less often in cases commenced under Chapter 11.}

In Chapter 11 cases, where the debtor usually remains in
possession, the U.S. trustee may need specific authorization to commence a suit against a state.

C. Repercussions of *Seminole* on Other Bankruptcy Policy Decisions

The Bankruptcy Code strikes a delicate balance between the rights of creditors to collect debts and the rights of debtors to restructure or discharge those debts. By exempting states from the jurisdiction of the bankruptcy court, *Seminole* arguably places states and state agencies outside this delicate balance regardless of what role they play in the case. This exclusion is detrimental to both debtors and creditors. Bankruptcy works in large measure because it provides a single forum with a binding determination of all of the competing rights in the debtor’s property. Exempting even one party from this process invariably reduces its effectiveness for the remaining parties.

The state “is frequently both creditor and regulator, and its status as creditor often arises directly out of its position as a regulator. Its claims can run the gamut from taxes to compensatory and punitive damages for violations of environmental laws, to back wages collected as an agent for employees, to pecuniary losses suffered by the government in its own right.” Under *Seminole* and absent a state waiver of Eleventh Amendment immunity, these actions may have to be brought in state court. The possible alternatives discussed above are effective, to a greater or lesser degree, depending on the underlying circumstances.

Altering the power of any of the possible roles that states play in bankruptcy will magnify the results under *Seminole*. As a result, *Seminole* could have an exaggerated effect on any amendments to the Bankruptcy Code. Bankruptcy litigation against states in state court differs from normal state court litigation in one key aspect: in the majority of circumstances, the state court action will be an alternative forum for the action against the state; it will not be a duplicative forum. In a bankruptcy case, state court litigation against a state has a far greater impact than in a straight two-party dispute where it essentially acts as a choice of forum provision. The result in bankruptcy will be dual proceedings, moving at different speeds and possibly having conflicting results. The administrative costs associated with these additional proceedings will be borne by the creditors. A “uniform” system of bankruptcy may be unattainable if bankruptcy courts no longer provide a single forum for the resolution of claims by and against a bankruptcy estate.

In the context of bankruptcy legislation, the inability of a bankruptcy court to enforce a state’s compliance with the Bankruptcy Code increases the power already

As part of the Chemical Weapons Implementation Act, which passed the Senate on May 23, 1997, section 362(b) would be amended to read as follows:

(1) by striking paragraphs (4) and (5); and
(2) by inserting after paragraph (3) the following:

“(4) under paragraph (1), (2), (3), or (6) of subsection (a) of this section, of the commencement or continuation of an action or proceeding by a governmental unit or any organization exercising authority under the Convention on the Prohibition of the Development, Production, Stockpiling and Use of Chemical Weapons and on their Destruction, opened for signature on January 13, 1993, to enforce such governmental unit’s or organization’s police and regulatory power, including the enforcement of a judgment other than a money judgment, obtained in an action or proceeding by the governmental unit to enforce such governmental unit’s or organization’s police or regulatory power[.]”

As both a creditor and a regulator of debtors, states benefit from the collective, binding procedures under the Bankruptcy Code. Creditors bear the cost of administering the estate and, as discussed previously, duplicative litigation costs

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Chemical Weapons Implementation Act of 1997, S. 610 (May 23, 1997). This amendment is part of the chemical weapons legislation because:

The international body which oversees enforcement of the Chemical Weapons Convention is non-governmental and therefore is not covered under the exemption. This means that under current law a bankruptcy court could issue an injunction preventing any inspection for, or seizure of, chemical weapons. If this law had not been changed, the United States would come into noncompliance with the treaty.

Senator Charles Grassley, News Release (May 23, 1997). Given the proposed language in section 603 of this legislation, which repeals sections 362(b)(4) and (5) in their entirety, the effects of the amendment would appear not to be limited to actions in connection with the Chemical Weapons Convention but, rather, would extend to all governmental units and all types of actions. Electronic mail transmission from Stephen H. Case, Senior Adviser, to National Bankruptcy Review Commission (May 29, 1997). This legislation was referred to the House Judiciary Committee.
will be borne by creditors. Similarly, states (as both creditor and regulator) benefit from the fresh start to the extent that individual debtors become productive members of society after bankruptcy. An expeditious and binding bankruptcy process advances these policies under the Bankruptcy Code. As a result, it may be in the state’s best interest to waive some or all of its Eleventh Amendment sovereign immunity and participate in bankruptcy cases to achieve these beneficial goals. If the waiver decision is left up to the state’s litigation attorneys on a case-by-case basis, however, it is doubtful that they will give up an absolute defense to the federal suit.