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The New Expanded Bankruptcy Court Jurisdiction Versus a State License Revocation: A Modern Clash in Federalism

Kenneth A. Graham
Sacred Heart University

THE NEW EXPANDED BANKRUPTCY COURT JURISDICTION VERSUS A STATE LICENSE REVOCATION: A MODERN CLASH IN FEDERALISM

by Kenneth A. Graham°

I. INTRODUCTION

From the date of ratification of the Constitution of the United States, Congress has possessed the power "[t]o establish . . . uniform Laws on the subject of Bankruptcies throughout the United States . . . ."[1] A statute enacted by Congress pursuant to this power brings into operation the Supremacy Clause of the Constitution.[2]

A significant part of the Bankruptcy Reform Act of 1978[3] (Act) was the expansion of the jurisdiction of the Bankruptcy Court. The court was vested with "original and exclusive jurisdiction of all cases under title 11"[4] and "original but *not* exclusive jurisdiction of all civil proceedings *arising under* title 11 *or arising in or related to* cases under title 11." (hereinafter "related to" jurisdiction).[5] The legislative history is also quite broad with respect to "related to" jurisdiction.[6]

The significance of the apparently open-ended language of this jurisdictional grant cannot be overstated. When read together with the other sections of bankruptcy law, such as the automatic stay which is effective upon the filing of a debtor's petition,[7] a party's

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° Assistant Attorney General, State of Connecticut; Adjunct Instructor, Sacred Heart University; Member of Connecticut, U.S. District Court for the District of Connecticut, U.S. Court of Appeals for the Second Circuit, and U.S. Supreme Court Bars; B.A., University of Bridgeport, M.A., Northeastern University, J.D., Suffolk University.

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1. U.S. CONST. art. I, § 8.
2. U.S. CONST. art. VI.
3. Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, Title VI, Stat. 2549 (1978).
4. 28 U.S.C. § 1471(a) (1978).
5. 28 U.S.C. § 1471(b) (1978) (emphasis added).
6. *See, e.g.*, H.R. REP. No. 595, 95th Cong., 2d Sess. 45-46, *reprinted in* 1978 U.S. CODE CONG. & AD. NEWS 6005.
7. 11 U.S.C. § 362(a) (1978).

power to remove a civil action pending in another court to the Bankruptcy Court,[8] and the Bankruptcy Court's general injunctive power[9] in the event that one of the exceptions to the automatic stay is applicable,[10] the jurisdiction of the Bankruptcy Court is very broad.

This article addresses five limitations upon the apparently limitless "related to" jurisdiction:[11] statutory full faith and credit (28 U.S.C. § 1738); the doctrine of sovereign immunity (11 U.S.C. § 106); powers of the Bankruptcy Court (28 U.S.C. § 1481); the eleventh amendment; and the tenth amendment. The recent case of *In re Prospect Restorative Health Center, Inc.*[12] will serve as an illustrative basis for a factual analysis of each of the limitations.

In *Prospect*, the debtor operated a nursing home and was a provider participant in the Connecticut Medicaid Program.[13] The Connecticut Department of Health Services had revoked a license required for the nursing home to continue in business.[14] The license

8. 28 U.S.C. § 1478(a) (1978). Although the Bankruptcy Court "may remand such removed claim or cause of action on any equitable ground," the Bankruptcy Court's decision to remand or not to remand cannot be appealed. 28 U.S.C. § 1478(b) (1978).

9. 11 U.S.C. § 105(a) (1978).

10. 11 U.S.C. § 362(b) (1978).

11. Notwithstanding the recent United States Supreme Court decision of Northern Pipeline Constr. Co. v. Marathon Pipeline Co., 102 S. Ct. 2858 (1982), holding the "related to" jurisdiction unconstitutional (the plurality perceiving an impermissible vesting of Article III judicial power in an Article I court), the statutory and constitutional issues to be discussed in this article will, in all probability, remain, after Congress cures the unconstitutionality of 28 U.S.C. § 1471 found in *Marathon Pipeline*. Three of the possible alternatives which Congress may choose to resolve the issue are: 1) making all bankruptcy judges Article III judges; 2) routing all "ancillary common law actions" to the district courts; or 3) allowing Bankruptcy Courts to act as federal magistrates with regard to ancillary common law actions involving the debtor. Hebron, *Bankruptcy Courts in a Nowhere Land*, Conn. L. Trib., Jan. 10, 1983, at 3, col. 1.

12. Case No. 205-5-82-00410, Adv. Nos. 205-5-82-0178, 205-5-82-0190, 205-5-82-0193 and 205-5-82-0226 (Bankr. D. Conn. 1982).

13. *See* Social Security Act, Title XIX, 42 U.S.C. §§ 1396a-i (1973) ("Grants to States for Medical Assistance Programs"); CONN. GEN. STAT. §§ 17-134a-l (1981). *See also* CONN. GEN. STAT. §§ 17-311, 314 (1981); CONN. AGENCIES REGS. §§ 17-311-50-126 (effective 1976). The Connecticut Department of Income Maintenance is the single state agency charged with the administration of the Connecticut Medicaid Program.

14. *In re* Prospect Restorative Health Center, Inc. (Conn. Dept. of Health Services, July 6, 1981). A nursing home provider in the Connecticut Medicaid Program must be licensed by the Connecticut Department of Health Services pursuant to CONN. GEN. STAT. § 19-578 (1977). This department is the state survey agency charged with compliance certification of providers with the federal and state requirements for participation in the Connecticut Medicaid Program. Upon such certification, a provider becomes eligible to execute a provider agreement with the Connecticut Department of Income Maintenance.

revocation was then affirmed by the Connecticut Superior Court.[15] The nursing home filed a petition for certification to appeal to the Connecticut Supreme Court in an attempt to stay the superior court affirmance.[16] On the theory that the appeal of the license revocation constituted "property of the estate,"[17] the nursing home then filed a Chapter 11 petition in Bankruptcy Court and named the Connecticut Departments of Health Services and Income Maintenance as defendants in adversary proceedings in an attempt to induce the Bankruptcy Court to either relitigate the license revocation or to take evidence on alleged "recent improvements." These improvements were allegedly sufficient to comply with statutory licensure requirements in an attempt to induce the Bankruptcy Court to order the State of Connecticut to relicense the debtor and to continue full Medicaid payments for which licensure was required. Subsequent to the briefing of the jurisdictional and abstention issues, all adversary proceedings against the State were withdrawn with prejudice as part of a settlement agreement. Under the settlement agreement a receiver was appointed and a deadline date for closing the nursing home, in the absence of a sale, was set.

II. STATUTORY "FULL FAITH AND CREDIT"[18]

A. *Full Faith and Credit to the Superior Court Decision*

28 U.S.C. § 1738[19] mandates that federal courts give full faith and credit to state court judgments whenever the courts of the state

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15. Prospect Restorative Health Center, Inc. v. Lloyd, Conn. Super. Ct., Judicial District of Hartford/New Britain at Hartford, Docket No. 81-0262354 (March 30, 1982). The license revocation appeal was pursuant to the Connecticut Uniform Administrative Procedure Act, CONN. GEN. STAT. §§ 4-166-188 (1981), specifically, § 4-183.

16. *See* Connecticut Practice Book § 3138 (1982) entitled "Rules of the Supreme Court," which provides for a stay of judgment pending the determination of the petition for certification of appeal. *But see* 1981 Conn. Acts 416 (Reg. Sess.), which requires that such an appeal be filed instead in the appellate session of the superior court.

17. *See* 11 U.S.C. § 541 (1978).

18. This is a threshold jurisdictional issue. *See In re* The Community Hosp. of Rockland County, 15 Bankr. 785, 789 (Bankr. S.D.N.Y. 1981) (11 U.S.C. § 106 sovereign immunity issue reached only after determination that res judicata no bar).

19. The records and judicial proceedings of any court of any such state . . . shall be proved or admitted in other courts within the United States and . . . shall have the same full faith and credit in every court within the United States . . . as they have by law or usage in the court of such state . . . from which they are taken.

28 U.S.C. § 1738 (1948).

from which the judgments emerge would do so.[20] Indeed, the United States Supreme Court has recognized that statutory full faith and credit, besides being a requirement of federal law, also serves to "[p]romote the comity that has been recognized as a bulwark of the federal system. . . ."[21]

A federal court presented with a state court judgment is required to give the same preclusive effect to that judgment as the judgment has in the state in which it was rendered. Ordinarily, this would require the federal court to apply the local law of res judicata[22] and collateral estoppel.[23]

Like other federal courts, Bankruptcy Courts are subject to this statute and have accorded state court judgments res judicata and collateral estoppel effect even with respect to state court determinations of debt dischargeability.[24] Of course, there are exceptional situations not relevant to the *Prospect* fact pattern.[25]

Applying 28 U.S.C. § 1738 to the facts outlined above, a Connecticut superior court final judgment affirming a license revocation by the State of Connecticut would clearly appear to preclude jurisdiction of any federal court with respect to the license revocation. In countering this presumption, a debtor might contend that his pending petition for certification to appeal to the Connecticut Supreme Court

20. "Congress has specifically required all federal courts to give preclusive effect to state court judgments whenever the courts of the state from which the judgments emerge would do so." Allen v. McCurry, 449 U.S. 90, 96 (1980) (citing 28 U.S.C. § 1738 (1948)).

21. *Allen*, 449 U.S. at 95-96.

22. That statute impose[s] on federal courts the obligation to give full faith and credit to judgments entered by state courts of competent jurisdiction. The federal court presented with a state court judgment is required to give that judgment the same force and effect as it has in the state in which it was rendered. Ordinarily, this would require an analysis of the res judicata effect of the state court proceedings within that state, involving examination of the local law of res judicata.

Winters v. Lavine, 574 F.2d 46, 54 (2d Cir. 1978).

23. "[Section] 1738 requires the federal court to apply, where appropriate, the state court's standards of collateral estoppel as well as its standards of res judicata." *Id.*

24. *See* Kuminski v. Peterman (*In re* Peterman), 5 Bankr. 687 (Bankr. E.D. Pa. 1980); Pares v. Pares, 428 F. Supp. 1005 (E.D. Wis. 1977).

25. *See* Williams v. Gurley (*In re* Williams), 3 Bankr. 401 (Bankr. N.D. Ga. 1980) (no res judicata effect to state court determination of debt dischargeability). But note that the *Peterman* court observed that the *Williams* court confused exclusive versus concurrent jurisdiction. *Peterman*, 5 Bankr. at 691. *See also* Cumis Ins. Soc'y v. Sneed (*In re* Sneed), 13 Bankr. 151 (Bankr. S.D. Ohio 1981) (no res judicata or collateral estoppel effect where the state court judgment did not make an express finding of fraud, but the Bankruptcy Court did admit the state court record into evidence and made its own finding of fraud and nondischargeability without any trial *de novo*). Murray v. Day (*In re* Day), 4 Bankr. 750 (Bankr. S.D. Ohio 1980) (no collateral estoppel effect to default judgment).

stays the execution of the superior court judgment during the state supreme court's consideration of the petition.[26] Therefore, the debtor would assert that there is not yet a superior court final judgment. Further, the debtor would argue that as a bankrupt, he could file under Chapter 11 in Bankruptcy Court with his limited remaining appeal rights being "property of the estate"; and, finally, that once within Bankruptcy Court jurisdiction, the equitable powers of the Bankruptcy Court may be used to expand those limited remaining appeal rights to benefit the debtor and his creditors at the expense of the state.

Such an argument is without merit. 28 U.S.C. § 1738 requires the Bankruptcy Court to look to Connecticut law to determine the res judicata effect of the superior court judgment during the pendency of the petition for certification to the state supreme court. It is clear under Connecticut law that a final judgment continues in effect, even when execution thereof is suspended by the pendency of an appeal, unless or until it is set aside on appeal.[27]

B. *Full Faith and Credit to the Administrative License Revocation Decision*

In the absence of a superior court final judgment affirming the license revocation, the state final administrative decision of license revocation itself would be entitled to res judicata effect and statutory full faith and credit. 28 U.S.C. § 1738 requires the federal courts to apply the state's standards of res judicata and collateral estoppel.

In *Corey v. Avco-Lycoming Division, Avco Corporation*,[28] the Connecticut Supreme Court, after defining res judicata and collateral

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26. *See* Connecticut Practice Book § 3138 (1982), entitled "Rules of the Supreme Court."

27. The Connecticut Supreme Court has stated: "The judgment . . . continued in force so long as it was not *set aside* on appeal, writ of error or other proper proceeding. *The fact that the judgment was appealed from makes no difference.* . . ." Salem Park, Inc. v. Salem, 149 Conn. 141, 144, 176 A.2d 571, 573 (1961) (emphasis added).

The Connecticut Supreme Court has also stated the following for the purpose of determining the res judicata effect of a judgment: "In Connecticut, this court has held the judgment of a trial court to be final, despite a pending appeal. . . ." Enfield Fed. Sav. and Loan Ass'n v. Bissell, 42 C.L.J. 8, 10 (July 7, 1981). *See also* Nicoli v. Frouge Corp., 34 Conn. Supp. 74, 376 A.2d 1122 (1977) in which a Connecticut Superior Court observed: "The defendant has secured a judgment . . . and, *while it is true that the judgment is currently under appeal, it continues in effect*, with execution thereof suspended, until such time as it may be set aside on appeal. The court cannot speculate that that will be the case." *Id.* at 77, 376 A.2d at 1124 (emphasis added).

28. 163 Conn. 309, 307 A.2d 155 (1972).

estoppel,[29] declared:

> [T]here is a wealth of reason and authority for the application of that doctrine, or a similar doctrine, to the determinations of an administrative agency in a proper case, generally where the determinations are made for a purpose similar to those of a court and in proceedings similar to judicial proceedings. In any event, the doctrine of res judicata may apply to a judgment rendered by a court on review of a decision made by an administrative body. . . .
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> The more recent cases also indicate that a decision of an administrative board, acting in a duly authorized judicial capacity, is a prior decision within the rule of res judicata . . . .[30]

It cannot be disputed that the administrative action of license revocation in *Prospect* was a proceeding of an administrative agency "similar to judicial proceedings," and resulted in an administrative final decision of an agency "acting in a duly authorized judicial capacity."

The administrative action under discussion was a "contested case" as defined by the Connecticut General Statutes (C.G.S.) § 4-166(2). This action was initiated by a notice in accordance with C.G.S. § 4-177. The proceeding involved a formal administrative hearing held in accordance with section 4-178 in which there is full opportunity for all parties to offer evidence and to cross-examine adverse witnesses. Finally, the action concluded with a written final decision in accordance with C.G.S. § 4-180, including findings of fact, and conclusions of law and orders, separately stated.

Clearly, when an administrative agency takes formal administrative action resulting in a license revocation, the agency is acting in its adjudicative, as opposed to rule-making,[31] function, and the above-cited sections of the Connecticut Uniform Administrative Procedure Act render the administrative proceeding "similar to judicial proceedings." The result is an administrative final decision of an agency "acting in a duly authorized judicial capacity."

Under Connecticut law, such an administrative final decision of license revocation would appear to be entitled to res judicata effect,

29. *Id.* at 317, 307 A.2d at 160.

30. *Id.* at 318, 307 A.2d at 160. *See generally* ACMAT Corp. v. Int'l Union of Operating Eng'rs, 442 F. Supp. 772, 783 (D. Conn. 1977); Fedorich v. Zoning Board of Appeals, 178 Conn. 610, 424 A.2d 289 (1979); Conn. Inst. for Blind v. Comm'n on Human Rights & Opportunities, 176 Conn. 88, 96, 405 A.2d 618, 625 (1978); Local 1219 v. Conn. Labor Relations Bd., 171 Conn. 342, 355, 370 A.2d 952, 964 (1976).

31. The rule-making sections of the Connecticut Uniform Administrative Procedure Act are CONN. GEN. STAT. §§ 4-168-174 (1981).

and 28 U.S.C. § 1738 would preclude the Bankruptcy Court from asserting jurisdiction over the license revocation. The Connecticut rule on the applicability of the doctrine of res judicata to administrative final decisions is virtually identical to the federal rule on this point.[32]

C. *Administrative Res Judicata as an Extension of the Exhaustion of Administrative Remedies Doctrine.*

Unlike the majority of this article, which has general applicability to the situation of a debtor who files under Chapter 11 in Bankruptcy Court in an effort to evade implementation of a state license revocation, this subsection deals with the narrow situation in which the debtor, also being a provider participant in the Connecticut Medicaid Program, seeks to induce the Bankruptcy Court to adjudicate a dispute over Medicaid payments from the State of Connecticut to the debtor.

In *In re Clawson Medical Rehabilitation and Pain Care Center, P.C.*,[33] there existed a Medicare reimbursement dispute between the debtor and the fiscal intermediary for the federal government. The Bankruptcy Court held that the "related to" jurisdiction of 28 U.S.C. § 1471, permitted the Bankruptcy Court to pass final judgment on the debtor's claims notwithstanding the debtor's failure to exhaust the established administrative remedy. The district court, on appeal, reversed the Bankruptcy Court, holding on the issue of 28 U.S.C. § 1471 jurisdiction:

> The bankruptcy court does not have any greater jurisdiction to invade and ignore the congressionally established procedures to challenge the decisions of the Secretary than does the district court. *Congress' broad grant of jurisdiction was not intended to confer upon the bankruptcy court unlimited boundaries upon its jurisdiction to be constrained only by the self-imposed and nonreviewable restraint of abstention*, as the bankruptcy court's opinion would suggest. *No tortured construction of § 1471 shall be permitted to catapult the bankruptcy court's jurisdiction to review administra-*

32. *See generally* United States v. Utah Constr. & Mining Corp., 384 U.S. 394 (1966); Mosher Steel Co. v. NLRB, 568 F.2d 436 (5th Cir. 1978); Gulf Oil Corp. v. F.P.C., 563 F.2d 588 (3d Cir. 1977), *cert. denied*, 435 U.S. 981 (1978); Safir v. Gibson, 432 F.2d 137 (2d Cir.), *cert. denied*, 400 U.S. 850, *cert. denied*, 400 U.S. 942 (1970); Painters Dist. Council v. Edgewood Contracting Co., 416 F.2d 1082 (5th Cir. 1969).

33. Andrews v. Blue Cross and Blue Shield of Michigan (*In re* Clawson Medical Rehabilitation and Pain Care Center, P.C.), 9 Bankr. 644 (Bankr. E.D. Mich.), *rev'd*, 12 Bankr. 647 (E.D. Mich. 1981).

> *tive action beyond that granted by Congress to the district court.* . . . This court simply holds that the breadth of the bankruptcy court's grant of jurisdiction does not include the power to shortcut the congressionally established procedures and to interject itself into a dispute before an applicable administrative process has been exhausted. . . .[34]

It is clear that the Bankruptcy Court's "related to" jurisdiction does not extend to Medicare (a Title XVIII Program under the Social Security Act)[35] reimbursement disputes where administrative remedies have not been exhausted.

Where a debtor, who is a provider participant in the Connecticut Medicaid Program (a Title XIX Program under the Social Security Act), has had his license to render service to patients revoked by the Department of Health Services and, as a result, has had his Medicaid payments reduced after formal administrative action within the Department of Income Maintenance, attempts to relitigate these matters in a Chapter 11 case in Bankruptcy Court, *Clawson* appears to be a jurisdictional bar. If *Clawson* expressly precludes "related to" jurisdiction over a Social Security Act reimbursement dispute where the provider has not yet exhausted administrative remedies, there can be no "related to" jurisdiction where the provider has pursued all of its rights on the administrative level in a formal administrative action and has lost on the merits.[36]

III. 11 U.S.C. § 106 AND THE DOCTRINE OF SOVEREIGN IMMUNITY

While 28 U.S.C. § 1471 and its legislative history[37] clearly indicate an expansion of Bankruptcy Court jurisdiction, this jurisdiction is not limitless. Under certain circumstances, the sovereign immunity enjoyed by the State of Connecticut is such a jurisdictional limitation. As recently as May 11, 1982, the Connecticut Supreme Court reiterated: "The doctrine of sovereign immunity, which establishes that the state cannot be sued without its consent, is well recognized in Connecticut. . . . The protection afforded by this doctrine has been extended to agents of the state acting in its behalf."[38]

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34. *Clawson*, 12 Bankr. at 652-53 (emphasis added).

35. Social Security Act, Title XVIII, 42 U.S.C. § 1395 (1965).

36. *See In re* Berger, 16 Bankr. 236 (Bankr. S.D. Fla. 1981) (Chapter 13 debtor's motion for contempt citation against U.S. Department of Health and Human Services denied due to lack of jurisdiction for Bankruptcy Court to question the Secretary's final administrative determination of Medicare overpayments).

37. *See supra* note 6.

38. Cahill v. Bd. of Educ. of Stamford, 187 Conn. 94, 101, 444 A.2d 907, 912 (1982).

A. *Statutory Construction of 11 U.S.C. § 106*

11 U.S.C. § 106(a) provides: "A governmental unit is deemed to have waived sovereign immunity with respect to any claim against such governmental unit that is the property of the estate and that arose out of the same transaction or occurrence out of which such governmental unit's claim arose."

In *Prospect*, the Connecticut state agencies filed no claim against the debtor's estate in Bankruptcy Court, nor were the plaintiffs in any other forum pursuing any claim against the debtor's estate. Therefore, there clearly was no waiver of Connecticut's sovereign immunity pursuant to 11 U.S.C. § 106(a).

11 U.S.C. § 106(b) provides: "There shall be offset against an allowed claim or interest of a governmental unit any claim against such governmental unit that is property of the estate."

There clearly was no waiver of Connecticut's sovereign immunity pursuant to 11 U.S.C. § 106(b) as Connecticut filed no claim against the estate. Together, subsections (a) and (b) of 11 U.S.C. § 106 address waiver of sovereign immunity where a governmental unit has a pending claim against a debtor's estate. By implication, where there is no such pending claim, sovereign immunity continues as a jurisdictional limitation.

It would be contrary to the canons of statutory construction to interpret 28 U.S.C. § 1471 as a repeal by implication of 11 U.S.C. § 106. Rather, the two sections of bankruptcy law should be construed in a manner consistent and harmonious with each other.[39] In 1978, Congress could have amended 11 U.S.C. § 106 to preclude the assertion of sovereign immunity absolutely (assuming that such an amendment would have passed constitutional muster), but failed to do so.

11 U.S.C. § 106(c) provides: "Except as provided in subsections (a) and (b) of this section and notwithstanding any assertion of sovereign immunity . . .

(1) a provision of this title that contains 'creditor,' 'entity,' or 'governmental unit' applies to governmental units; and

(2) a determination by the court of an issue arising under such a provision binds governmental units."

While 11 U.S.C. § 106(c) admittedly operates as a limitation

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39. Weinberger v. Hynson, Westcott & Dunning, Inc., 412 U.S. 609 (1973); Canton v. Todman, 259 F. Supp. 22, 25 (D.V.I.), *aff'd*, 367 F.2d 1005, *aff'd sub nom.* Williams v. Todman, 367 F.2d 1009 (3d Cir. 1966).

upon the assertion of sovereign immunity,[40] it cannot be construed as an absolute prohibition of the doctrine, for such an interpretation of 11 U.S.C. § 106(c) would render 11 U.S.C. § 106(a) and (b) meaningless. Once again, it is a canon of statutory construction that two sections of the same statute should be construed in a manner consistent and harmonious with each other and not in a manner which renders one or more of the sections meaningless and a nullity.[41] If Congress had intended 11 U.S.C. § 106(c) to absolutely bar the jurisdictional defense of sovereign immunity, it would have amended that subsection.[42]

B. *Legislative History of 11 U.S.C. § 106*

The legislative history of 11 U.S.C. § 106[43] recognizes that, absent use of the supremacy clause to prevent or prohibit state action that is contrary to fundamental bankruptcy policy, Congress lacks the

40. 11 U.S.C. § 106(c) (1978) was intended to, at a minimum, codify two cases in which the Internal Revenue Service refused to file tax claims against debtors in bankruptcy courts. Gwillian v. United States, 519 F.2d 407 (9th Cir. 1975) and Dolard v. District Director of Internal Revenue, 519 F.2d 282 (9th Cir. 1975). It is Collier's opinion that 11 U.S.C. § 106(c) goes even further than this. COLLIER, BANKRUPTCY MANUAL, § 106.04 (3d ed. 1979). But how far does 11 U.S.C. § 106(c) go in the erosion of the sovereign immunity jurisdictional defense? As will be demonstrated later in this article, research has indicated only the existence of cases utilizing 11 U.S.C. § 106(c) to refuse to honor sovereign immunity which have fact patterns readily distinguishable from *Prospect*.

41. *See supra* note 39.

42. Also note that another canon of statutory construction requires that statutes purporting to waive a government's sovereign immunity should be strictly construed. See Honda v. Clark, 386 U.S. 484, 501 (1967) (Supreme Court stated that "in many cases the Court has read procedural rules embodied in statutes waiving immunity strictly, with an eye to effectuating a restrictive legislative purpose when Congress relinquishes sovereign immunity").

43. The legislative history of 11 U.S.C. § 106 indicates:

> Section 106 provides for a limited waiver of sovereign immunity in bankruptcy cases. Though Congress has the power to waive sovereign immunity for the Federal Government completely in bankruptcy cases, the policy followed here is designed to achieve approximately the same result that would prevail outside of bankruptcy. *Congress does not, however, have the power to waive sovereign immunity completely with respect to claims of a bankrupt estate against a State*, though it may exercise its bankruptcy power through the supremacy clause to prevent or prohibit State action that is contrary to bankruptcy policy.
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> There is, however, a limited change from the result that would previal [sic] in the absence of bankruptcy; *the change is twofold* and is within Congress' power vis-a-vis both the Federal Government and the State. *First, the filing of a proof of claim against the estate by a governmental unit is a waiver by that governmental unit of sovereign immunity with respect to compulsory counterclaims. . . .* The governmental unit cannot receive a distribution from the estate without subjecting itself to any liability it has to the estate within the confines of a compulsory counterclaim rule. Any other result could be one-sided.

power to waive sovereign immunity with respect to the claims of a bankrupt estate against a state.[44]

In *Prospect* where the state agency had filed no claim, no objection to discharge, no request for affirmative relief from the Bankruptcy Court, and was not the plaintiff in any other forum pursuing a claim against the debtor's estate, Congress has recognized that it lacks the power to invoke the supremacy clause to preclude the assertion of a state's sovereign immunity.[45] Clearly, where article I, section 8 of the Constitution is not applicable, the supremacy clause cannot be invoked with respect to the Bankruptcy Code.[46]

C. *Case Law Concerning 11 U.S.C. § 106*

The *Prospect* fact pattern is similar to other cases in which the governmental unit did not file a claim, objection to discharge, or seek any affirmative relief from the Bankruptcy Court. *Prospect* is also similar in that the governmental unit was not a plaintiff in any other forum pursuing a claim against the debtor's estate so as to waive sovereign immunity pursuant to 11 U.S.C. § 106.

Second, the estate may offset against the allowed claim of a governmental unit, up to the amount of the governmental unit's claim . . . . No affirmative recovery is permitted. Subsection (a) governs affirmative recovery.

Though this section creates a partial waiver of immunity when the governmental unit files a proof of claim, it does not waive immunity if the debtor or trustee, and not the governmental unit, files proof of a governmental unit's claim under proposed 11 U.S.C. § 501(c).

BANKRUPTCY REFORM ACT OF 1978, JUDICIARY COMMITTEE, S. REP. No. 989, 95th Cong., 2d Sess. 29-30, *reprinted in* 1978 U.S. CODE CONG. & AD. NEWS, 5787, 5815-16 (emphasis added); H. REP. No. 595, 95th Cong. 2d Sess. 317, *reprinted in* 1978 U.S. CODE CONG. & AD. NEWS, 5963, 6274 (emphasis added).

44. *Id.*

45. A third canon of statutory construction provides that where a statute can be construed two ways—one which would render the law constitutional and the other which would render the law unconstitutional—the constitutional interpretation must be chosen. *See* Anderson v. Edwards, 505 F. Supp. 1043, 1048 (S.D. Ala. 1981).

46. While unconnected with the legislative history of 11 U.S.C. § 106, the legislative history of 11 U.S.C. § 362 (the automatic stay section) states in pertinent part:

> With respect to stays issued under other powers, or the application of the automatic stay, *to governmental actions*, this section and the other sections mentioned are intended to be an express waiver of sovereign immunity of the Federal government, and an assertion of the bankruptcy power over State governments under the Supremacy Clause notwithstanding a State's sovereign immunity.

H. R. REP. No. 595, *supra* note 43, at 342, *reprinted in* 1978 U.S. CODE CONG. & AD. NEWS at 6299 (emphasis added). The response to this excerpt is the condition precedent of governmental action, which is clearly not the situation when a state agency as in *Prospect* has filed no claim, no objection to discharge, no request for affirmative relief from the Bankruptcy Court, and is not the plaintiff in any other forum pursuing a claim against the debtor's estate.

In *In Re Neavear*,[47] the Chapter 7 debtor filed a complaint against the Secretary of Health and Human Services alleging that the Secretary's right to recoup disability overpayments was dischargeable in bankruptcy. The Bankruptcy Court found a lack of jurisdiction because the United States had not filed a proof of claim in the bankruptcy proceeding,[48] and that sovereign immunity had not been waived pursuant to 11 U.S.C. § 106.

In *In re The Community Hospital of Rockland County*,[49] the Chapter 11 debtor filed a complaint in an adversary proceeding based on an 11 U.S.C. § 724 claim against the Internal Revenue Service to obtain a release of funds that were seized under the government's pre-petition levies. After observing that the 11 U.S.C. § 724 claim was available in a Chapter 7, and not a Chapter 11 case, the Bankruptcy Court again found the absence of any 11 U.S.C. § 106 waiver of the government's sovereign immunity because the government had not filed any claim in the bankruptcy case.[50] An appeal was taken to the district court,[51] which in response to the debtor's claim that the Bankruptcy Code strips the government of sovereign immunity, held that the government must have taken the affirmative step

47. Neavear v. Schweiker (*In re* Neavear), 16 Bankr. 528 (Bankr. C.D. Ill. 1981).

48. This Court lacks jurisdiction because defendant has not waived its sovereign immunity.

This debtor cannot sue the Secretary because there has been no waiver of sovereign immunity, even given 11 U.S.C. § 106, because the United States has not filed a proof of claim in the matter. The legislative history of section 106 makes it clear that there is a waiver of sovereign immunity only where the United States has filed a claim in bankruptcy. Since the United States has not filed a claim, it has not waived sovereign immunity.

A waiver of sovereign immunity cannot be implied but must be unequivocally expressed. Unless Congress specifically provides for statutory consent, a Court is without jurisdiction to enter orders against the sovereign.

Id. at 530-31.

49. 5 Bankr. 7 (Bankr. S.D.N.Y. 1979).

50. Reference must be had to Code § 106 in ascertaining the extension of the Government's waiver of sovereign immunity. This section provides for a limited waiver of sovereign immunity in bankruptcy cases. [Citation omitted]. Code § 106(a) is inapplicable since it is conceded that the issue before the court does not involve a compulsory counterclaim to any governmental claim. Therefore, consideration must be given to Code § 106(b) . . . . This subsection has the effect of waiving the Government's sovereign immunity for the purpose of the setoff of claims. *Since the Government has not filed any claim in this case, it may properly assert that it has not waived its sovereign immunity.*

Id. at 10-11 (emphasis added).

51. The Community Hosp. of Rockland County v. United States, 5 Bankr. 11 (S.D.N.Y. 1980).

of filing a claim in order to waive its sovereign immunity.[52]

In *In Re Ramos*,[53] the trustee and debtor sought turnover of funds being held by the Illinois Department of Public Aid as a set-off against funds allegedly owed to it by the debtor. In response to Illinois' eleventh amendment defense, the plaintiffs claimed that 11 U.S.C. § 106 barred an assertion of sovereign immunity and subjected Illinois to their claim. The Bankruptcy Court held that 11 U.S.C. § 106 describes circumstances where sovereign immunity will be deemed to have been waived but "[i]t does not operate as a waiver, however, of Illinois' sovereign immunity absent action by Illinois. . . ."[54]

In *In re Trina Dee, Inc.*,[55] the Bankruptcy Court declined to dismiss an adversary proceeding against a township charged with civil rights violations due to certain zoning conduct. The court held that the township's governmental immunity had been abolished by Pennsylvania in 1973.[56] By implication, a state which continues to enjoy the protection of sovereign immunity may assert the doctrine as a jurisdictional limitation upon the Bankruptcy Court.

In *In re Regal Construction Co., Inc.*,[57] the debtor-in-possession filed a complaint for breach of contract against the State of Maryland and two of its agencies. The Bankruptcy Court declared:

> Merely because Plaintiff in the instant case brought suit in this court under the Bankruptcy Code, a federal statute enacted pursu-

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52. The legislative history to this section [Section 106] makes clear that in order to waive sovereign immunity, *it is not enough that the Government have a claim against the Debtor; the Government must have taken the affirmative step of filing that claim in the underlying proceeding. Since the Government has not filed a claim in that subject proceeding, it has not waived its sovereign immunity.*

Id. at 12 (emphasis added).

53. Cohen v. Ill. Dept. of Public Aid (*In re* Ramos), 12 Bankr. 250 (Bankr. N.D. Ill. 1981).

54. *Id.* at 251.

55. Trina Dee, Inc. v. Township of Plainfield (*In re* Trina Dee), 18 Bankr. 330 (Bankr. E.D. Pa. 1982).

56. The Township of Plainfield, as a quasi-corporation, would be entitled to governmental immunity, as opposed to sovereign immunity. Sovereign immunity is only available to a state and its instrumentalities. Governmental immunity applies to political subdivisions created by the state legislature. This type of immunity was abolished in Pennsylvania . . . [in 1973].

Id. at 333.

57. Regal Constr. Co., Inc. v. Marlyand (*In re* Regal Constr. Co.), 18 Bankr. 353 (Bankr. D. Md. 1982).

> ant to Article I, § 8 of the Constitution, does not mean that the sovereign immunity of the State of Maryland is waived.
>
> The question, then, is whether Maryland has taken any action that constitutes waiver of immunity or whether Congress has expressly abnegated that immunity insofar as it has the power to do so.
>
> The State of Maryland took no affirmative action that waived its immunity. . . . *If, as Plaintiff contends, 11 U.S.C. § 106(c) constitutes a general waiver of immunity, it would render § 106(a) and § 106(b)*, which refer to cases in which the states file claims, *meaningless. This court will not interpret the section in a way that would render part of it redundant or meaningless.*[58]

The *Regal Construction* court sustained Maryland's eleventh amendment defense, but found that overall sovereign immunity had been waived by a state statute[59] specifically waiving immunity for contracts entered into by the State of Maryland after July 1, 1976.[60] The *Regal Construction* court's 11 U.S.C. § 106 analysis and holding appear to apply to general sovereign immunity as well, where a state has not so specifically waived its sovereign immunity by state statute. Connecticut has no such statute.

Bankruptcy case law, applying 11 U.S.C. § 106(c) to declare sovereign immunity unavailable, appears to be readily distinguishable from the *Prospect* fact pattern. There is a line of cases finding a waiver of sovereign immunity where states filed an objection to discharge, a proof of claim, or sought other affirmative relief from the Bankruptcy Court.[61] By implication, where a state does none of the above, the state sovereign immunity continues.

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58. *Id.* at 356-57 (emphasis added).

59. MD. ANN. CODE art. 21, § 7-101 (1981).

60. *Regal Constr.*, 18 Bankr. at 356.

61. In State of Connecticut v. Glidden, 653 F.2d 85 (2d Cir. 1981), the State of Connecticut challenged the constitutionality of a section of the bankruptcy statute which rendered dischargeable a child support obligation, the rights of which were assigned to the State. When the debtor filed his petition in Bankruptcy Court, Connecticut filed an objection to the discharge of this debt. In rejecting Connecticut's eleventh amendment claim that a bankruptcy discharge would give the debtor an "indirect" suit against the state, the court cited Connecticut v. Crisp, 521 F.2d 172, 178 (2d Cir. 1975).

In *Crisp*, the debtor filed a voluntary petition for bankruptcy listing the Connecticut Department of Finance and Control as an unsecured creditor, the claim arising out of Crisp's hospitalization at Norwich State Hospital. In the bankruptcy case, the Commissioner filed a proof of claim and objected to the discharge of the scheduled debt. *Id.* at 174. In response to Connecticut's sovereign immunity claim, the *Crisp* court held: "Connecticut waived any immunity it arguably might have by filing its proof of claim. Connecticut was not obliged to follow this course, but invoked the jurisdiction of the bankruptcy court in an

Moreover, *Prospect* is readily distinguishable from Chapter 14 cases concerning Social Security benefits received directly by the debtor.[62] These cases cite legislative history as to Congress' intent that such benefits be treated in the same manner as wages from an employer, and further cite the fundamental bankruptcy policy interest in including such directly received Social Security benefits in the overall Chapter 13 reorganizational plan. This rationale appears sufficient to invoke 11 U.S.C. § 106(c) on this set of facts, but the broad language in some of these cases, implying that 11 U.S.C. § 106(c) constitutes an express waiver of sovereign immunity, in general, is dicta and incorrect. The better reasoned cases limit themselves to Chapter 13 situations. It must be noted, however, that none of these cases involve state governments.

Other distinguishable fact patterns include: Section 547 preferential transfer situations involving tax levies by the Internal Revenue Service;[63] cases involving governmental conduct which took place *after* the debtor filed in bankruptcy;[64] a complaint to determine the dischargeability of an overpayment owed to the federal Social Security Administration for past benefits received directly by the debtor;[65] the debtor's residual property interest in accounts receivable levied upon by the Internal Revenue Service on the day before and the very day that the debtor filed under Chapter 11;[66] or where a creditor, and

attempt to benefit itself. By doing so, Connecticut waived any possible sovereign immunity." *Id.* at 178.

In *In re* State of Missouri, 7 Bankr. 974 (E.D. Ark. 1980), the district court held: "Petitioners invoked the jurisdiction of the Bankruptcy Court by filing a written pleading seeking affirmative relief; they were not obligated to follow this course of action, but did so in an attempt to benefit themselves. In so doing, Petitioners waived any arguable sovereign immunity." *Id.* at 982.

62. *See, e.g., In re* Howell, 4 Bankr. 102 (Bankr. M.D. Tenn. 1980); *In re* Buren, 6 Bankr. 744 (Bankr. M.D. Tenn. 1980); *In re* Devall, 9 Bankr. 41 (Bankr. M.D. Ala. 1980); *In re* Hughes, 7 Bankr. 791 (Bankr. E.D. Tenn. 1980).

63. *See* Remke, Inc. v. United States (*In re* Remke), 5 Bankr. 297 (Bankr. E.D. Mich. 1980); *In re* The Community Hosp. of Rockland County, 15 Bankr. 785 (Bankr. S.D.N.Y. 1981).

For a general discussion of 11 U.S.C. § 106(c) precluding the assertion of sovereign immunity when sued by a trustee in bankruptcy in the exercise of the avoiding powers, see *In re* Yonkers Hamilton Sanitarium, Inc. d/b/a Yonkers Professional Hospital, Debtor, MEDICARE & MEDICAID GUIDE (CCH) ¶ 32,121 (S.D.N.Y. 1982).

64. *See, e.g., In re* Reiber's Inn of Westchester, Inc., 1 Bankr. 305 (Bankr. S.D.N.Y. 1979), *aff'd sub nom.* Schindler v. Indus. Comm. of New York (*In re* Reiber's Inn), 3 Bankr. 706 (S.D.N.Y. 1980); Coleman American Moving Serv. v. Tullos (*In re* Coleman), 8 Bankr. 379 (Bankr. D. Kan. 1980); *In re* Eisenberg, 7 Bankr. 683 (Bankr. E.D.N.Y. 1980).

65. *See* Rowan v. Morgan (*In re* Rowan), 15 Bankr. 834 (Bankr. N.D. Ohio 1981).

66. *See In re* Hudson Valley Ambulance Serv., Inc., 11 Bankr. 860 (Bankr. S.D.N.Y. 1981).

not the trustee, was pursuing the claim against the Farmers Home Administration to seek recovery of crop proceeds paid by the debtor to the government.[67]

Finally, a fact pattern inapplicable to *Prospect* is the case of *England v. Industrial Commission of Utah*,[68] which held that the eleventh amendment jurisdictional defense was unavailable where wage claimants, through assignment to a state collection agent, could garnish a debt of the state to a corporation after the corporation's bankruptcy filing.[69] The State of Utah, in this situation, was held not to be the real, substantial party in interest.[70]

This latter group of cases appear to involve appropriate fact patterns for the invocation of 11 U.S.C. § 106(c) to preclude the assertion of sovereign immunity where a frustration of fundamental bankruptcy policy would otherwise result. However, to apply 11 U.S.C. § 106(c) to the *Prospect* fact pattern would render 11 U.S.C. § 106(a) and (b) meaningless and a nullity. Rather, the cases discussed at the outset of this subsection, particularly *Regal Construction*, would appear to be the applicable authority.

IV. 28 U.S.C. § 1481

28 U.S.C. § 1481 provides in pertinent part: "A bankruptcy court shall have the powers of a court of equity, law and admiralty, *but may not enjoin another court. . . .*" (emphasis added). This statutory language has been construed not only as a prohibition against the Bankruptcy Court enjoining another court, but also as a prohibition against preventing the completion of a state court process under the guise of enjoining the conduct of parties.

In *In re Stuart Motel, Inc.*,[71] the Bankruptcy Court refused to enjoin a party from effectuating a state court ordered foreclosure sale, stating that the Bankruptcy Court's 11 U.S.C. § 105(a) power to issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of Title 11

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67. *See* Maddox v. United States (*In re* Lunsford), 12 Bankr. 762 (Bankr. M.D. Ala. 1981).

68. 643 F.2d 1356 (9th Cir. 1981).

69. *Id.* at 1360.

70. *Id.* at 1361.

71. Stuart Motel, Inc. v. Columbia Banking Sav. & Loan Ass'n (*In re* Stuart Motel), 15 Bankr. 28 (Bankr. S.D. Fla. 1981).

> is, of course, subject to the limitations set forth in 28 U.S.C. § 1481 which states that a bankruptcy court may not enjoin another court. . . . *We further agree that we cannot circumvent that plain language by preventing the completion of a state court process under the guise of enjoining conduct of parties.*[72]

The rule of *Stuart Motel* would appear to be directly applicable to *Prospect*, where a debtor who lost both the license required for continued business operation and his superior court appeal of the license revocation prior to filing under Chapter 11, and then seeks to induce the Bankruptcy Court to either relitigate the license revocation or to take evidence on alleged "recent improvements" in the debtor's effort to comply with the applicable requirements of law, so as to induce the Bankruptcy Court to order state officials to relicense the debtor. Such an order would enjoin implementation of the state order of license revocation.

There exist two unique fact patterns in which bankruptcy courts have enjoined parties from pursuing state court actions.[73] In *In re Gorin*,[74] the Bankruptcy Court held an automobile leasing corporation in contempt for causing a warrant to issue for the arrest of the debtor and for the return of the motor vehicle after receiving notice of the filing of the debtor's Chapter 7 petition. Clearly, such post-filing creditor conduct is violative of express bankruptcy law and its public policy.

In the second fact pattern, bankruptcy courts have enjoined parties from pursuing "bad check" state criminal proceedings.[75] In these

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72. *Id.* at 30 (emphasis added).

73. Note also the somewhat *sui generis* case of Willard v. Willard (*In re* Willard), 15 Bankr. 898 (Bankr. 9th Cir. 1981), where the debtor filed under Chapter 7, a trustee took title of the family home, and a state court marriage dissolution judgment was then handed down awarding the home to the debtor's wife. The Bankruptcy Court held that the judgment was not voided (as between the parties) by the automatic stay, but the trustee would retain possession since the estate was taken from the debtor prior to judgment.

By implication, this case is supportive of the full faith and credit and res judicata discussion *supra*, when a state court judgment precedes the filing in bankruptcy.

74. Transitowne Leasing, Inc. v. Gorin (*In re* Gorin), 18 Bankr. 151 (Bankr. D. Conn. 1982).

75. Whitaker v. Lockert (*In re* Whitaker), 16 Bankr. 917 (Bankr. M.D. Tenn. 1982); Barnett v. K-Mart (*In re* Barnett), 15 Bankr. 504 (Bankr. D. Kan. 1981); Bray v. Holley (*In re* Bray), 12 Bankr. 359 (Bankr. M.D. Ala. 1981); *In re* Lake, 11 Bankr. 202 (Bankr. S.D. Ohio 1981).

"bad check" cases, a virtual "frontal assault" upon the fundamental public policy of bankruptcy law occurs when a bankruptcy court orders a debt partially or totally discharged, and a party or prosecutor can then present the debtor with a choice of full restitution or incarceration. Under these extreme circumstances, a Bankruptcy Court will enjoin parties from pursuing a state court action.[76] In *In Re Whitaker*,[77] the Bankruptcy Court did enjoin both the parties and the District Attorney General from pursuing the "bad check" criminal action after finding that "it is a matter of common knowledge that creditors in Tennessee frequently resort to the threat of a criminal prosecution to compel the payment of a civil debt. . . . When a criminal statute is used primarily to recover a dischargeable debt, the Bankruptcy court may enjoin the criminal prosecution."[78] Yet, the *Whitaker* Bankruptcy Court discussed 28 U.S.C. § 1481 and admitted that "*the ultimate effect*, of course, [of enjoining individuals from prosecuting as opposed to enjoining the state court] *is the same.*"[79]

The *Whitaker* court did in fact utilize "the guise of enjoining conduct of the parties." But absent the situation of the "bad check" criminal proceeding constituting a de facto collection suit with full restitution in defiance of a bankruptcy discharge being the ultimate goal, it would appear that even the *Whitaker* court would have followed the rule of *Stuart Motel*, that utilizing the guise of enjoining individuals from pursuing a state court action is the same as enjoining the state court itself and is violative of 28 U.S.C. § 1481.

The *Prospect* case involved a state license revocation prior to the filing in bankruptcy and did not involve any attack on fundamental bankruptcy policy. It would appear that the rule of *Stuart Motel* would govern and 28 U.S.C. § 1481 would constitute a jurisdictional limitation; or, at a minimum, would result in the debtor failing to state a claim upon which relief could be granted by the Bankruptcy Court.

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76. In *In re Barnett*, the Bankruptcy Court merely enjoined the prosecutor from recommending or requesting restitution but permitted the "bad check" criminal case to proceed. *Barnett*, 15 Bankr. at 512.

77. 16 Bankr. 917 (Bankr. M.D. Tenn. 1982).

78. *Id.* at 922.

79. *Id.* at 920 n.3.

V. THE ELEVENTH AMENDMENT

The eleventh amendment to the Constitution of the United States provides that: "[T]he judicial power of the United States shall not be construed to extend to any suit in law or equity, commenced or prosecuted against one of the United States by Citizens of another State, or by Citizens or Subjects of any Foreign State."[80]

It has been repeatedly held by the United States Supreme Court that this amendment also renders an unconsenting state immune from suits brought in federal courts by her own citizens as well as by citizens of another state.[81]

It is also well established that, even where the state is not named as a party, the eleventh amendment may be asserted even though individual officials are the nominal defendants.[82] Further, the rule has evolved that any suit by private parties seeking to impose a liability to be paid by the state treasury is barred by the eleventh amendment.[83]

The eleventh amendment is applicable when the debtor seeks a Bankruptcy Court order that a state pay damages to the debtor's estate for a past alleged wrong. For example, in *Prospect*, the eleventh amendment issue arose because the debtor, besides seeking to induce the Bankruptcy Court to order state officials to relicense him, also sought to litigate a past Medicaid rate reimbursement dispute in Bankruptcy Court.

In *Edelman v. Jordan*,[84] the issue was whether the Illinois Department of Public Aid, which administered the federal-state cooperative program of Aid to the Aged, Blind, or Disabled, could be

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80. U.S. CONST. amend. XI.

81. *See, e.g.*, Edelman v. Jordan, 415 U.S. 651, 663 (1974); Employees v. Dept. of Public Health and Welfare, 411 U.S. 279 (1973); Parden v. Terminal Ry. Co., 377 U.S. 184, 186 (1964); Great N. Life Insurance Co. v. Read, 322 U.S. 47, 51 (1944); Duhne v. New Jersey, 251 U.S. 311, 313 (1920); Hans v. Louisiana, 134 U.S. 1 (1890).

82. *See, e.g.*, Edelman v. Jordan, 415 U.S. 651 (1974) (quoting Ford Motor Co. v. Dept. of Treasury, 323 U.S. 459, 464 (1945)). "[W]hen the action is in essence one for recovery of money from the state, the state is the real, substantial party in interest and is entitled to invoke its sovereign immunity from suit even though individual officials are nominal defendants." *Edelman*, 415 U.S. at 663.

83. *See Edelman*, 415 U.S. at 663. "Thus the rule has evolved that a suit by private parties seeking to impose a liability which must be paid for by public funds in the state treasury is barred by the Eleventh Amendment." *Id.*

84. 415 U.S. 651 (1974).

ordered to make retroactive payments. The United States Supreme Court held that such an order was barred by the eleventh amendment, quoting with approval language from the Second Circuit case of *Rothstein v. Wyman*:[85]

> It is one thing to tell the Commissioner of Social Services that he must comply with the federal standards for the future if the state is to have the benefit of federal funds in the programs he administers. It is quite another thing to order the Commissioner to use state funds to make reparation for the past. The latter would appear to us to fall afoul of the Eleventh Amendment if that basic constitutional provision is to be conceived of as having any present force.[86]

The *Edelman* court rejected the argument that the retroactive payment order was permissible as "equitable restitution" instead of damages.[87] To describe "[t]his retroactive award of monetary relief as a form of 'equitable restitution,' it is in practical effect indistinguishable in many aspects from an award of damages against the State. It will to a virtual certainty be paid from state funds . . . ."[88] The *Edelman* Court concluded with language strictly construing arguable "constructive consent" or "implied waiver" of eleventh amendment immunity with respect to a state participating in a cooperative federal-state program under the Social Security Act.[89]

85. 467 F.2d 226 (2d Cir. 1972).

86. *Edelman*, 415 U.S. at 665 (quoting Rothstein v. Wyman, 467 F.2d 226, 236-37 (2d Cir. 1972)).

87. *Edelman*, 415 U.S. at 666.

88. *Id.* at 668.

89. *Id.* at 673. For significant post-*Edelman* eleventh amendment cases within this circuit, see McAuliffe v. Carlson, 520 F.2d 1305 (2d Cir.), *cert. denied*, 427 U.S. 911 (1975); Hosp. Ass'n of New York State, Inc. v. Toia, 577 F.2d 790, 794 (2d Cir. 1978); Lombardi v. Ambach, 522 F. Supp. 867, 872 (E.D.N.Y. 1981).

Bankruptcy courts have also applied the above-discussed Supreme Court decisions and found that the eleventh amendment bars Bankruptcy Court jurisdiction concerning claims against states for retroactive monetary relief. *See* Regal Constr. Co., Inc. v. Maryland (*In re* Regal Constr. Co., Inc.), 18 Bankr. 353 (Bankr. E.D. Md. 1982); *In re* Ramos, 12 Bankr. 250 (Bankr. N.D. Ill., 1981); *In re* Kahr Brothers, Inc., 5 Bankr. 765 (Bankr. D.N.J. 1980). *See also* Alabama Nursing Home Ass'n v. Harris, MEDICARE & MEDICAID GUIDE (CCH) ¶ 30,505 (5th Cir. 1980), in which the Fifth Circuit Court of Appeals noted "[c]ounsel for the plaintiffs conceded at oral argument that any other claims the plaintiffs might have to the [Medicaid] funds withheld . . . are barred by the Eleventh Amendment. See *Edelman v. Jordan*. . . ." *Id.* ¶ 30,505 at 9947.

Finally see Ohio v. Madeline Marie Nursing Homes #1 and #2, MEDICARE & MEDICAID GUIDE (CCH) ¶ 32,309 (6th Cir. 1982), in which the Court of Appeals for the Sixth Circuit described a Bankruptcy Court's turnover order concerning monies allegedly owed by Ohio

VI. THE TENTH AMENDMENT

There are two distinct analyses, based upon the tenth amendment,[90] which preclude Bankruptcy Court jurisdiction in a *Prospect* situation.

First, the Bankruptcy Court should reject a statutory construction of 28 U.S.C. § 1471 and 11 U.S.C. § 106, which would render the Bankruptcy statute unconstitutional. Where a state agency has filed no claim, no objection to discharge, no request for affirmative relief from the Bankruptcy Court, and is not the plaintiff in any other forum pursuing a claim against the debtor's estate, it is the tenth amendment, and not article I, section 8, which is applicable to an attempt by a debtor to invoke a Bankruptcy Court's jurisdiction to force relitigation (or a reopening of evidence on the issue of "recent improvements" already res judicata) of a final state court judgment affirming a state license revocation, which took place prior to the debtor's filing in bankruptcy, and which has nothing to do with bankruptcy law.

As discussed previously, the legislative history of 11 U.S.C. § 106[91] recognizes the general rule that Congress lacks the power to abnegate sovereign immunity with respect to claims of a bankrupt estate against a state, absent use of the supremacy clause to prevent or prohibit state action that is contrary to fundamental bankruptcy policy. It is a canon of statutory construction that where a statute can be construed in two ways—one which would render the law constitutional and the other which would render the law unconstitutional—the constitutional interpretation must be chosen.[92] The United States

to a nursing home for past services rendered to Title XIX Medicaid patients as "a raid of the state treasury for an accrued monetary liability." *Id.* ¶ 32,309 at 9523 (quoting Milliken v. Bradley, 433 U.S. 267, 290 n.22 (1977), and expressly applying said quotation to the Bankruptcy Court turnover orders in *Madeline Marie*). The Sixth Circuit held that: "Under *Edelman v. Jordan*, this form of retroactive relief against a state, even if put in the form of equitable restitution, is barred by the Eleventh Amendment." *Id.* Although *Madeline Marie* involved the predecessor bankruptcy law, the constitutional principle of law is equally applicable to the existing bankruptcy statute.

90. The tenth amendment to the Constitution provides: "The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people."

Article I, Section 8 of the United States Constitution provides in pertinent part: "The Congress shall have the power . . . to establish . . . uniform laws on the subject of Bankruptcies throughout the Untied States."

91. *See* supra note 43.

92. *See* Anderson v. Edwards, 505 F. Supp. 1043, 1048 (S.D. Ala. 1981).

Supreme Court has already declared the 28 U.S.C. § 1471 "related to" jurisdiction unconstitutional on another ground.[93]

Even after Congress takes action to cure the constitutional problem raised by *Marathon Pipeline*, a decision that 11 U.S.C. § 106(c) or 28 U.S.C. § 1471 absolutely bars the assertion of sovereign immunity (even where a state agency has filed no claim, no objection to discharge, no request for affirmative relief from the Bankruptcy Court, and is not the plaintiff in any other forum pursuing a claim against the debtor's estate), beside being contrary to the express wording of section 106, its legislative history and the applicable case law, would also needlessly jeopardize the constitutionality of section 1471 on a tenth amendment ground and hence would needlessly imperil the benefits to the public achieved in the Bankruptcy Reform Act of 1978.

Second, under the rule of *National League of Cities v. Usery*,[94] the assertion of section 1471 jurisdiction concerning a state license revocation prior to the debtor filing in Bankruptcy would be violative of the tenth amendment.

In *National League of Cities*, the plaintiffs challenged the constitutionality of the 1974 amendments to the Fair Labor Standards Act, which had extended federal minimum wage and maximum hour requirements to state and municipal employees. The United States Supreme Court held that as the challenged amendments "significantly alter or displace the States' abilities to structure employer-employee relationships" in areas of traditional operations of state and local governments, such amendments were violative of the tenth amendment.[95] The majority applied a two-prong test asking: 1) whether the government activities were "typical of those performed by state and local governments in discharging their dual functions of administering the public law and furnishing public services . . . which the states have traditionally afforded their citizens" and 2) whether the challenged federal legislation would "impermissibly interfere with the integral governmental functions" and thereby "impair the States' ability to function effectively in a federal system."[96] Although *National League of Cities* involved federal legislation (mandating minimum

93. *See supra* note 11.
94. 426 U.S. 833 (1976).
95. *Id.* at 851.
96. *Id.* at 851-52.

wages and maximum hours for state and municipal employees) enacted under the commerce clause, the federal considerations reflected generally in the decision and specifically in the two-prong test could also apply to federal legislation based on authority granted Congress by other sections of the Constitution.

Applying the *National League of Cities* two-prong test to *Prospect*,[97] the licensure of chronic and convalescent nursing homes by the Connecticut Department of Health Services is clearly a traditional state function in administering the law so as to protect the health, safety and welfare of the citizens of Connecticut generally and of the patients in such facilities specifically. The remedy of license revocation is clearly essential to provide the public with the statutory protections of the licensure statute. If the threat of license revocation ceased to be an available and effective remedy, the level of industry-wide compliance with the statutory requirements would quickly fall off to the detriment of the public health, safety and welfare.

Therefore, the assertion of 28 U.S.C. § 1471 jurisdiction solely for the purpose of frustrating and preventing a completed license revocation from being implemented clearly constitutes "impermissible interference with an integral governmental function which impairs the State's ability to function effectively in a federal system." The result would be adverse consequences for the public health, safety and welfare both in terms of the continued business operation of one whose license has been revoked after having been adjudicated in noncompliance with statutory requirements and in terms of the inevitable industry-wide drop in compliance with requirements of law when "word gets out" that a licensee, no matter how unsafe or unfit, who has accordingly had his license revoked, need only file under Chapter 11 and induce a federal Bankruptcy Judge to order the state to restore his license.

The tenth amendment's applicability to this situation appears even greater than in *National League of Cities*. What is literally at stake is the integrity of every state statute of a regulatory nature which provides for licensure and the remedy of license revocation.

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97. Concerning this tenth amendment analysis, *In re* Glidden, 653 F.2d 85 (2d Cir. 1981) must be distinguished. In *Glidden*, there existed a strong federal interest in a uniform bankruptcy law treatment concerning dischargeability of child support obligations assigned to states. Such was not the case in *Prospect*.

If the Bankruptcy Court could assert 28 U.S.C. § 1471 jurisdiction to relitigate a pre-filing state license revocation or to take evidence of alleged post-revocation "recent improvements" resulting in the Bankruptcy Court ordering relicensure, then lawyers representing all licensees in Connecticut could advise their clients that they need no longer be concerned with staying in compliance with the health, sanitation or any other requirements for the retention of their license. The worst that can happen is that the State would revoke their license and the Connecticut Superior Court would affirm. But even that creates no problem. They can just file under Chapter 11, clean up for a day or two, tell the Bankruptcy Judge that losing their license would be bad for business and induce him to order the State to relicense them.

The Connecticut Bakeries Act[98] and the history of its enforcement from January 1, 1979 to January 1, 1981[99] are illustrative of a licensure statute utilized by the state to protect the public health, safety and welfare, the enforcement of which would be impaired under the above scenario. Bakeries in Connecticut are required to be licensed by the Commissioner of Consumer Protection and such license may be revoked if bakery products are "produced, prepared, packed or held under unsanitary conditions whereby they may be rendered unwholesome or otherwise injurious to health."[100] When a routine inspection indicates the existence of unsanitary conditions to a degree deemed violative of the statute, reinspections are conducted. If those reinspections indicate the continued existence of unsanitary conditions, a formal administrative action is commenced seeking license revocation.

During the period from January 1, 1979 to January 1, 1981, thirteen formal administrative actions seeking license revocations took place. During this period there were approximately 2,000 bakery licensees. Virtually all of the thirteen administrative actions included exhibits and laboratory samples establishing the existence of vermin, insects or rodent feces in or close to the bakery production area. In twelve of the thirteen formal administrative actions, the licensee ad-

98. CONN. GEN. STAT. §§ 19-283-291 (1981).

99. Prior to appointment as Assistant Attorney General, the author of this article was employed as an attorney by the Connecticut Department of Consumer Protection. During the period from January 1, 1979 to January 1, 1981, he exclusively represented the agency as complaint counsel in all formal administrative actions seeking revocation of bakery licenses.

100. CONN. GEN. STAT. § 19-284 (1981).

mitted being in violation of the sanitary requirements of the law on the dates of all of the inspections. In all thirteen formal administrative actions, the licensee claimed "recent improvement" in sanitation and requested that the formal administrative action be dropped with one more reinspection.

The enforcement of the Connecticut Bakeries Act—like the enforcement of every state licensure statute—is of necessity static in nature. Three or four consecutive unsatisfactory inspections indicate a pattern of noncompliance as evidenced by the conditions observed and documented on those three or four days. If there is some evidence of improved sanitation, albeit insufficient, or an inspection indicates a need for improvement but conditions are close to satisfactory, the agency generally exercises its discretion to grant additional reinspections before bringing formal administrative action. Once the agency determines that the nature and extent of conditions warrant formal administrative action seeking license revocation, it is too late for a licensee to say "recent improvement, withdraw the license revocation action and give me one more chance."

This is the separation of powers aspect of the enforcement of licensure statutes. The executive branch (the state agency) has the discretion to decide whether and when to initiate formal administrative action seeking license revocation (and, in a very unusual situation, to rescind voluntarily a license revocation). Once the agency has revoked the license through formal administrative action, the reviewing court is limited to a C.G.S. § 4-183 review of the record to insure that the agency acted lawfully and had substantial evidence to support its findings.[101] A reviewing court cannot remand whenever a claim of "recent improvement" is made because that, besides constituting a judicial usurpation of agency discretion, would mean that no license would ever be revoked. Each time a license revocation appeal came before the superior court, the licensee would claim a new "recent improvement."

The development of the law in this century to provide for state licensure, a body of administrative law and limited judicial review of administrative license revocations, has served the State of Connecticut well. Regulated industries have demonstrated overall compliance

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101. *See* Prospect Restorative Health Center, Inc. v. Lloyd, Conn. Super. Ct. Judicial District of Hartford/New Britain at Hartford, Docket No. 81-0262354, at 14, 18-20 (March 30, 1982).

with statutory requirements protecting the public health, safety and welfare. When a state agency deems license revocation necessary, the licensee is afforded the protection of the Connecticut Uniform Administrative Procedure Act and its judicial review.[102] The number and percentage of license revocations has not been very large. In that two year period only thirteen of approximately 2,000 bakery licenses were revoked.

The administrative law and the licensure system which has served Connecticut so well to protect the public would be in jeopardy if the Bankruptcy Court could assert 28 U.S.C. § 1471 "related to" jurisdiction in the above-described scenario. If a licensee can ignore requirements of law in order to retain his license, can have his license revoked by the state in a formal administrative action, can lose his C.G.S. § 4-183 appeal of the license revocation, but can then file under Chapter 11, allege "recent improvement," and induce the Bankruptcy Judge to order the state to relicense him, then the entire system of administrative law and licensure statutes, would be subverted and when "word gets out," the level of industry-wide compliance with statutory health, safety and welfare protections would inevitably fall.

Where a state agency has avoided filing a claim, objection to discharge, has made no request for affirmative relief from the Bankruptcy Court, and is not the plaintiff in any pending claim against the debtor's estate in any other forum, it would appear that the assertion of section 1471 jurisdiction against the state for the purpose of subverting a licensure statutory system would impermissibly interfere with integral and traditional state functions and would thereby impair the State's ability to function effectively in our federal system.[103] Such a frontal assault upon the heart of our federal system—the sovereignty of states to exercise their police power to protect the public health, safety and welfare by means of licensure statutes—would appear to be clearly violative of the tenth amendment.

VII. Conclusion

This article has discussed five statutory and constitutional jurisdictional limitations upon the apparently limitless "related to" jurisdiction of 28 U.S.C. § 1471. The interest of state governments in assert-

102. Conn. Gen. Stat. § 4-183 (1981).

103. *See supra* notes 90 & 94 and accompanying text.

ing these jurisdictional limitations when named as defendants in adversary proceedings within a Chapter 11 bankruptcy case is obvious.

Yet, it is also in the best interests of the Bankruptcy Court and the public as well that the powers of the Bankruptcy Court not be asserted in a situation which would result in one or more of these five statutory and constitutional jurisdictional limitations being applicable. The aftermath of the *Marathon Pipeline* decision is illustrative that a forced judicial declaration of the unconstitutionality of 28 U.S.C. § 1471 "related to" jurisdiction imperils the benefits to the public of the entire bankruptcy law at a time when the need for the benefits of the statute may be the greatest.

The bankruptcy statute itself displays sensitivity to the danger of interference with the exercise of a state's police or regulatory power. Examples include the exception to the automatic stay concerning "the commencement or continuation of an action or proceeding by a governmental unit to enforce such governmental unit's police or regulatory power;"[104] the limiting language upon a party's right to remove to Bankruptcy Court a civil action by a government unit to enforce the police or regulatory power;[105] and the Bankruptcy Court's power to remand such a removed action.[106]

These bankruptcy law sections assume initial Bankruptcy Court jurisdiction and hence do not prevent the problems discussed in this article from arising. For example, the debtor may argue as an issue of fact that a state license revocation was not in fact an exercise of police or regulatory power, but rather was an attempt by state officials to punish the licensee for reasons other than statutory noncompliance. In the alternative, the debtor might argue that, even if the "police or regulatory power" exception to the automatic stay is applicable, the Bankruptcy Court may still exercise its general equitable power under 11 U.S.C. § 105(a) to enter an order staying the license revocation. Moreover, the debtor may purport to remove a pending appeal of a state license revocation to Bankruptcy Court and again raise as an issue of fact whether the license revocation was an exercise of police or regulatory power. In lieu of removal, the debtor might file an adversary proceeding against the State within his bankruptcy case stating allegations identical to those in his state court

104. 11 U.S.C. § 362(b)(4) (1978).
105. *See* 28 U.S.C. § 1478(a) (1978).
106. *See* 28 U.S.C. § 1478(b) (1978).

license revocation appeal. Finally, the problem with the remand power of the Bankruptcy Court is that it is discretionary and not reviewable by appeal.

To protect the fundamental sovereignty of a state to protect the public health, safety and welfare through enforcement of licensure statutes, an awareness of the five above discussed jurisdictional limitations upon the 28 U.S.C. § 1471 "related to" jurisdiction is essential. If the debtor questions the motivation of the state officials who revoked his license or the validity of the license revocation itself, the proper forum in which to raise these issues is the state court hearing his license revocation appeal. Both the applicable statutes and the federal constitutional system demand this.