EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET

ROUTE SLIP

TO
Mike Uhlmann
✓ BIll Barr
John Komoroske
Mike Esposito

- [ ] Take necessary action
- [ ] Approval or signature
- [ ] Comment
- [ ] Prepare reply
- [ ] Discuss with me
- [ ] For your information
- [ ] See remarks below

FROM Greg Jones 7/20/82 DATE

REMARKS

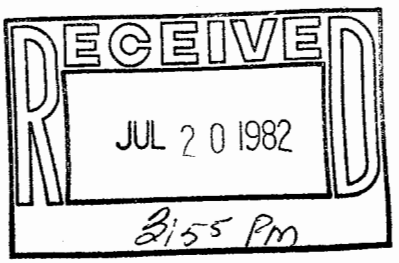
Please review asap. Hearing is tomorrow.

SPECIAL

OMB FORM 4
REV AUG 70

[Draft of July 20]

[Testimony of Jonathan C. Rose]



Mr. Chairman and members of the Committee, I appreciate this opportunity to appear and discuss the views of the Department of Justice as to how best to amend the Bankruptcy Act of 1978 to remedy the constitutional defects pointed out by the Supreme Court in its recent decision in Northern Pipeline Construction Co. v. Marathon Pipe Line Co.

Before discussing the alternatives available, I would like to briefly trace the manner in which we arrived at the situation in which we presently find ourselves.

Prior to 1978 the federal district courts served as bankruptcy courts. In pre-1978 jargon, a bankruptcy court was a district court exercising the bankruptcy jurisdiction conferred by the Constitution. The jurisdiction of the bankruptcy court was "summary" - that is, it could exercise jurisdiction over controversies involving property in the actual or constructive possession of the bankruptcy court and could adjudicate all rights and claims pertaining thereto. However, without consent, the bankruptcy court did not have jurisdiction over cases involving claims to property in the hands of third-parties, so called "plenary suits". The judges of the district courts appointed

referees who, in fact, exercised the bankruptcy powers of the district courts, with appeals of final orders of referees to the district courts.

Several serious problems existed with respect to the pre-1978 system. First, because of the degree of specialization involved, the district courts preferred not to involve themselves with bankruptcy matters and the bankruptcy referees for all practical purposes acted as a district court in matters relating to bankruptcies. Second, the distinction between summary and plenary suits resulted in bifurcated jurisdiction over bankruptcy proceedings, and this created an inefficient system for dealing with the assets and liabilities of debtors. Third, while many of the bankruptcy referees were well-qualified and competent, some were notoriously inept and suitors almost invariably chose to present their cases to the district courts if possible.

The Bankruptcy Act of 1978 attempted to address these problems, among others. The Act established in each judicial district a bankruptcy court staffed by judges with fourteen year terms. The distinction between summary and plenary suits was eliminated, and the bankruptcy courts were given jurisdiction over all civil proceedings relating to a bankruptcy case. Final orders of the bankruptcy judges are appealable to the district courts, or with consent of the parties, to the Courts of Appeal.

In the Northern Pipeline decision, the Supreme Court struck down the grant of jurisdiction to the bankruptcy

judges in its entirety but stayed the effective date of its judgment until October 4 to give Congress time to cure the jurisdictional defects. Justice Brennan wrote a plurality opinion. Justices Rehnquist and O'Connor concurred in the plurality opinion, but stated in a separate opinion that they felt the plurality's opinion to be overbroad and were concurring only because they were of the opinion that the unconstitutional portions of the jurisdictional grant could not readily be severed from the constitutional portions.

The plurality opinion analyzed the doctrine of separation of powers and the case law concerning Article III of the Constitution and concluded that persons who did not enjoy life tenure or guarantees against diminutions in salary could not constitutionally adjudicate traditional common law claims, such as the claim in issue. In the view of plurality, the power of Congress to create courts which are not true Article III courts because their judges do not enjoy the protections required by Article III are limited to three situations: specialized geographic areas such as territories or the District of Columbia; military courts; and courts which adjudicate so-called "public rights." Only the third category is relevant for our purposes. The attributes of a public right are (i) that the right is a matter that historically could have been determined exclusively by the Executive or by Congress, (ii) that it is a claim between the government and others, (iii) that the government be a proper party to an adjudication of the

right, and (iv) that the right was not one that could have been adjudicated by a court prior to the adoption of the Constitution. Public rights are appropriately adjudicated by an Article I court because "the Framers expected that Congress would be free to commit such matters completely to nonjudicial determination, and . . . as a result there can be no constitutional objection to Congress' employing the less drastic expedient of committing their determination to a legislative court or an administrative agency." Slip op. 17.

Bankruptcy cases apparently involve certain matters which are "public rights" such as the restructuring of the debtor-creditor relationship and probably also the grant of a discharge in bankruptcy. However, bankruptcy cases also involve issues which are not public rights like suits between the debtor and third parties. The breach of contract claim at issue in Northern Pipeline is one such example.

The plurality rejected the argument that bankruptcy courts are adjuncts of Article III courts, stating that judicial adjuncts meet the requirements of Article III only if Congress created the substantive federal right to be adjudicated and if the functions of the adjuncts are "limited in such a way that the 'essential attributes' of judicial power are retained in the Art. III court." Slip op. 30. The bankruptcy courts fail both tests. Unlike other adjuncts created by Congress, the bankruptcy courts

adjudicated more than simply federal rights created by Congress; they also adjudicated questions of state law. Moreover, the bankruptcy courts exercised "essential attributes" of judicial power because they had sweeping bankruptcy and non-bankruptcy subject matter jurisdiction, coequal with that of the district courts, had all ordinary powers of district courts, enjoyed a higher standard of review upon appeal, and issued final judgments.

The invalidation of the Bankruptcy Act's jurisdictional grant by the Supreme Court would seem to leave at least three options for amending the Act to correct the defects. Today, I shall simply analyze these alternatives, as the Administration has not yet developed a position on them. The first option would be to return to the pre-1978 system of bankruptcy referees. The second option would be to amend the Act to grant Article III status to bankruptcy judges. The third option would be to continue the bankruptcy courts as Article I courts, but to narrow their jurisdiction to exclude private civil cases such as Northern Pipeline. In connection with this third option, Article I bankruptcy courts might serve as "adjuncts" to the district courts in private civil actions by holding the trials themselves and making recommended findings of fact and conclusions of law to the district courts.

Abandoning the 1978 Bankruptcy Act's provisions creating independent bankruptcy courts in favor of a return to the pre-1978 system of bankruptcy referees would resolve

the issues raised in Northern Pipeline, but at the expense of scrapping the 1978 bankruptcy procedural reforms altogether and returning to the referee system whose shortcomings were a major impetus to the reforms made to the bankruptcy laws in 1978. If we were to return to the pre-1978 referee system, we would have to return jurisdiction over bankruptcy claims and private, civil claims alike to the district courts, although the district judges would be free to refer all or any part of these cases to bankruptcy referees. As before, the bankruptcy referees' orders would be subject to review by the district courts under a "clearly erroneous" standard. In connection with this option, I would like to note that there is nothing to prevent Congress from giving referees the title of judge, granting them longer terms of office or paying a salary which would be high enough to attract qualified candidates.

A simple solution, at least over the long run, would be to reconstitute the bankruptcy courts as Article III courts. This remedy, however, does not appear to be a practical alternative in the little time available before October 4, 1982, when the Supreme Court's decision in Northern Pipeline will be given effect. There would be a need to update FBI files, process candidates and arrange for a massive number of confirmation hearings. While it might be possible to appoint the present bankruptcy judges, who, for the most part were referees under the pre-1978 system, as Article III judges, the lackluster performance of a number of them was

widely complained of in 1978. By giving them expanded jurisdiction and life tenure as well, we might be unwisely weakening our federal judiciary.

If it is thought desirable to grant Article III status to bankruptcy judges, until such time as the new judges can be confirmed, a possible short term option would be to continue to vest the authority to conduct bankruptcy proceedings in an Article I court, but to limit the jurisdiction of that court to those matters which are "public rights", in essence the core issues in bankruptcy adjudications. The practical problems of administration which would result from this limited authority could be resolved by constituting the bankruptcy courts as adjuncts of the district courts for some purposes, and for other purposes by granting the bankruptcy courts the power to make initial findings of fact and conclusions of law, subject to close review by the district courts.

The third option, namely to convert the bankruptcy court to an Article I court is analytically perhaps the most troublesome. Neither the plurality nor the concurring opinions specify which matters may be adjudicated by non-Article III courts. The plurality opinion indicates that matters which are "public rights" may be entrusted to a non-Article III court, but in the context of a bankruptcy proceeding, it is not clear which rights are public and which are private. The plurality found that a discharge in bankruptcy "may well be a 'public right'," and other

precedent also suggests this to be the case, The United States v. Kras, 409 U.S. 434, 447 (1922). Slip op. 21. However, it is not clear whether proceedings in a bankruptcy court ancillary to the adjudication of the bankruptcy petition may properly be adjudicated by an Article I judge. The responsibilities of the bankruptcy court in conducting a bankruptcy proceeding include staying lawsuits against the bankrupt, collecting the bankrupt's assets, conducting "summary proceedings" concerning property of the bankrupt that is within the actual or constructive possession of the bankruptcy court, allowing or disallowing claims, and adjudicating fraudulent conveyances and preferences. In varying degrees, all of these functions require bankruptcy judges to adjudicate questions of private civil law; however, it is doubtful whether a bankruptcy court could efficiently adjudicate bankruptcy petitions unless it were permitted to exercise authority over these ancillary matters.

Because these ancillary responsibilities traditionally were discharged by district courts or by referees who were adjuncts of Article III courts, the constitutionality of an Article I court performing these functions has never been raised. It is well established that the separation of powers doctrine recognizes that the allocation of power among the legislative and executive branches of government frequently involves the sharing of authority to some degree, and that one branch of government may act in an area of

authority reserved for the other so long as it does so in the course of performing a proper function and provided that it does not intrude upon the central functions of another branch. See Youngstown Sheet & Tube Co. v. Sawyer, 343 U.S. 579, 637 (1952) (concurring opinion of Justice Jackson). Although we have found no modern cases which involve the allocation of power between the legislative and judicial branches, an analogous argument may be made that it would be proper for Congress to vest certain adjudicative functions in a legislative court so long as the adjudicative functions were incidental to a proper legislation function and due process requirements were satisfied. See Crowell v. Benson, 285 U.S. 22, 86-88 (1932) (dissenting opinion of Justice Brandeis). If this analogy is applied to an Article I bankruptcy court, it can be argued that such a court should have authority to adjudicate matters of private civil law if these matters were necessary to the adjudication of the bankruptcy petition itself. Since conflicting claims over the property of the bankrupt, the allowance and disallowance of claims, and the adjudication of fraudulent conveyances and preferences all are matters that must be resolved before the value of the debtor's estate and the amount of claims against the estate can be adjudicated, there are sound reasons to vest the power to adjudicate these matters with the bankruptcy court.

If an Article I approach were adopted, the district courts would have to adjudicate all matters of private civil

law. There would, of course, be problems with the bifurcated jurisdiction over bankruptcy proceedings that would result from creating an Article I court with limited powers, but these difficulties could be minimized by making bankruptcy judges adjuncts to the district courts on private civil matters that arise from or relate to a bankruptcy proceeding. In such matters, bankruptcy judges could hold evidentiary hearings, make recommended findings of fact, and prepare initial conclusions of law. The bankruptcy judges' recommended opinions would then be submitted to the district judges for adoption under the same standards governing the findings, reports and decisions of referees, special masters, or magistrates. A system along these lines would permit a bankruptcy judge to perform virtually all of the functions assigned to him under the 1978 Bankruptcy Act, without requiring the bankruptcy judge to be appointed an Article III judge.

Under such a scheme, the standard of review must be lower than the "clearly erroneous" standard that so troubled the plurality in Northern Pipeline. See Slip Op. 34, 35; Rehnquist Op. 3. While de novo review would almost certainly be constitutionally adequate, I would think that a "substantial evidence" standard is a sufficient and more appropriate test.

Thus, under any of these three approaches -- a pre-1978 referee system, making bankruptcy judges Article III judges, or creating Article I bankruptcy courts with limited

original jurisdiction but with powers to act as adjuncts of the district courts in other matters -- it would be possible to satisfy the commonly accepted notion that the bankruptcy process would work better if all matters pertaining to the bankruptcy -- including claims by or against third parties -- were placed in the hands of a single judge. Any of these three systems would eliminate the need to require a district court to separately adjudicate third-party claims involving the debtor, which would disrupt the orderly conduct of bankruptcy proceedings. This point is of enormous importance, since in many bankruptcy cases, claims by or against third parties are at the core of the proceeding, either because the size of the debtor's estate cannot be determined until assets such as causes of action are realized upon or because the liabilities of the bankrupt cannot be determined until lawsuits against the bankrupt are decided. Bifurcated authority over bankruptcy proceedings and ancillary suits thus would delay and complicate the handling of bankruptcy cases.

In summary, there are several alternatives available. If it is thought to be important to retain all of the procedural reforms of the 1978 Act, then it is probable the easiest and safest course to grant Article III status to the bankruptcy judges.

If, on the other hand, it is thought not to be advisable to tenure bankruptcy judges, the bankruptcy court could be either made into an Article I court with broad

review by the district courts or it could be made an adjunct of the district courts along the lines of Magistrate Act.

Because the Northern Pipeline decision gives no clear guidance as to which powers granted by the 1978 Act may be exercised by non-Article III judges, I am unable at this time to speak to the question of exactly which functions maybe exercised by a non-Article III court. That question is being reviewed at this time by the Department, but it may be several weeks before I can convey to you any definitive conclusions.

In summary, Mr. Chairman, I would like to assure you and the other members of the Committee that we are willing to work closely with you so that before October 4, a constitutional bankruptcy statute will be in existence. I would further like to urge that we together take this opportunity to consider addressing a series of other urgent legislative measures affecting the health of the federal judiciary such as: mandatory supreme court jurisdiction, diversity jurisdiction, conference recommendations for additional judgeships. These matters all relate to each other and could well be dealt with together.

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PLEASE REFER YOUR REPLY TO:
Joseph Weissman
LOS ANGELES OFFICE

21 July 1982

William Barr
Deputy Assistant Director
Michael Ohlman
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The White House
Washington, D.C. 205-0

Dear Mike and Bill:

I want to express my deep gratitude for your taking time from your busy schedules to meet with Ron Orr and me on the problems created in the administration of the bankruptcy laws by the decision of the Supreme Court in Northern v. Marathon.

Last Friday afternoon we had a meeting of the Board of Governors of the Financial Lawyers Conference. That organization is made up of about 400-500 lawyers in the Southern California area who specialize in representing banks, commercial finance companies, factors and similar types of clients. Many of the members are bankruptcy specialists on both the creditor and debtor sides.

The meeting was called at my request as a governor and past president. We had a rather vigorous exchange of views. It is quite obvious that the Board of Governors is fairly evenly divided on the question of the preferred method of solving the constitutional problem and a sub-committee was formed for the purpose of preparing a memorandum of the impact of the decision assuming that the temporary stay expires and the judgment of the court becomes effective. I was appointed chairman of that sub-committee, two other attorneys were appointed to it, they are, Kenneth N. Klee of Stutman, Treister & Glatt and Joel R. Ohlgrin of the Los Angeles office of Rogers & Wells.

I understand that the commercial bankruptcy committee of the Business Law Section of the American Bar Association, which has about 160 members, is polling its members to see whether there is a consensus as to the best method of solving the problem. If I receive any information concerning the outcome of that poll, I will send it to you.

As you know, Ron Orr is Chairman of the Commercial Law and Bankruptcy Section of the Los Angeles County Bar Association and I understand that when he gets back from vacation he will appoint a committee to work with the sub-committee appointed by the Financial Lawyers Conference, at least he indicated he would do so on the plane ride home.

Also, our firm has been contacted by the National Commercial Finance Conference ("NCFC") to express our views on the topic. General counsel for that organization is A. Bruce Schimberg of the law firm of Sidley & Austin. A. Bruce Schimberg is in that firm's main office in Chicago. You may recall that J. Ronald Trost (was going to be at the Washington meeting but was unable to attend) is the senior partner of Sidley & Austin at its Los Angeles office. Frankly, I don't know at this time what his position is and I certainly don't know the position of the NCFC. But, as a very preliminary guess, I would say that the NCFC, which is the largest trade organization of the commercial finance, factoring and other asset-based lending industry will probably be in favor of what I conceive to be the position of the Senate sub-committee of which Senator Dole is the chairman, which is to press for a bill that will include the substantive changes in the bankruptcy law. Personally, I still feel that this will result in a legislative impasse and will virtually assure that there will be no legislative action by October 4th when the temporary stay expires.

All of this fills me with a very strong sense of foreboding and, perhaps, an even stronger sense that there are a lot of Neros fiddling. But, perhaps I am being unduly pessimistic. No doubt, the best policy is to wait until the memorandum of law is generated and we have an educated appraisal of what is likely to occur in October, if as I anticipate no action is taken.

I hope this long letter hasn't taken too much of your time. Once again, thank you for your time and patience, it was indeed a pleasure to meet both of you.

Cordially,

JOSEPH WEISSMAN
JW/igh
cc: Ronald Orr, Esq., Gibson, Dunn & Crutcher

Dole Seeks Bankruptcy Law Shifts

Consumer Credit Provisions Prime Target of Senator

By Warren Brown
Washington Post Staff Writer

Sen. Robert Dole (R-Kan.) said yesterday that he will use Monday's Supreme Court decision limiting the power of federal bankruptcy judges to tighten the consumer credit provisions of the 1978 U.S. Bankruptcy Act.

The court's ruling that Congress must act by Oct. 4 to correct flaws in the law "provides an opportunity for Congress to enact other bankruptcy reform measures which have been pending in the House and Senate for some time," Dole said.

Among those measures are a grain elevator bankruptcy bill sponsored by Dole and a host of proposals to put tougher restrictions on debtors seeking to liquidate all outstanding debts under Chapter 7 of the 1978 code.

Dole, chairman of the Senate Judiciary subcommittee on courts, said he would "act immediately" to push through legislation accommodating the Supreme Court's decision on bankruptcy judges. The senator also said he is "especially optimistic" that the other changes sought by the nation's farmers and creditors could be inserted into a revised law.

The catalyst was the court's 6-3 ruling Monday that the nation's 193 federal bankruptcy judges were granted unconstitutional powers under the 1978 act. The court said the law violates Article III of the Constitution, which specifies the kinds of cases and the kinds of judges who can hear those cases in federal court. The 1978 law allows bankruptcy judges to hear cases once restricted to federal courts, but fails to give bankruptcy judges the lifetime tenure and salary protections awarded to other federal magistrates, the court said.

Congress either can limit the power of the bankruptcy judges or upgrade their status by giving them the perquisites of their peers, the court said, emphasizing that its ruling was not retroactive. The court said its decision will not become final until Oct. 4 "to afford Congress an opportunity to reconstitute the bankruptcy courts or to adopt other valid means of ajudication."

Therein lies the bit of legislative serendipity that Dole and other critics of the 1978 law were smiling over yesterday. For nearly two years, they have argued that the law—by increasing the number and value of items debtors may hold exempt from confiscation by creditors in bankruptcy proceedings—has encouraged debtors to file for bankruptcy. Many of those debtors actually could afford to pay their bills, the critics say.

The critics want to establish an "eligibility threshold," based on a debtor's ability to pay a portion of his or her debts out of future income, for persons seeking relief under Chapter 7. Several bills that would meet this goal have been floating around Congress for a while. But they have met stiff opposition, especially from House Judiciary Committee Chairman Peter W. Rodino Jr. (D-N.J.). Rodino has argued that the proposed income test would create a kind of indentured servitude for debtors who legitimately seek Chapter 7 protection.

Some Capitol Hill sources speculated yesterday that Rodino and

See BANKRUPTCY, D8, Col. 1

Dole Promises Hill Action on Bankruptcy Act

BANKRUPTCY, From D7

other opponents of the income test idea will fight to keep any revisions affecting bankruptcy judges separate from the consumer credit matter. Even lobbyists who want to tighten the consumer credit provisions admit that the proposed Chapter 7 changes and the judges are different issues.

But the Supreme Court action "is a vehicle, a horse," said Robert B. Evans, senior vice president and general counsel of the National Consumer Finance Association, a national creditors' group that has been leading the fight for Chapter 7 revisions. The ruling and the Oct. 4 deadline for congressional action "creates activity, and activity is the biggest thing" in making any gains on Capitol Hill, Evans said.

Wash. Post
6/30/1982

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→ Bivens

Introduction

On June 28, 1982, the Supreme Court, in a plurality decision and over a strong dissent, declared unconstitutional the broad grant of jurisdiction to bankruptcy courts contained in §241(a) of the Bankruptcy Reform Act of 1978, P.L. 95-598, 92 Stat. 2549 ("the Act"). Northern Pipeline Construction Co. v. Marathon Pipeline Co., Nos. 81-151 and 81-546 (S. Ct., June 28, 1982) ("Northern Pipeline"). While concurring Justices Rehnquist and O'Connor would limit the Court's judgment narrowly to a holding that only "traditional actions at common law tried by the courts at Westminster in 1789 "1/ were without the jurisdiction of the Article I bankruptcy judges, Justice Brennan's opinion is not so limited. Instead, concluding that the bankruptcy courts as constituted neither fall within one of the three historically recognized situations in which Art. I courts may exercise Art. III jurisdiction (territorial courts, courts-martial, and courts resolving "public rights" issues), nor qualify as "adjuncts" to the Art. III district courts, the plurality holds generally that the grant of jurisdiction [contained in 28 U.S.C. §1471(b)] conferred upon the bankruptcy courts in §241(a) of the Act is constitutionally impermissible. Furthermore, observing that adjudication of all bankruptcy litigation in a single forum was a primary objective of Congress in enacting the Act, the plurality holds that the Act's jurisdictional provisions cannot be severed and that Congress should determine whether bankruptcy

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1/ Northern Pipeline, Slip Op. at 3 (Rehnquist, J. concurring).

jurisdiction should be divided between the bankruptcy courts and other forums. Northern Pipeline, slip opinion at 37, n. 40. Thus, §241(a) in its entirety is declared unconstitutional. Finally, the Court's judgment applies only prospectively and is stayed until October 4, 1982, in order to permit Congressional action.

We discuss briefly below various options available to Congress "to reconstitute the bankruptcy courts or to adopt other valid means of adjudication. Id., slip opinion at 38.2/ In addition, we discuss briefly the consequences should Congress fail to act by October 4, 1982.

Options Available to Congress

I. Make The Bankruptcy Courts Article III Tribunals.

A. Description.

Under this option, Congress would provide all bankruptcy judges with life tenure, subject only to removal by impeachment, and fixed and irreducible compensation in accordance with Art. III of the Constitution. It would not be necessary to pay these bankruptcy judges at the same rate as other Art. III judges.

B. Advantages.

1. This option would be the safest course available as it clearly would satisfy the objections of the plurality.

2/ To obtain some idea of the number of state/common law cases which are constitutionally suspect under both the Brennan and Rehnquist opinions, we contacted a representative of the Bankruptcy Division of the Administrative Office of the United States Courts. He reported a study conducted in 1979 (when over 200,000 bankruptcy estates were pending) indicated that, as a result of the changes in the Act, the bankruptcy courts would consider approximately 8,000 new "proceedings" previously tried in plenary proceedings in state court. Today, with over 518,000 estates pending, the study's results would project over 20,000 cases being tried in bankruptcy courts which previously were tried in nonbankruptcy forums. These figures are inflated, since they would include actions to set aside preferences that involve "public rights" under the Bankruptcy Act, and not purely actions to recover damages under state law. The Administrative Office expects to complete a more reliable study in the next several days.

2. Because of its apparent constitutionality, this option would minimize uncertainty concerning the status of the bankruptcy courts, thereby promoting economic stability and confidence in the bankruptcy system.

3. All proceedings under Title 11, or "arising in or related to cases under Title 11," 28 U.S.C. §1471(b), would be tried in a single forum, thereby avoiding the delay and expense of jurisdictional disputes and bifurcated adjudication.

4. The enhanced status of bankruptcy judges presumably would attract more and better qualified candidates for appointment.

C. Disadvantages.

1. This option could not be effectuated by October 4, 1982, unless there was an agreement between the Executive and the Congress as to which individuals would be appointed and confirmed as the Art. III judges. This is because, even after creation of the Art. III courts, approximately 190 positions would require appointment and confirmation. Any hiatus would disrupt and confuse the administration of the bankruptcy laws. (It is always possible, of course, that the Supreme Court might consent to a further stay of Northern Pipeline while the new judges were confirmed.)

2. The caliber of prospective appointees could be diminished due to the specialized nature of the court. If candidates were limited to bankruptcy practitioners, only a small percentage of the legal community would, as a threshold matter, be eligible. Many of these bankruptcy specialists are not highly experienced in trial practice. If generalists were considered, the universe of prospective candidates would be reduced to those willing to continue their careers (even as Art. III judges) in a limited substantive area. In addition, most generalists, having little or no background in bankruptcy and appointed as bankruptcy judges, would be inefficient until such time as they became fully conversant with bankruptcy principles and practice.

3. If the Art. III judgeships were filled by "grand-fathering," a number of marginal judges would assume life-tenured positions. Presumably "grand-fathering" on a large scale would be the most likely feature of a political agreement designed to ensure prompt confirmation of Art. III bankruptcy judges.

4. The existence of approximately two hundred life-tenure bankruptcy judges would limit Congress' flexibility in responding to future bankruptcy problems. For example, should the number of bankruptcies decline sharply, Congress "would then face the prospect of large numbers of idle federal judges." Id., slip opinion at 27 (White, J., dissenting).

5. "The addition of several hundred specialists may substantially change, whether for good or bad, the character of the federal bench." Id.

II. Provide That All Unconsented In Personam Suits By Bankrupt Involving State/Common Law Issues Be Brought In The District Court Of Which The Bankruptcy Court Is An Adjunct.

A. Description.

This option would adopt Chief Justice Burger's suggestion that "[t]he problems arising from [the Court's] judgment can be resolved simply by providing that ancillary common-law actions, such as the one involved in [Northern Pipeline], be routed to the United States district court of which the bankruptcy court is an adjunct." Id., slip opinion at 2 (Burger, C.J., dissenting).

B. Advantages.

1. This option would provide a relatively simple method for expeditiously curing the defects identified by the plurality. It arguably could be implemented before October 4, 1982, thereby minimizing disruption in the administration of the bankruptcy laws.

2. By utilizing the existing Art. III structure of the federal district courts, this option would obviate the need for nominating and confirming approximately 200 new Art. III judges. In addition to permitting immediate implementation, the additional needed judgeships (presumably only a fraction of 200) could be filled much more expeditiously. In addition, other needs of a judicial district could be taken into account in determining more rationally the number of additional judgeships required.

3. The disadvantages (identified in Option I above), stemming from the appointment of specialists in the federal judiciary, would be avoided and the flexibility of Congress to deal with future bankruptcy problems would be enhanced.

4. Assuming Chief Justice Burger is correct in limiting the plurality's decision to a "relatively narrow category of claims," id., slip opinion at 1-2, this option would pass constitutional muster with at lease five members of the Court.

5. Because the caseload of the district courts would be increased, additional federal judges would be appointed; however, their number would be far fewer than under Option One, and their generalist backgrounds would more likely be assured. As district court judges, these positions likely would attract a higher caliber of candidates.

6. The reluctance which district court judges have expressed with respect to bankruptcy litigation should be assuaged because the narrow category of cases referred to them would involve few bankruptcy issues. Instead, the cases would be substantially similar to diversity cases already heard in district courts.

7. The district courts would provide expertise already developed from the trial and disposition of substantially similar diversity actions.

C. Disadvantages.

1. Any method of "fixing" the problem created by Northern Pipeline other than Option 1 may be much more difficult to get through Congress in a short time because altering the method of handling bankruptcy cases will raise a host of conflicting considerations and interests.

2. This option would require assuming the risk that the Supreme Court would not restrict its holding to the facts of Northern Pipeline, but would, instead, declare other types of claims to be without the jurisdiction of the reconstituted bankruptcy courts. Thus, uncertainty would exist as various claims are subjected to Art. III constitutional challenges on a case-by-case basis. See Northern Pipeline, slip opinion at 37, n. 40.3/

3. Jurisdictional disputes, which Congress sought to avoid under the 1978 Act, would continue. However, since the bankruptcy courts will be adjuncts of the district courts, these disputes would be far less serious and time consuming than if the cases were tried in state courts.

4. Proceedings in the bankruptcy court would be delayed while related litigation was tried in the overburdened district courts. This disadvantage could be remedied by requiring that bankruptcy related actions be given priority. Such prioritization, however, could conflict with other policies articulated by Congress, e.g., prompt adjudication of criminal cases under the Speedy Trial Act.

3/ On the other hand, the plurality does not expressly disagree with Chief Justice Burger's suggestion. It simply states that it cannot "assume" that Congress would adopt the suggestion and expresses the view that "it is for Congress to determine the proper manner of restructuring the Bankruptcy Act of 1978 to conform to the requirements of Art. III, in the way that will best effectuate the legislative purpose." Id.

5. During the initial implementation period, the district courts would be overburdened with a swell of new cases. This would not only delay bankruptcy proceedings but would also adversely affect all other litigation in the district courts. Projections of the increased bankruptcy litigation might be employed to appoint additional judges; nevertheless, some disruption appears unavoidable. (Of course, some disruption will likely occur under most, if not all, of the options proposed.)

III. Provide Litigants In In Personam State/Common Law Actions An Absolute Right To Removal Of Actions From Bankruptcy Court To The District Court To Which Bankruptcy Court Is An Adjunct.

A. Discussion.

This option would provide a slight variation of Option II. State/common law actions would be initiated in bankruptcy court where they would be adjudicated unless a party exercised its right to removal to district court.

B. Advantages.

1. See discussion under Option II.

2. Fewer cases would be heard by the district courts, lessening the caseload burden resulting under Option II, and reducing the required number of Art. III judges.

3. By failing to remove in a timely fashion, parties would be deemed to have consented to adjudication by the bankruptcy court, thereby avoiding due process questions. See DeCosta v. Columbia Broadcasting Sys., Inc., 520 F.2d 499, 503-08 (1st Cir. 1975), cert. denied, 423 U.S. 1073 (1976) (holding consensual reference to magistrate satisfies litigant's due process right to Art. III tribunal). In addition, although the plurality observes that the power and authority of bankruptcy judges under the old Act was never explicitly endorsed by the Court (Northern Pipeline, slip opinion at 29, n. 31), consent provided a long recognized basis for bankruptcy court adjudication of plenary proceedings under the old Bankruptcy Act.

C. Disadvantages.

1. See discussion under Option II.

2. It is not clear in what percentage of cases all parties would consent to stay in the bankruptcy court.

IV. Revert To Old Bankruptcy Act Scheme, Limiting Bankruptcy Court's Jurisdiction On The Basis Of Possession/Consent

A. Description.

Actions involving state/common law issues brought by the bankrupt to which the defendant did not consent would be adjudicated primarily in state courts. This procedure would be substantially similar to that utilized under the old Bankruptcy Act.

B. Advantages.

1. This option could be adopted and implemented promptly by reverting to old Bankruptcy Act practices.

2. The federal courts would not be as overburdened under this option as under Option 2, because most affected cases would be adjudicated by state courts.

3. Fewer additional Art III. judges would be required.

4. Although the plurality observes that the power and authority of bankruptcy judges under the old Bankruptcy Act was never explicitly endorsed by the Court (Northern Pipeline, slip opinion at 29, n. 31), this option probably would pass constitutional muster -- at least for most kinds of cases.

C. Disadvantages.

1. Uncertainty would remain concerning the constitutionality of leaving other claims within the bankruptcy courts' jurisdiction. [See II(c)(2) above.]

2. Significant delay in resolving the ancillary actions could result from jurisdictional disputes, thereby frustrating a primary motivation of Congress in enacting under the Act a single forum for dispute resolution. Thus, a principal reform of the 1978 Act would be abolished.

3. Significant delay in disposing of bankruptcy proceedings could result because the timeliness of disposition would depend directly on the speed with which state courts throughout the country could dispose of the ancillary proceedings. The condition of the dockets in the various states would be beyond the control of the bankruptcy courts or Congress. Congress could not mandate expedited handling by the state courts.

V. Strengthen The "Adjunct" Relationship Between Bankruptcy Courts And District Courts

A. Description.

This option would reinforce the bankruptcy court's role as an "adjunct" by assuring that "the essential attributes of the judicial power" would be retained by Art. III tribunals. Northern Pipeline, slip opinion at 26, citing Crowell v. Benson, 285 U.S. 22, 51 (1932). This reinforcement could be accomplished by adding one or more of the following provisions to the Act:

1. Limit the bankruptcy court's role to fact finding in state/common law cases or other types of cases.

2. Require that an Art. III tribunal exercise all coercive powers, including award of execution (see Northern Pipeline, slip opinion at 35, n. 38).

3. Replace the present "clearly erroneous" standard of review with a "not supported by the evidence" standard or de novo review [but see Northern Pipeline, slip opinion at 24, n. 28 (characterizing as "incorrect" dissent's view that appellate review is sufficient to satisfy the requirements of Art. III)].

4. Replace present scheme of appointment by President with advice and consent of the Senate, with provision for appointment and removal by Art. III tribunals.

5. Provide for discretionary reference of cases by district courts to bankruptcy courts.

B. Advantages.

1. Given the concurring opinion's citation of "traditional appellate review" as the flaw proscribing adjunct status for bankruptcy courts [Northern Pipeline, slip opinion at 3-4 (Rehnquist, J., concurring)], provision of more stringent review standards seemingly would garner sufficient votes to forestall a successful constitutional attack. Addition of other attributes of an adjunct court would enhance the probability of this result.

2. This option would be more likely to be enacted promptly than others requiring significant modification of the judicial system.

C. Disadvantages.

1. Judicial economy would be disserved by requiring close supervision and control by district or appeals courts; de novo review would cause a redundancy of effort by two levels of federal courts.

2. Delay would result from such requirements as de novo review, or resort to an Art. III tribunal for enforcement of bankruptcy court orders.

3. Appointment and removal of bankruptcy judges by district courts would resurrect the old Bankruptcy Act appearance of cronyism and the view held by some that district courts merely "rubber stamped" the actions of their appointees. (This disadvantage could be blunted partially by requiring appointment by a court of appeals.)

4. The discretionary reference of all cases by district courts to bankruptcy courts, if not consented to by the parties, could result in constitutional challenges by litigants asserting a due process right to adjudication by an Art. III court. See, DeCosta v. Columbia Broadcasting Sys., Inc., supra.

VI. Appoint "Senior" Art. III Bankruptcy Judges In Each Judicial District Or In Each Circuit To Adjudicate State/Common Law Actions Requiring Art. III Judges.

A. Description.

This option would recognize that only a fraction of the cases adjudicated in connection with a bankruptcy proceeding require the exercise of Art. III powers. Instead of creating Art. III positions for all bankruptcy judges, one or more bankruptcy judges in each judicial district would be life-tenured with a minimum fixed salary. Alternatively, several Art. III bnakruptcy judges could be appointed in each circuit. They could "ride circuit" to conduct trials; in addition, they could serve as members of the bankruptcy appellate panels (see 28 U.S.C. §§ 160, 1482).

B. Advantages.

1. This option probably would pass constitutional muster.

2. Jurisdictional disputes would be minimized, since all matters would be heard in the bankruptcy court.

3. Delay would be avoided, because the bankruptcy proceedings would not be subject to clogged dockets in federal district courts and state courts.

4. The Art. III status of the "senior" bankruptcy judge could attract more highly qualified candidates.

5. With fewer Art. III bankruptcy judges than under Option 1, Congress' flexibility in dealing with future bankruptcy policy would be enhanced.

6. Adoption of the circuit approach would provide an Art. III appellate forum which could be substituted for the present appellate review in district courts and courts of appeals. This could reduce caseloads in those courts and expedite bankruptcy appeals.

C. Disadvantages.

1. This option would require considerable time to implement. If the district approach were adopted, at least 94 bankruptcy judges would require nomination and confirmation as Art. III judges. Adoption of the circuit approach would require the appointment of considerably fewer judges.

2. The disadvantages indentified under Option I(c), above, involving selection and appointment of specialists to the Art. III federal judiciary would result, although to a lesser degree than under Option I.

3. Appointment of at least one Art. III bankruptcy judge to each judicial district would result in uneven resource allocation. For example, only one full-time bankruptcy judge sits in each of 31 judicial districts. Thus, regardless of need, for roughly one-third of the bankruptcy system, the only bankruptcy judge in the judicial district necessarily would be an Art. III judge. On the other hand, in larger districts, such as the Central District of California, which handles thousands of cases each year and has twelve full-time bankruptcy judges, several Art. III judges presumably would be required. Using the circuit approach would permit greater flexibility in the allocation of judges.

4. Requiring the Art. III judges to "ride circuit" could result in delayed adjudication of cases.

VII. Modify Each Option Providing For Disposition Of State/Common Law Cases To Provide That Cases Requiring Adjudication By An Art. III Tribunal Shall Be Identified By The Courts On A Case-By-Case Basis.

A. Description.

Several options described above provide for referral of the narrow category of state/common law disputes to Art. III tribunals or state courts. This option suggests modification of those proposals to have the courts, rather than Congress, define on a case-by-case basis the categories of cases which may not be adjudicated by Art. I or adjunct bankruptcy courts.

B. Advantages.

1. This modification would enhance the other options' likelihood of passing constitutional muster. (This advantage would be less significant if, under the other options, Congress clearly provided for severability in the event that another category of cases must be heard by Art. III tribunals.)

C. Disadvantages.

1. This modification would generate considerable uncertainty in the administration of the bankruptcy laws as the courts would be required to determine the appropriate forum for numerous categories of cases. (On the other hand, such issues would arise, but to a lesser degree, if Congress defined the category of cases requiring Art. III adjudication.)

VIII. Provide For Bifurcation Of Jurisdiction Between Bankruptcy Courts And Art. III Tribunals Based Upon Principles Of Summary/Plenary Jurisdiction Established Under The Old Bankruptcy Act.

A. Description.

This modification of Options II and VI would provide that all actions recognized under the old Bankruptcy Act as beyond the summary jurisdiction of the bankruptcy courts would be adjudicated by Art. III tribunals.

B. Advantages.

1. This option would provide a tested method of determining the jurisdiction of the bankruptcy courts, thereby simplifying consideration and expediting passage of remedial legislation.

2. The boundaries of jurisdiction would be defined by traditional bankruptcy principles and long standing precedents; therefore, jurisdictional disputes could be reduced.

3. This option would likely pass constitutional muster, although the plurality notes that the summary authority exercised historically by bankruptcy courts has not been explicitly endorsed by the Court. Northern Pipeline, slip opinion at 29, n. 31.

C. Disadvantages.

1. This option would increase significantly the caseload of Art. III tribunals, thereby frustrating a primary objective of Congress in enacting the 1978 Act. Plenary jurisdiction under the old Act extended to many more cases than those involving simply state/common law claims. They included, for example, actions to recover property not within a bankrupt's possession, actions to avoid preferences, and actions to enforce other avoidance powers under the old Bankruptcy Act. In addition, many of the cases beyond the bankruptcy court's summary jurisdiction were filed in state courts. Under this option, all such cases would be adjudicated by Art. III tribunals.

IX. Modify Options II And VI To Provide That Unconsented In Personam Actions Against The United States Would Also Be Adjudicated By An Art. III Tribunal.

A. Description.

This option addresses the consequences possible under the plurality's observation that only "private-rights" disputes, as distinguished from "public-rights" disputes between the government and other persons, need be adjudicated by Art. III tribunals. Northern Pipeline, slip opinion at 17-19.

B. Advantages.

This option would insure that the United States shares with private litigants equal access to Art. III tribunals.

C. Disadvantages.

1. This option could be viewed as an effort to advance the parochial interests of the United States and thereby detract from efforts to persuade Congress to consider narrow, emergency legislation dealing only with the jurisdictional problems raised by Northern Pipeline.

2. This option would increase the Art. III tribunals' caseloads.

Result If No Remedial Legislation

The offending section of the Act, 241(a), gives jurisdiction over bankruptcy cases to the district courts. 28 U.S.C. §1471(a). It also grants the district courts jurisdiction over all proceedings "arising in or related to" bankruptcy cases, such as the proceedings at issue. 28 U.S.C. §1471(b). Section 241(a) further provides that the bankruptcy court for the appropriate district shall exercise bankruptcy jurisdiction. 28 U.S.C. §1471(c). The remainder of the Chapter contains venue and removal provisions, creates panels of bankruptcy judges to hear appeals and provides certain powers to the bankruptcy courts, including the power to punish contempt, and the power to conduct jury trials.

Section 241(a) and most of the other amendments to Title 28 contained in the Act actually become effective on April 1, 1984,4/ but §405(b) of the Act allows the current bankruptcy courts to exercise the jurisdiction described in §241(a) during the transition period, October 1, 1979, to April 1, 1984.5/

4/ Section 402(b) of the Act.

5/ Title IV of the Act.

Therefore, 28 U.S.C. §1334, which governs jurisdiction under the old Bankruptcy Act, remains applicable until 1984. 28 U.S.C. §1334 does not appear to be part of any of the bankruptcy acts repealed by §401 of the Act, and it gives bankruptcy jurisdiction to district courts, not to the bankruptcy courts. But, unlike 28 U.S.C. §1471(b), it does not contain the language "proceedings ... arising in or related to cases under Title 11." It is this language which extends bankruptcy jurisdiction to matters involving property in the possession of nonconsenting third parties, i.e., "plenary matters."

Under 28 U.S.C. §1334, the district court could hear any bankruptcy case under the new Code, or it could refer the case to the bankruptcy court under current bankruptcy rules.6/ It could also hear plenary matters involving the bankrupt and third parties, provided an independent basis for federal jurisdiction exists. Under 28 U.S.C. §1334, the district court would not be able to hear plenary matters involving only state law issues and citizens of the same state.

It is arguable that §241(a) is not separable from the remainder of the Act and that the entire Act must fall because §241(a) is invalid. In such a case the repeal of the old Act would also be invalidated. Presumably, the courts could attempt to apply the old Act to pending cases and would transfer or dismiss proceedings over which they have no jurisdiction. The courts might also decide that bankrupts who wish to continue under the old Act must re-petition the court for relief under the old Act. We would expect a case-by-case resolution of the complicated title disputes which would arise.

2 C. Sands, Sutherland on Statutory Construction §44.03 (4th ed. 1973), indicates that separability is a matter of legislative intent. There is no clause in the Reform Act indicating that any provision of the Act is separable, and there is no legislative history on this point. In addition, footnote 40 of the plurality opinion raises a question as to whether the Court intended that the whole Act should fall if not corrected by Congress. On the other hand, none of the factors which weigh against separability is present in this case, e.g., a penal statute, an indication that the provision at issue induced the remainder of the legislation, or the impossibility of reasonably applying the remaining legislation.

Accordingly, if there is no timely, effective legislation, there would be uncertainty as to whether a bankruptcy system exists and, if so, what it is.

6/ Bankruptcy Rule 102 provides for automatice reference.

MEMORANDUM

THE WHITE HOUSE

WASHINGTON

August 27, 1982

FOR: EDWIN MEESE III

FROM: MICHAEL M. UHLMANN

SUBJECT: Bankruptcy Reform Legislation

Attached is a draft memo prepared by Justice which sets forth the options. Because the Attorney General does not return until Monday, he has not yet had a chance to review it, but no major changes are anticipated.

Fred Fielding and I met with Jon Rose yesterday, and we concluded that the call at this point was essentially a tactical one on which your guidance is needed. I would therefore suggest sitting down immediately upon your return to discuss the specific options, particularly as they relate to getting more Article III judges.

If in the meantime you need further information, please let me know.

SEP 23 1982

September 21, 1982

The Honorable Peter W. Rodino, Jr.
Chairman, House Judiciary Committee
2137 Rayburn H.O.B.
Washington, D.C. 20515

Re: Judicial Conference Report on the Bankruptcy Courts

Dear Mr. Chairman:

We are writing in response to the Report of the Judicial Conference of the United States on proposed responses to Northern Pipeline Construction Co. v. Marathon Pipe Line Co., ____ U.S. ___, 102 S.Ct. 2858, 50 U.S.L.W. 4892 (June 28, 1982). We are all attorneys who practice commercial bankruptcy law. Our clients include large and small business debtors, and institutional and non-institutional creditors. We are not writing on behalf of any particular clients, but solely out of our individual concerns for the continued functioning of the bankruptcy courts. We strongly believe that the Judicial Conference Report, if implemented, could seriously damage the operation of the courts and significantly increase the costs of bankruptcy to debtors, creditors, the economy, and the federal treasury. We urge that the Report be rejected.

Northern Pipeline held unconstitutional the grant of expanded jurisdiction to bankruptcy courts staffed with non-Article III bankruptcy judges. The Judicial Conference Report insists that the precise holding of the case reached only an action for breach of contract in the bankruptcy court by a debtor in possession against a third party. However, six of the justices found the jurisdiction granted under section 1471 of title 28 nonseverable and therefore ruled that the entire jurisdictional grant was invalid.

The Supreme Court suggested two possible alternatives: Congress could "reconstitute the bankruptcy courts, or . . . adopt other valid means of adjudication," such as by limiting the jurisdiction of the bankruptcy court and requiring certain matters to be heard in other courts. However, with one exception, the the Court did not indicate how Congress could do either so as to render the bankruptcy court system and its jurisdiction constitutional. The one exception was for Congress to reconstitute the courts as Article III courts. As so constituted, there would be no constitutional impediment to the exercise of any of the jurisdiction granted under the 1978 Act. The issue for Congress is whether to modify the form or the jurisdiction of the bankruptcy courts.

While there was debate over the form of the bankruptcy court system, there has been little, if any, disagreement as to the bankruptcy courts' jurisdiction. Before 1978, jurisdiction was divided and frequently litigated. Creditors suffered in terms of net recovery, and the cost to debtors, creditors, and employees resulting from delay in reorganization cases was often substantial. Every organization that studied the bankruptcy laws during the 1970's agreed that the artificial division of the bankruptcy courts' jurisdiction should be abolished. The Commission on the Bankruptcy Laws of the United States (which included representatives of the Judicial Conference, the House, and the Senate, and three presidential appointees) first formally proposed unified bankruptcy court jurisdiction. The American Bankers Association, the National Commercial Finance Conference, the National Bankruptcy Conference, the Commercial Law League of America, the Department of Justice, and, significantly, the Judicial Conference, all recommended elimination of the distinction between summary and plenary jurisdiction. In the words of then-Attorney General Griffin Bell,

> "the distinction . . . is cumbersome, outmoded, and inefficient, and . . . resort to such legal fictions as jurisdiction by 'consent' should end in favor of explicit authority in the district court to take jurisdiction over the affairs of the estate . . . and a mechanism [should be] established to insure that the bankruptcy court is delegated the power to exercise the jurisdiction granted to the district court."

That reform was enacted in 1978.

Since 1978, the wisdom of Congress' decision to eliminate the possession and consent or other limitations on jurisdiction has become apparent. Litigants now address the merits of their disputes and do not attempt to divert attention from substantive issues by litigation over jurisdiction solely for purpose of delay. Trustees in liquidating cases and debtors in possession in reorganization cases are able to recover promptly assets improperly seized by creditors before the filing of a bankruptcy petition. All legal relationships of a bankrupt entity may be resolved expeditiously, efficiently, and at reasonable cost to the litigants and the taxpayers. All still agree that unified jurisdiction is essential to a healthy bankruptcy system, but the Supreme Court has ruled that unified jurisdiction may only be vested in an Article III court.

Form and jurisdiction have now become inseparable. Unified jurisdiction may only be granted to Article III bankruptcy

courts, with judges who are appointed by the President with the advice and consent of the Senate, and who have tenure during good behavior. Any system that does not involve Article III bankruptcy judges will require some division of jurisdiction. In the current debate over the court system, different jurisdictional limits for different kinds of non-Article III courts have been suggested to meet the constraints imposed by Northern Pipeline. The short answer to all of these suggestions is that Northern Pipeline simply did not define its reach. There is no certainty short of Article III. The variables of jurisdictional line-drawing, scope of review by district courts, scope of authority granted to non-tenured bankruptcy judges, and method of appointment or removal of bankruptcy judges, among others, all will create more opportunities for litigants to argue constitutionality as well as the interpretation of the statutory grant of jurisdiction, to delay bankruptcy cases, and to burden the bankruptcy system.

The Judicial Conference opposes an Article III court. Therefore, it attempts to reargue the broad agreement on unified jurisdiction. It does so by belittling the scope of the jurisdictional problem. The Conference Report pronounces that only 15% of all adversary proceedings are within the reach of Northern Pipeline's prohibition, without any explanation of the derivation of the 15% number and without any attempt to define the reach of Northern Pipeline. Then, the Conference fails to distinguish between caseload and workload, which it emphasized earlier in its Report, and concludes that expanded jurisdiction is unnecessary. To avoid a bankruptcy court with the constitutional protections of Article III, the Judicial Conference recommends that the bankruptcy courts' jurisdiction once again be split.

The Judicial Conference's opposition to unified jurisdiction is artificial at best. The 1978 Act did not grant the bankruptcy courts jurisdiction over kinds of lawsuits that it could not hear before 1978. The prior limitation was never subject-matter related. The bankruptcy court had jurisdiction to hear all kinds of federal and state law causes of action, including the breach of contract claim that was litigated in Northern Pipeline, as long as there was "possession" or "consent." The 1978 jurisdictional change only eliminated these irrelevancies as jurisdictional limitations. The 1978 Act did not make the bankruptcy court a "trial court of general jurisdiction." The issues that it hears must still be related to bankruptcy cases. The bankruptcy court heard many, if not all, of those same issues before 1978.

The Judicial Conference proposes splitting jurisdiction by categorizing matters as "cases", "subsidiary proceedings", and

"related proceedings", as defined. The definitions include only claims arising under federal statutes. The district courts would have jurisdiction over each, but "cases" and "subsidiary proceedings" could be referred to bankruptcy judges, while "related proceedings" would be retained in the district court. Matters referred could be recalled, and matters recalled or originally retained in the district court could be referred to magistrates. Instead of one forum for bankruptcy matters, the Judicial Conference, in the interest of efficiency, proposes three forums in the federal system.

The most obvious defect in the proposal is the amount of litigation it will generate over whether a particular action is a "case", a "subsidiary proceeding", a "related proceeding", or none of those. Any attempt to draw a dividing line between different kinds of disputed matters in bankruptcy cases will create such litigation. Courts and scholars struggled mightily with two divisions under former law. The Judicial Conference proposes three divisions.

The nature of matters that arise in bankruptcy cases are not so easily categorized. There are matters of administration, both disputed and undisputed, not involving third parties' rights. At the other extreme, there are actions like the action in Northern Pipeline involving a breach of contract claim by an estate against a third party. In between these extremes, there are numerous other kinds of matters which involve various proportions of state and federal and public and private issues, based on the complex incorporation into the Bankruptcy Code of state-created private rights and rules of decision.

Adding to the uncertainty created by the attempted statutory categorization, Northern Pipeline did not define the constitutionally permissible reach of the jurisdiction of a non-Article III bankruptcy court. The plurality opinion of Mr. Justice Brennan strongly questioned the constitutionality of the exercise of any jurisdiction by the bankruptcy courts as presently constituted. Mr. Justice Rehnquist's concurring opinion may be broader than to cover simply state common law actions. In his concurring opinion in Northern Pipeline, he characterized the matter at issue there as "the stuff of the traditional actions at common law tried by the courts at Westminster in 1789." Many other actions in or related to a bankruptcy case might fall in this category, including any attempt by a trustee or debtor in possession to recover assets or a cause of action from a third party. The actions might be based on state or federal law, on a statute or on common law. Given the expanse of the Seventh Amendment's definition of "suits at common

law", it is not clear that the source of the rule of decision for a cause of action governs whether constitutional protections apply in the federal courts. The Judicial Conference's bill contains a separability clause, so that the constitutionality of applying the proposed jurisdiction to any particular case can be litigated anew in each fact situation as it arises.

In sum, a jurisdictional line cannot be drawn with any statutory or constitutional precision. Any jurisdictional line drawing will require extensive litigation, but new litigation will not be aided by 80 years of case law construing the bankruptcy court's jurisdiction under the Bankruptcy Act. Lawyers and courts will have a fresh start trying to find new limits on the bankruptcy court's jurisdiction. The same wasteful conditions that led to unanimous support of unification of jurisdiction will reappear. The bankruptcy court's jurisdiction must be unified to handle the 600,000 cases and the tens of billions of dollars of assets and liabilities that pass through the bankruptcy courts annually.

It is not just the need for unified jurisdiction that requires the creation of Article III courts. All organizations, including the Judicial Conference and the Department of Justice, have recognized that Article III courts will attract the best qualified judges. The tremendous number of litigants and the staggering amount of dollars involved annually in the bankruptcy courts demand the best judges available.

Finally, the Constitution itself speaks of vesting the judicial power of the United States in judges appointed during good bahavior. It would be unseemly for Congress to attempt to avoid the clear dictates of Article III, notwithstanding numerous minor exceptions that the Supreme Court has made to the requirements of that Article. Article III should not be brushed aside in the name of efficiency. Constitutional protections are for the benefit of litigants, not the government. They should not be lightly disregarded.

Very truly yours,

Herman L. Glatt, Los Angeles
Richard Levin, Los Angeles
Louis Levit, Chicago
Harvey Miller, New York
Herbert P. Minkel, Jr., New York
Patrick A. Murphy, San Francisco
Leonard M. Rosen, New York
George M. Treister, Los Angeles

National Conference of Bankruptcy Judges

September 19, 1982

The Honorable Peter W. Rodino, Jr.
Chairman, Committee on the Judiciary
House of Representatives
Washington, DC 20515

Re: Judicial Conference Report dated September 9, 1982, on Northern Pipeline Construction Co. v. Marathon Pipeline Co., and proposals for remedial Congressional action

Dear Congressman Rodino:

There may be a natural reaction on the part of any legislator who reads the captioned report to cast it aside, and unfortunately any consideration of the serious issue it addresses, as no more than another example of competition for bureaucratic turf. Perhaps in this response to that report, if we make it crystal clear at the outset how the problem arose, the significance of it, and what we seek as bankruptcy judges, we may lessen the tendency to pigeonhole the whole matter as a highly technical, but still thoroughly bureaucratic, dispute.

What bankruptcy judges seek is the same thing all bankruptcy practitioners seek -- an efficient solution to the problem of lack of clarity in regard to bankruptcy jurisdiction. As essentially non-political specialists, many do not expect to receive the Presidential appointments the solution they have always proposed would require. Thus, the net effect of their efforts will be to eliminate the very jobs they now possess. They do not seek two-storied courtrooms, marshals, bailiffs, or all of the other panoply and splendor of the federal judiciary. They do not seek to be trial courts of general jurisdiction as so often stated in the report, but desire to remain only specialized courts with all disputes having a bankruptcy beginning, but with the power to resolve those disputes equitably, quickly, with finality, and with the speed necessary to protect both creditors and debtors. Clarity as to

jurisdiction has priority over higher salaries (although the office would seem to justify them), and also priority over the much-maligned enhanced retirement benefits. It is true that bankruptcy judges have given their productive middle years to a bankruptcy system now administering almost $100 billion in assets, with little hint of scandal or corruption, and that their present retirement system is geared to the civil service worker who becomes a federal clerk at age twenty and retires 40 years later. It would only seem fair and equitable to shelter in some small way the plight of the bankruptcy judge who will not be appointed when the court is reconstituted, and who has contributed so much to create that remarkable system. BUT, if securing clarity as to jurisdiction requires that sacrifice also, then so be it. No, we do not come with hands outstretched, or with petulant bickering over status or prestige.

The Judicial Conference report cannot be understood without a brief review of the origin of this problem. Every bankruptcy system requires a great deal of administration as distinguished from dispute-resolving functions. Meetings of creditors must be called and kept orderly, notices must be sent, claims filed, trustees appointed and supervised, and so on ad infinitum. The Bankruptcy Act of 1867 had created an official to handle such administration. He was called a register, and he was expressly directed by the statute to sit "in chambers" and there transact such administrative duties as the district judges should assign to him. Yet, an odd provision appeared in the statute, contrary to the general principle in every other field of the law, that jurisdiction could never be conferred by consent. The 1867 statute, unlike the proposed statute of the Judicial Conference on which we will later comment, conferred jurisdiction on the register instead of the district judge if the parties consented that the register resolve the dispute. Where the consent was not obtained, the district court had to try the issue. It is obvious from the subsequent course of events that the district courts came to rely to a great extent upon the register to handle not only administration in bankruptcy matters, but also to perform dispute-resolving functions, and that gradually the dispute-resolving functions assigned to the register, referee, and later, bankruptcy judge, evolved with the passage of time. There were various reasons for that evolution. The district court had at its ready disposal an official whom it had appointed, and thus, in whom obviously it had confidence, a trained specialist to whom all bankruptcy matters could

be referred. Additionally, it should not be forgotten that until the depression of the thirties and the addition of the business rehabilitation chapters X and XI, bankruptcy, except perhaps in the larger metropolitan centers, was a scuffling, scavenger type business, scorned by the general public, practiced by attorneys with little general repute, and involving cases of inconsequential dollar amounts.

The cases became larger, and the issues more complex, and so it was that in the Bankruptcy Act of 1898, that assistant to the district judge had now become called a referee, and his powers had been substantially enhanced into something closer akin to a court than to an administrator directed to sit "in chambers". By then, he was trying some of the most critical issues in a bankruptcy case, with the district judge acting as an appellate court. All involved seemed to want the district court to try certain things, and the bankruptcy court to try others, but where to draw the line? That was the rub. It was to become a problem for eighty years. It is the problem today.

At first the courts and Congress approached the problem in the same naive way the Judicial Conference report now approaches it. They attempted to isolate "bankruptcy" law matters on the one hand from "non-bankruptcy" matters on the other. Thus, since quick action in reference to property in the possession of the debtor is required because otherwise it will be stolen, or vandalized, or taken by creditors, it was decided bankruptcy courts would decide all issues relating to property in the "possession" of the debtor. Ostensibly, this exercise of so-called summary jurisdiction was said to be no more than the exercise of in rem jurisdiction, but that explanation never really fit all of the many issues that, in later years, the bankruptcy court ultimately decided. It was really the necessity for speed in resolution of the disputes that determined where first the line was to be drawn. If a matter could wait a while to have the issue decided, then let the district court or the state court do it.

"Possession" then became the simple, magic word that plagued the bankruptcy courts for decades, and represented the place where the line between bankruptcy court and district court was to be drawn. It is a simple word like the words "claim", or "subsidiary proceeding", or "related proceeding" contained in the Judicial Conference proposed

bill. The test of possession in the debtor at the time of the filing of the petition worked well when all that was involved was a $10 bag of potatoes, or a $200 bale of cotton. Once, however, bankruptcy law became more complex, and debtors started seeking to assert $10 million lawsuits for breach of contract, the clear-cut line became clouded. Who is "in possession" of a chose in action? Additionally, what if a thief is in possession. As to the latter, the courts said there was no problem, that the thief, although in actual "possession", had no real claim to the property, so the debtor really was in "constructive" possession. What then of the bankrupt who had created an alter ego corporation and treated that corporation as no more than another pocket, if the property in question was in the "possession" of the alter ego corporation, did it come under bankruptcy jurisdiction? Or the bailee who had some claim of right? A multitude of possible "constructive possession" cases began to arise as bankruptcy became more and more complicated, and in every circuit there was a different rule as to where the line was to be drawn. Finally, the evolution continued and the simple word "possession" was no longer capable of defining the precise line, so the courts came up with another simple concept and said if there was a "substantial" adverse claim to the property (as distinguished from an adverse claim), then the district court had jurisdiction. Some circuits interpreted this with great strictness, and others encouraged the bankruptcy courts to try everything possible. Other circuits indicated that the judges could determine from the pleadings whether there was a substantial adverse claim, but a reading of the pleadings showed nothing but a clear-cut disagreement on all points. There became no other solution to the problem of determining whether a "substantial adverse claim" was being asserted than to <u>try</u> the case. So it was that day after day, year after year, the bankruptcy courts of this country tried the jurisdictional issue of whether the claim was "substantial" by trying the merits of the entire case. Millions and millions of dollars were wasted in lawyer and court time, and delays in payments to creditors. All the while, the issue of who would win the law suit was not being tried, but only the issue of <u>where</u> would the lawsuit ultimately be tried. As the years passed, and the cases became more and more complicated and numerous, more and more jurisdiction was gradually assigned to the bankruptcy courts, and the absurdity of bifurcated jurisdiction became more apparent to bankruptcy practitioners and judges.

It was this jurisdictional absurdity that largely

was responsible for the creation in 1970 of the Commission on Bankruptcy Laws of the United States. After a two year study, that Commission strongly recommended a bankruptcy court with the expanded jurisdiction to handle "every controversy involving property of the estate regardless of possession". Because of the political difficulties involved in achieving an Article III court, the Commission had recommended an Article I court with all of the expanded powers that Northern Pipeline tells us can only be exercised by an Article III judge. There is, then, no solution to clarity in regard to jurisdiction without Article III status for bankruptcy judges. It will not be a task easily accomplished, but eighty years has shown us there can be no fall back position, no position of compromise. That is the background of the problem we now address.

There is a strong temptation for anyone with even a superficial knowledge of the pre-Code jurisdictional morass to attempt once again to patiently correct all of the naive assumptions and conclusions that are embodied in this report. Time will not permit that laborious an undertaking since, as this response is being dictated, less than forty-eight hours remain before H.R. 6978 is considered on the floor of the House. This response will cover only three principal areas where the report is totally in error.

I. The Judicial Conference proposed bill does not provide for clarity in regards to jurisdiction, but, on the contrary, it sets that quest back to 1867.

(a) There is no provision for consent jurisdiction in the proposed bill, a part of bankruptcy law since 1867. If the comment in footnote 31 to Justice Brennan's plurality opinion casting doubt on the constitutionality of consent jurisdiction is the reason for this omission, it is suggested the balance of the opinion be reviewed where he requires Article III status to determine "the liability of one individual to another under the law as defined".

(b) There is no absolute removal power provided, which would presumably mean a large number of cases pending in other courts in the typical large corporate case would all be separately tried in those other courts, with duplication of effort on the part of the debtor, and excessive delay in the proposal and confirmation of a plan of reorganization for creditors.

(c) §1471(e) of the proposed bill confers jurisdiction on the bankruptcy court "over all property ... of the debtor or the estate", and is presumably designed to confer a form of in rem jurisdiction similar to the sections that appeared in

the 1898 Bankruptcy Act. That jurisdiction was based on possession and resulted in the plenary and summary jurisdiction above described, but those similar sections in the 1898 Bankruptcy Act were fleshed out by sections 2 and 23 of the old Act, plus eighty years of case law. The old approach represented the principal problem of jurisdictional uncertainty the Code was designed to solve, and in view of the fact that the 1898 Act was repealed by the Code, and the proposed section does not adequately bring in the plenary and summary distinction, apparently the Judicial Conference contemplates a new beginning in the resolution of the jurisdictional uncertainty of in rem proceedings. If this abbreviated restatement of the old law is an attempt to restore plenary and summary jurisdiction, then the confusion that existed in the past will have no parallel in the future. Many bankruptcy disputes relate to whether a given res is "property of the estate." Must the court try the merits of the entire case under this section to determine whether the res is "property of the estate", and thus whether it has jurisdiction? Does not §1471(e) conflict with the other provisions regarding who tries related and subsidiary "proceedings". If a company called Northern Pipeline had a suit against Marathon Pipeline for breach of contract at the commencement of the case, and contended that the chose in action was "property of the estate" under §541, would the bankruptcy court under §1471(e) have jurisdiction to try the very case that the Supreme Court has held it has no constitutional authority to decide?

(d) The references to "related" and "subsidiary" proceedings will create all manner of judicial uncertainty and delay in the trial of bankruptcy cases. The whole thrust of the approach appears to be to now create in the interest of efficiency four layers of courts, where only one now exists. The first layer created is presumably the state court deciding actions at common law or under state law where federal diversity statutes would not be applicable. There is no incorporation of actions based on the common law into subsidiary or related proceedings if the ambiguous §1471(e) is not applicable, and if a tortured application of the Federal Judiciary Act as being "a statute of the United States" under §1471(g)(3) that incorporates the common law is not attempted. As will be explained later, much of the judicial work of the bankruptcy court is the determination of common law disputes and disputes under the Uniform Commercial Code. Presumably, now the state courts will laboriously try those issues while creditors and debtors wait.

The second and third layers in §1471 of courts now involved in the bankruptcy process would be the district and bankruptcy courts, with the power in the district court, at any time during the course of a case, to recall the case for no stated reason from the bankruptcy court. The fourth layer proposed is

incredibly the magistrates, where presumably two trials may now be required, one at the magistrate level and another de novo at the district court level. This is the "responsible and sensible remedy" to the problem of Northern Pipeline!!

II. How many Article III issues arise in bankruptcy cases? The Judicial Conference report attempts to belittle the importance of the Northern Pipeline problem by concluding that "less than 5% of the caseload in the bankruptcy courts during the transition period" have Article III implications. This amazing result is achieved by (a) limiting the holding of the Supreme Court to the explanation of that holding by the Chief Justice in his single dissent as striking down only ancillary common law actions; (b) arbitrarily assuming, without the slightest explanation, that 15% of all adversary proceedings "have involved the resolution of ancillary issues"; and (c) advancing the novel legal theory that when a bankruptcy judge hears some issue of bankruptcy law in conjunction with issues of private rights, he can decide the private rights dispute "in furtherance of the public right conferred by Congress".

As to (a), all would concede it is difficult to know what a majority of the Supreme Court held in Northern Pipeline, but certainly four justices held quite clearly that no Article I bankruptcy judge could ever decide private rights disputes between individuals, and two justices held the court could not decide the non-severable Northern Pipeline ancillary law dispute. How many additional private rights disputes the concurring justices will strike down is mere speculation, but the indecision as to what they will do is in itself a strong argument for correcting the problem. However, regardless of whether the "non-bankruptcy" work of the bankruptcy court be called the resolution of private rights disputes, or of ancillary common law actions, both of those phrases describe most of the work of the bankruptcy court.

The assumption that bankruptcy courts do only "bankruptcy law work" could be refuted by attendance at bankruptcy hearings on any given day in any metropolitan court that handles business reorganizations. There is rarely a disputed case that is decided strictly on bankruptcy law principles. In Appendix D, page 2 to the report, the premise is blithely advanced, obviously by one who has never attended such a hearing, that all one decides in a complaint to lift the stay are adequate protection and related bankruptcy issues, and thus this writer was wrong in including such complaints as possible Article III problems in his congressional testimony. It is certainly true that if the parties would stipulate as to the amount of the debt and the validity and priority of the lien, only bankruptcy

issues would arise, but in well over half of the cases this writer tries, disputes arise as to the amount of the debt, and the validity of the liens under U.C.C. or applicable real estate law. It is also clear that when jurisdictional uncertainty is again injected into the bankruptcy process, the party who will benefit from delay will not stipulate as to anything.

Likewise, in the response to my exhibit, the Judicial Conference refers to lien avoidances as not involving private rights. On the contrary, the bankruptcy court must decide the right to an exemption under state law in a dispute strictly between two private parties when §522(f) is involved. Thus, again, the decision is possibly within the scope of Northern Pipeline.

All of the other categories included by me as possible Article III problems are summarily rejected under the theory that when a bankruptcy judge hears a matter "in furtherance of the public right", it has no Article III defects.

The only problem with this latter distinction is that I know of no case authority supporting it, but if it is a valid principle of the law, one has difficulty understanding the current furor. Northern Pipeline could have been decided on that very principle. This debtor had the public duty and right by the Bankruptcy Code (Sections 541, 704, 1106, 1107 and 1108) to pursue the chose in action it had against Marathon. It was in furtherance of this public right that the suit was brought against the third party Marathon, and the Supreme Court held that the bankruptcy judge still had no Article III power to make the decision. We see no constitutional difference between Northern Pipeline suing Marathon, or Marathon filing a claim in the Chapter 11 against Northern Pipeline, with Northern raising an objection to that claim. Both matters would have been decided strictly under the common law with the application of no bankruptcy law. We do not understand why the action out against Marathon is an ancillary common law issue, but the action in against Northern decided on common law principles would be a "bankruptcy law issue". Those of us who practiced bankruptcy law before 1978 are accustomed to tenuous jurisdictional distinctions, but not a distinction that goes this far. Every bankruptcy controversy is going to begin because of a bankruptcy section, generally §541, and if we could be certain this would mean that all of the multitude of ancillary common law actions we have to decide because of this beginning could constitutionally be decided by Article I judges, there would no longer be any problem. Northern Pipeline clearly indicates that is not so.

III. The Cost. This "red herring" covers many pages in the

Judicial Conference report. Most of the figures assume some radical change in status of the bankruptcy judges "comparable to Article III judges", and astronomical costs are added for second law clerks, upgraded court reporters, and the like.

There is a simple answer to those figures. Article III status means only two things: (a) appointment during good behavior; and (b) no power in Congress to reduce compensation during term in office. There is absolutely no requirement that bankruptcy judges be paid the same salary as other Article III judges, have the same facilities, or be arrayed in all of the panoply of other courts. It is solely up to Congress to say what those costs will be, and since bankruptcy judges are now doing precisely what their Article III successors will be doing, it is not understood why any substantial increase in present cost would be required, other than the salary increase set forth in H.R. 6978. Present bankruptcy judges face Presidential appointment for fourteen years under the Code, and fifteen years is the average productive time of a federal district judge as established by the Administrative Office. The difference between life and fourteen years is inconsequential. Furthermore, salary diminution has not occurred in these modern inflationary times, and probably will not be a possibility in the future. Nothing really changes. One fails to understand why the reason for the furor if bankruptcy judges continue to do precisely the same thing they are now doing after Article III status is attained. We cannot, of course, guarantee whether our successors, once clothed in lifetime security, will be equally dedicated and unconcerned with pomp and status, but we do know Congress alone will set the cost, and if nothing changes, it will be substantially the present cost except for the salary differential.

When bankruptcy was of no consequence in the judicial or economic scheme of things, the problem of jurisdictional uncertainty worried only a small number of judges, lawyers, small merchants, and an occasional farmer. Times, however, have changed. In 1976 a limited study by the National Conference of Bankruptcy Judges found bankruptcy courts administering $27 billion in assets, with $43 billion in debts, involving the lives of nine million creditors. Since that limited survey, the case numbers have almost tripled, and with clarity in regard to jurisdiction having been resolved up to the time of the Northern Pipeline explosion, much larger cases have been filed indicating the assets administered may very well now approach some $100 billion. A recent survey of the ten largest cases in only three courts (New York, Dallas, and San Francisco) indicated that in those courts alone those cases involved the administration of $8 billion in assets. Bankruptcy has ceased

to be scavenger work. It now is a very attractive alternative for any financially ill company, or body of creditors, that seeks rehabilitation in an orderly way. The jurisdictional problem that has plagued bankruptcy for eighty years is very much now a national problem.

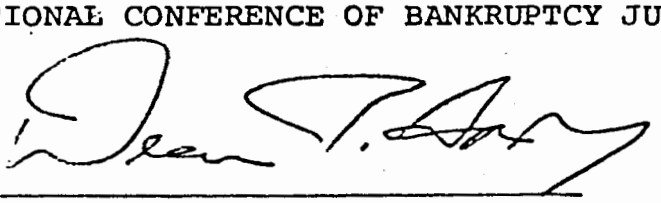
There really has never been during the 1970's any opposition to expanded jurisdiction in the bankruptcy court from any organization that has studied the problem. The Commission on Bankruptcy Laws of the United States (which included representatives from the Judicial Conference, the House, the Senate, three Presidential appointees, and no bankruptcy judges) first formally proposed expanded bankruptcy court jurisdiction. The American Bankers Association, the National Commercial Finance Conference, the National Bankruptcy Conference, the Commercial Law League of America, the Department of Justice, and even the Judicial Conference, all recommended elimination of the distinction between summary and plenary jurisdiction.

The problem is that each time the point was made that only an Article III judge could have that expanded jurisdiction all seemed to want the bankruptcy court to have, the specter of political expediency was raised, and each time proponents of Article III were encouraged to fall back to a "Rube Goldberg" solution, where, by drafting legerdemain, the bankruptcy court was given Article III powers, but by creating "adjunct" courts or delegating jurisdiction, it still remained something else. The plurality opinion in Northern Pipeline clearly indicates it is time to face this problem once and for all and to solve it by reconstituting the bankruptcy court as an Article III court.

Thank you for letting us respond to this report.

Respectfully submitted,

NATIONAL CONFERENCE OF BANKRUPTCY JUDGES

by 

Dean M. Gandy, President