Continued from previous folder

PROFESSOR VERN COUNTRYMAN
PROFESSOR FRANK R. KENNEDY
PROFESSOR LAWRENCE P. KING

SEP 23 1982

September 20, 1982

Honorable Peter W. Rodino
Chairman, House Judiciary Committee
Rayburn House Office Building
Washington, D. C. 20515

Honorable Strom Thurmond
Chairman, Senate Judiciary Committee
209 Russell Senate Office Building
Washington, D.C. 20510

Honorable Robert Dole
Chairman, Subcommittee on Courts
2213 Dirksen Senate Office Building
Washington, D. C. 20510

Re: Report and Proposals of Judicial Conference to Congress on Northern Pipeline Construction Co. v. Marathon Pipe Line Co.

Gentlemen:

We have reviewed the report and proposals of the Judicial Conference of the United States dated September 9, 1982 with respect to the above cited case and remedial action being considered by Congress in connection with that case. With all due respect for the members of the Judicial Conference, we find the report replete with inaccurate facts and unsubstantiated assumptions and the legislative proposals thoroughly unsound.

The Report

At the outset the Judicial Conference deprecates others' perceptions of the problems created by Northern Pipeline while it proposes a solution to the "real problem" (Report p. 3). The authors of the Report undertake to make a definitive statement of the holding of Northern Pipeline Construction Co. v. Marathon Pipe Line Co.: "... the conferral of jurisdiction in section 241(a) to decide actions at common law arising under state law

- and only that authority - ... has actually been held to be unconstitutional by the Court" (Report at p. 13). This statement is predicated on Justice Rehnquist's opinion written for himself and one other member of the Court. The Justice's last paragraph is more accurate and helpful:

> "I would, therefore, hold so much of the Bankruptcy Act of 1978 as enables a Bankruptcy Court to entertain and decide Northern's lawsuit over Marathon's objection to be violative of Article III of the United States Constitution. Because I agree with the plurality that this grant of authority is not readily severable from the remaining grant of authority to Bankruptcy Courts under §241(a), ... I concur in the judgment." 102 Sup.Ct. at 2882.

Wherefore, Congressman Rodino observed, in the much criticized statement appearing at the middle of p. 13 of the Report, that "[t]he Court held that the jurisdiction conferred on the bankruptcy court by the Bankruptcy Reform Act of 1978 cannot be constitutionally exercised by these courts ...." And for that reason the plurality and concurring opinions gave Congress "an opportunity to reconstitute the bankruptcy courts or to adopt other valid means of adjudication."

The Report revises Congressman Rodino's statement to interpret the Supreme Court's decision to preclude the authorization of all jurisdiction conferred by section 241(a) (Report at the middle of p. 11) and then (just below the middle of p. 12) to expressly hold "all jurisdiction conferred by section 241(a) ... to be invalid." The leap is then made by the Report to its implicit conclusion that the Court held that existing bankruptcy judges, although not members of an Article III court, may constitutionally exercise jurisdiction to resolve questions of law "arising under Title II" -- "questions of bankruptcy law" (Report at the middle of p. 13).

The Judicial Conference's characterizations of others' perceptions of the effect of the Supreme Court's decision are not a mere matter of semantics but are indicative of the Conference's continuous failure to recognize, or its willingness to ignore, what has become over the years a major sore spot in the federal judicial system, i.e., the need for bankruptcy reform. The real problem is the one sought to be resolved by the Bankruptcy Reform Act of 1978, that is, to permit resolution of all bankruptcy-related disputed matters in one forum, the bankruptcy court. The reason that was and now is the real problem is that, prior to October 1, 1979, the effective date of the Bankruptcy Code, disputed matters usually required resolution of jurisdictional issues by trial and appellate courts before the substantive issues could be tried. As a result, lawsuits often had to be sent out to state courts, and thereby the entire bankruptcy process was subjected to the delays inherent in such courts' trial calendars.

To resolve the problem the Bankruptcy Reform Act gave bankruptcy courts jurisdiction over all related matters. Because of the adamant opposition of the Judicial Conference those courts were, however, not constituted Article III courts. This grant of jurisdiction, the Supreme Court in Northern Pipeline has now said, is unconstitutional. Since the jurisdictional problem must still be solved, the resolution must be to change the court structure, i.e., reconstitute the courts as Article III courts.

The Judicial Conference also resorts to statistics to attempt to prove that state and federal law "ancillary questions" are a small part of the issues that must be disposed of in the course of a bankruptcy case - less than 5% of the total cases filed and only 15% of all adversary proceedings (Report pp. 17-18). But these statistics are as firm as quicksand. The number of ancillary matters is based on no information but is calculated by estimating ancillary issues as 15% of adversary proceedings and then applying the estimated percentage to the total number of

adversary proceedings to get the number of ancillary matters which, when applied to total filings, yields 5%. Quite apart from this legerdemain, the Judicial Conference ignores the fact that the function of allowing claims - not an adversary proceeding - with reference to the vast majority of claims involves the application of state law.

The Report and draft legislation submitted by the Judicial Conference fail in their misreading of Northern Pipeline, surprising in itself in view of the makeup of the Judicial Conference. The Conference finds it clear at pp. 11-12 that six Justices (plurality of four plus two concurring Justices) decided only that the Constitution forbade Article I bankruptcy judges to decide the debtor in possession's state law action for breach of contract against Marathon and did not decide that such courts could not decide questions of bankruptcy law. Apart from the fact that the six Justices gave no such affirmative assurance as to what the bankruptcy courts may decide, the Conference has attempted to divide into two parts that which is made up of many more. As indicated above, most claims filed in a bankruptcy case, which cannot proceed unless disputes about their allowance are resolved, are based on state law. Do these disputes present questions of bankruptcy law? Debtors may claim their state law exemptions in bankruptcy. Are the questions about the scope of state exemptions questions of bankruptcy law? Trustees may avoid prebankruptcy transfers voidable by unsecured creditors under state law. Does the trustee's avoidance action present questions of bankruptcy law?

The plurality opinion, in footnote 31, has now raised the spectre that the system as it existed from 1898 until 1979 may itself have been unconstitutional. This system which created the summary-plenary dichotomy in jurisdiction, had never previously been approved or disapproved by the Supreme Court. It is absolutely clear that if the jurisdiction of the bankruptcy court were now to revert, in any guise, to that system the constitutionality issues would be litigated, requiring another decision of the

Supreme Court after the usual time delay while continuing the uncertainty that permeates the entire bankruptcy practice. It is also absolutely clear that the draft legislation proposed by the Judicial Conference is a reversion to that dichotomy. In view of the failure of the plurality opinion or the concurring opinion of the two Justices to agree in this respect with Justice White's conclusion, any jurisdictional division depending on a distinction between claims based on bankruptcy law and claims based on other federal law involving other property claimed by the representative of the estate is immediately suspect. It is surprising that the Judicial Conference is willing to perpetuate that continued uncertainty.

The Report of the Judicial Conference appears to read the dissenting opinion of Chief Justice Burger as if it were the ruling of the entire Bench. The simplicity of the solution offered by the Chief Justice in the dissenting opinion, which forms the basis of the Report of the Judicial Conference and its legislative proposal, does not withstand analysis. To state simply that the bankruptcy court does not have jurisdiction "to decide actions at common law arising under state law" (p. 13 of the Report) is to ignore much of what occurs routinely in bankruptcy cases, not to mention major reorganization cases. When summary jurisdiction existed either through possession of the property by the court or by consent, the bankruptcy judge frequently decided matters of state law including corporate law, domestic relations law, property law, trust and estates law, tax law, etc. Questions of state law or actions at common law arise in many different contexts in the bankruptcy court. The state law of fraudulent conveyances is applied in proceedings to recover property for the estate. State matrimonial law is typically involved in proceedings to determine the issue of nondischargeability of debts. When a creditor files a claim, the trustee may object to the claim on any ground

that the bankrupt could have asserted under state law, including nonexistence of the claim, illegality of the claim, the statute of frauds, or the statute of limitations. Although the Chief Justice and the Judicial Conference seem to be expressing a judicial opinion that the bankruptcy court could have jurisdiction over these issues even though based on state law or common law, no careful lawyer could give such an opinion based on the decision in the Northern Pipeline Construction case.

Judicial Conference's Legislative Proposal

The Report is replete with phrases and labels having no content other than that poured into them by the authors of the Report: "ancillary issues" and "ancillary cases"; "substantive bankruptcy law questions"; "bankruptcy law cases"; and "subsidiary proceedings." The authors seem to have no appreciation of the vagueness and potential disagreements as to the meanings of such language. Yet the Report purports to make a statistical calculation as to the proportion of the bankruptcy-connected litigation that is or would be embraced by the term "ancillary cases." It would of course be impossible to disprove the accuracy of the estimate because only the authors can know what is embraced by the term.

It thus appears that a substantial part of the jurisdiction that shall be exercised by the bankruptcy court under proposed §1471(c) may be challenged as beyond the power that may be exercised by that court. On the other hand no disposition is made at all respecting a large part of the regular business of the bankruptcy court. Jurisdictional challenges and problems of interpretation would be rife for at least a generation under such a cryptic statute.

The Report speaks of the need to clarify the jurisdictional grant made by the Bankruptcy Reform Act and to deal with the ambiguities in that grant. There is neither ambiguity nor a need for clarification of the grant of jurisdiction in §1471. The amendment proposed by the Judicial Conference would create ambiguity, confusion, and litigation-producing doubts about every exercise of jurisdiction by the bankruptcy court. The Report glosses over the many problems the flood of litigation it would loosen, and the delays and expense that would be entailed by superimposing on bankruptcy administration the obscure provisions of the proposed 28 U.S.C. §1471.

The legislation proffered by the Judicial Conference is totally unresponsive to current needs. It not only reintroduces a bifurcated jurisdictional system; one might say it would establish a trifurcated system. Instead of permitting all disputes to be resolved in one forum it would give the bankruptcy courts jurisdiction over title 11 cases and subsidiary proceedings, which may, however, be recalled by the district judge and then referred to a magistrate. Related proceedings, another legislative term, would remain with the district court but supposedly could be referred to a bankruptcy judge as special master under proposed §1471(f).

Thus, we would have cases under title 11, subsidiary proceedings, and related proceedings. We would also have the district judge, the bankruptcy judge, and the magistrate. Perhaps the view of the Judicial Conference is to place the magistrate above the bankruptcy judge since the district judge could recall a case or related proceeding from the bankruptcy judge and refer it to a magistrate. In any event this trifurcated system, although it includes Article III district judges, apparently could not handle claims based on state law, which would have to go to the state court in the absence of diversity of citizenship. How

many motions for abstention will the district court be called upon to hear and decide? What kind of person will be attracted by the position of bankruptcy judge in such a system?

It is inferable that the draftsmen assume or believe that the proviso that would enable a district judge to recall a case or proceeding of the very special variety described in §1471(g)(3) would resolve all challenges based on Article III of the Constitution. Such an assumption or belief is credible only if the Supreme Court is willing to regard the existence of the power of the Article III court to recall a case or a certain proceeding as of the essence of the guaranties embedded in Article III. It is to be noted that the district judge's decision to abstain or not to abstain is not reviewable by appeal. A decision not to recall is presumably a decision to abstain and thus not reviewable. A case or related proceeding of the kind specified in §1471(b) may be referred to a magistrate, but there is certainly nothing in Northern Pipeline Construction Co. v. Marathon Pipe Line Co. that affords a basis for rejecting constitutional challenges to this procedure. It may ultimately be upheld, but that outcome would not be clear until after litigation produced an authoritative determination.

The Report makes the perfectly valid point at page 18 that "routine" bankruptcy cases often involve little personal judicial attention beyond the discharge hearing. The Commission on Bankruptcy Laws addressed this problem by recommending that these routine, nonjudicial functions should be assigned to and performed by nonjudicial personnel with cost savings and savings of time and energy of the bankruptcy judges. The proposal made by the Judicial Conference, however, moves in the opposite direction by injecting the district judges into the process, authorizing them to recall cases or certain proceedings and to designate special masters in such cases and proceedings, whose reports presumably

would be reviewed by the district judges. The concerns expressed about "consequential costs" and "thoroughly unjustified growth" of the entire federal judicial system on page 26 are not reflected in proposals for involving the district judges, the bankruptcy judges as special masters, and the magistrates as special masters.

The record in both the House and the Senate throughout the legislative process leading to enactment of the Bankruptcy Code is replete with testimony as to the need to attract qualified persons to be bankruptcy judges. This record contains ample and persuasive evidence to the effect that retaining the bankruptcy courts as second class courts, under the control through the appointment and appellate processes of the district courts, giving them less jurisdiction than they need to do a complete job, keeping the salaries of the judges at lower levels, and withholding from the bankruptcy judges necessary support services and a voice in their own government through the Judicial Conference, makes it difficult if not impossible to interest capable, qualified persons to serve on the court. The Report and the proposals of the Judicial Conference would retain all of these disadvantages but one (appointment).

The suggestion at p. 4 of the Report that the problem presently before Congress is a direct consequence of "specialized advocacy" warrants elaboration and clarification. During the years of study of the bankruptcy system by the Congressionally created Commission on the Bankruptcy Laws in 1971-73 and the Judiciary Committees of the House and the Senate, with extensive hearings conducted by both Committees in 1975-78, there was virtual unanimity in the opinion expressed by witnesses and communications received that litigation of questions of jurisdiction of the bankruptcy court was a blight on the administration of the bankruptcy laws that required resolution in any meaningful reform. That reform was effected by 28 U.S.C. §1471. The House Judiciary Committee and the House itself recognized the constitutional problem presented by a pervasive grant of jurisdiction

to an Article I court and proposed to create an Article III court in H.R. 8200, which passed the House on February 1, 1978. As the Report acknowledges, the Judicial Conference opposed the establishment of the bankruptcy court as an Article III court, and that opposition was at least influential in the ultimate Congressional choice of court structure made in the Bankruptcy Reform Act. To suggest that specialized advocacy is responsible for the problem now confronting the Congress is correct, but it is the specialized advocacy that opposed the creation of an Article III court.

We suggest to the Congress that the sole purpose of the Judicial Conference's proposals is to maintain as elite a group as possible of district court judges. There exists a fear that upgrading the bankruptcy court to an Article III court will dilute the prestige of the district court. Whether this fear is realistic or not, the actual needs as found throughout the process leading to enactment of the 1978 bankruptcy law are of greater importance and significance.

Conclusion

The only possible response to the Supreme Court's decision is Northern Pipeline is an Article III bankruptcy court.

Respectfully submitted,

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cc: Honorable William French Smith
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September 24, 1982

C. Boyden Gray, Esq.
Counsel to the Vice President
Old Executive Office Building
Washington, D.C. 20500

BY HAND

Dear Boyden:

I am writing to bring you up-to-date on the status of my discussions concerning the pending bankruptcy legislation.

Following my meeting with Bill, Dick and you on Wednesday, I called Steve Kaminer and sought to arrange a meeting with Jonathan Rose. Steve was able to arrange such a meeting for this morning and I was able to prevail upon Charles Horsky, President of the National Bank Conference, to join us.

I feel that the meeting was very productive. It was clear that Jonathan and his staff had given a substantial amount of thought to the various alternatives and appreciate the problems that would arise from any proposal other than an Article III solution.

Charles Horsky made available to Jonathan and his staff three short memoranda that persuasively argue the case for an Article III solution. I am enclosing a copy of these memoranda for your review and sending copies to Bill Barr with this letter.

If we can provide any additional information to the Administration, please do not hesitate to call me.

Sincerely,

Bill

William J. Perlstein

cc: William P. Barr, Esq. (w/enclosures)
Charles A. Horsky, Esq. (w/o enclosures)

Enclosures

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 guest 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

PROFESSOR VERN COUNTRYMAN
PROFESSOR FRANK R. KENNEDY
PROFESSOR LAWRENCE P. KING

SEP 23 1982

September 20, 1982

Honorable Peter W. Rodino
Chairman, House Judiciary Committee
Rayburn House Office Building
Washington, D. C. 20515

Honorable Strom Thurmond
Chairman, Senate Judiciary Committee
209 Russell Senate Office Building
Washington, D.C. 20510

Honorable Robert Dole
Chairman, Subcommittee on Courts
2213 Dirksen Senate Office Building
Washington, D. C. 20510

Re: Report and Proposals of Judicial Conference to Congress on Northern Pipeline Construction Co. v. Marathon Pipe Line Co.

Gentlemen:

We have reviewed the report and proposals of the Judicial Conference of the United States dated September 9, 1982 with respect to the above cited case and remedial action being considered by Congress in connection with that case. With all due respect for the members of the Judicial Conference, we find the report replete with inaccurate facts and unsubstantiated assumptions and the legislative proposals thoroughly unsound.

The Report

At the outset the Judicial Conference deprecates others' perceptions of the problems created by Northern Pipeline while it proposes a solution to the "real problem" (Report p. 3). The authors of the Report undertake to make a definitive statement of the holding of Northern Pipeline Construction Co. v. Marathon Pipe Line Co.: "... the conferral of jurisdiction in section 241(a) to decide actions at common law arising under state law

- and only that authority - ... has actually been held to be unconstitutional by the Court" (Report at p. 13). This statement is predicated on Justice Rehnquist's opinion written for himself and one other member of the Court. The Justice's last paragraph is more accurate and helpful:

> "I would, therefore, hold so much of the Bankruptcy Act of 1978 as enables a Bankruptcy Court to entertain and decide Northern's lawsuit over Marathon's objection to be violative of Article III of the United States Constitution. Because I agree with the plurality that this grant of authority is not readily severable from the remaining grant of authority to Bankruptcy Courts under §241(a), ... I concur in the judgment." 102 Sup.Ct. at 2882.

Wherefore, Congressman Rodino observed, in the much criticized statement appearing at the middle of p. 13 of the Report, that "[t]he Court held that the jurisdiction conferred on the bankruptcy court by the Bankruptcy Reform Act of 1978 cannot be constitutionally exercised by these courts ...." And for that reason the plurality and concurring opinions gave Congress "an opportunity to reconstitute the bankruptcy courts or to adopt other valid means of adjudication."

The Report revises Congressman Rodino's statement to interpret the Supreme Court's decision to preclude the authorization of all jurisdiction conferred by section 241(a) (Report at the middle of p. 11) and then (just below the middle of p. 12) to expressly hold "all jurisdiction conferred by section 241(a) ... to be invalid." The leap is then made by the Report to its implicit conclusion that the Court held that existing bankruptcy judges, although not members of an Article III court, may constitutionally exercise jurisdiction to resolve questions of law "arising under Title II" -- "questions of bankruptcy law" (Report at the middle of p. 13).

The Judicial Conference's characterizations of others' perceptions of the effect of the Supreme Court's decision are not a mere matter of semantics but are indicative of the Conference's continuous failure to recognize, or its willingness to ignore, what has become over the years a major sore spot in the federal judicial system, i.e., the need for bankruptcy reform. The real problem is the one sought to be resolved by the Bankruptcy Reform Act of 1978, that is, to permit resolution of all bankruptcy-related disputed matters in one forum, the bankruptcy court. The reason that was and now is the real problem is that, prior to October 1, 1979, the effective date of the Bankruptcy Code, disputed matters usually required resolution of jurisdictional issues by trial and appellate courts before the substantive issues could be tried. As a result, lawsuits often had to be sent out to state courts, and thereby the entire bankruptcy process was subjected to the delays inherent in such courts' trial calendars.

To resolve the problem the Bankruptcy Reform Act gave bankruptcy courts jurisdiction over all related matters. Because of the adamant opposition of the Judicial Conference those courts were, however, not constituted Article III courts. This grant of jurisdiction, the Supreme Court in Northern Pipeline has now said, is unconstitutional. Since the jurisdictional problem must still be solved, the resolution must be to change the court structure, i.e., reconstitute the courts as Article III courts.

The Judicial Conference also resorts to statistics to attempt to prove that state and federal law "ancillary questions" are a small part of the issues that must be disposed of in the course of a bankruptcy case - less than 5% of the total cases filed and only 15% of all adversary proceedings (Report pp. 17-18). But these statistics are as firm as quicksand. The number of ancillary matters is based on no information but is calculated by estimating ancillary issues as 15% of adversary proceedings and then applying the estimated percentage to the total number of

adversary proceedings to get the number of ancillary matters which, when applied to total filings, yields 5%. Quite apart from this legerdemain, the Judicial Conference ignores the fact that the function of allowing claims - not an adversary proceeding - with reference to the vast majority of claims involves the application of state law.

The Report and draft legislation submitted by the Judicial Conference fail in their misreading of Northern Pipeline, surprising in itself in view of the makeup of the Judicial Conference. The Conference finds it clear at pp. 11-12 that six Justices (plurality of four plus two concurring Justices) decided only that the Constitution forbade Article I bankruptcy judges to decide the debtor in possession's state law action for breach of contract against Marathon and did not decide that such courts could not decide questions of bankruptcy law. Apart from the fact that the six Justices gave no such affirmative assurance as to what the bankruptcy courts may decide, the Conference has attempted to divide into two parts that which is made up of many more. As indicated above, most claims filed in a bankruptcy case, which cannot proceed unless disputes about their allowance are resolved, are based on state law. Do these disputes present questions of bankruptcy law? Debtors may claim their state law exemptions in bankruptcy. Are the questions about the scope of state exemptions questions of bankruptcy law? Trustees may avoid prebankruptcy transfers voidable by unsecured creditors under state law. Does the trustee's avoidance action present questions of bankruptcy law?

The plurality opinion, in footnote 31, has now raised the spectre that the system as it existed from 1898 until 1979 may itself have been unconstitutional. This system which created the summary-plenary dichotomy in jurisdiction, had never previously been approved or disapproved by the Supreme Court. It is absolutely clear that if the jurisdiction of the bankruptcy court were now to revert, in any guise, to that system the constitutionality issues would be litigated, requiring another decision of the

Supreme Court after the usual time delay while continuing the uncertainty that permeates the entire bankruptcy practice. It is also absolutely clear that the draft legislation proposed by the Judicial Conference is a reversion to that dichotomy. In view of the failure of the plurality opinion or the concurring opinion of the two Justices to agree in this respect with Justice White's conclusion, any jurisdictional division depending on a distinction between claims based on bankruptcy law and claims based on other federal law involving other property claimed by the representative of the estate is immediately suspect. It is surprising that the Judicial Conference is willing to perpetuate that continued uncertainty.

The Report of the Judicial Conference appears to read the dissenting opinion of Chief Justice Burger as if it were the ruling of the entire Bench. The simplicity of the solution offered by the Chief Justice in the dissenting opinion, which forms the basis of the Report of the Judicial Conference and its legislative proposal, does not withstand analysis. To state simply that the bankruptcy court does not have jurisdiction "to decide actions at common law arising under state law" (p. 13 of the Report) is to ignore much of what occurs routinely in bankruptcy cases, not to mention major reorganization cases. When summary jurisdiction existed either through possession of the property by the court or by consent, the bankruptcy judge frequently decided matters of state law including corporate law, domestic relations law, property law, trust and estates law, tax law, etc. Questions of state law or actions at common law arise in many different contexts in the bankruptcy court. The state law of fraudulent conveyances is applied in proceedings to recover property for the estate. State matrimonial law is typically involved in proceedings to determine the issue of nondischargeability of debts. When a creditor files a claim, the trustee may object to the claim on any ground

that the bankrupt could have asserted under state law, including nonexistence of the claim, illegality of the claim, the statute of frauds, or the statute of limitations. Although the Chief Justice and the Judicial Conference seem to be expressing a judicial opinion that the bankruptcy court could have jurisdiction over these issues even though based on state law or common law, no careful lawyer could give such an opinion based on the decision in the Northern Pipeline Construction case.

Judicial Conference's Legislative Proposal

The Report is replete with phrases and labels having no content other than that poured into them by the authors of the Report: "ancillary issues" and "ancillary cases"; "substantive bankruptcy law questions"; "bankruptcy law cases"; and "subsidiary proceedings." The authors seem to have no appreciation of the vagueness and potential disagreements as to the meanings of such language. Yet the Report purports to make a statistical calculation as to the proportion of the bankruptcy-connected litigation that is or would be embraced by the term "ancillary cases." It would of course be impossible to disprove the accuracy of the estimate because only the authors can know what is embraced by the term.

It thus appears that a substantial part of the jurisdiction that shall be exercised by the bankruptcy court under proposed §1471(c) may be challenged as beyond the power that may be exercised by that court. On the other hand no disposition is made at all respecting a large part of the regular business of the bankruptcy court. Jurisdictional challenges and problems of interpretation would be rife for at least a generation under such a cryptic statute.

The Report speaks of the need to clarify the jurisdictional grant made by the Bankruptcy Reform Act and to deal with the ambiguities in that grant. There is neither ambiguity nor a need for clarification of the grant of jurisdiction in §1471. The amendment proposed by the Judicial Conference would create ambiguity, confusion, and litigation-producing doubts about every exercise of jurisdiction by the bankruptcy court. The Report glosses over the many problems the flood of litigation it would loosen, and the delays and expense that would be entailed by superimposing on bankruptcy administration the obscure provisions of the proposed 28 U.S.C. §1471.

The legislation proffered by the Judicial Conference is totally unresponsive to current needs. It not only reintroduces a bifurcated jurisdictional system; one might say it would establish a trifurcated system. Instead of permitting all disputes to be resolved in one forum it would give the bankruptcy courts jurisdiction over title 11 cases and subsidiary proceedings, which may, however, be recalled by the district judge and then referred to a magistrate. Related proceedings, another legislative term, would remain with the district court but supposedly could be referred to a bankruptcy judge as special master under proposed §1471(f).

Thus, we would have cases under title 11, subsidiary proceedings, and related proceedings. We would also have the district judge, the bankruptcy judge, and the magistrate. Perhaps the view of the Judicial Conference is to place the magistrate above the bankruptcy judge since the district judge could recall a case or related proceeding from the bankruptcy judge and refer it to a magistrate. In any event this trifurcated system, although it includes Article III district judges, apparently could not handle claims based on state law, which would have to go to the state court in the absence of diversity of citizenship. How

many motions for abstention will the district court be called upon to hear and decide? What kind of person will be attracted by the position of bankruptcy judge in such a system?

It is inferable that the draftsmen assume or believe that the proviso that would enable a district judge to recall a case or proceeding of the very special variety described in §1471(g)(3) would resolve all challenges based on Article III of the Constitution. Such an assumption or belief is credible only if the Supreme Court is willing to regard the existence of the power of the Article III court to recall a case or a certain proceeding as of the essence of the guaranties embedded in Article III. It is to be noted that the district judge's decision to abstain or not to abstain is not reviewable by appeal. A decision not to recall is presumably a decision to abstain and thus not reviewable. A case or related proceeding of the kind specified in §1471(b) may be referred to a magistrate, but there is certainly nothing in Northern Pipeline Construction Co. v. Marathon Pipe Line Co. that affords a basis for rejecting constitutional challenges to this procedure. It may ultimately be upheld, but that outcome would not be clear until after litigation produced an authoritative determination.

The Report makes the perfectly valid point at page 18 that "routine" bankruptcy cases often involve little personal judicial attention beyond the discharge hearing. The Commission on Bankruptcy Laws addressed this problem by recommending that these routine, nonjudicial functions should be assigned to and performed by nonjudicial personnel with cost savings and savings of time and energy of the bankruptcy judges. The proposal made by the Judicial Conference, however, moves in the opposite direction by injecting the district judges into the process, authorizing them to recall cases or certain proceedings and to designate special masters in such cases and proceedings, whose reports presumably

would be reviewed by the district judges. The concerns expressed about "consequential costs" and "thoroughly unjustified growth" of the entire federal judicial system on page 26 are not reflected in proposals for involving the district judges, the bankruptcy judges as special masters, and the magistrates as special masters.

The record in both the House and the Senate throughout the legislative process leading to enactment of the Bankruptcy Code is replete with testimony as to the need to attract qualified persons to be bankruptcy judges. This record contains ample and persuasive evidence to the effect that retaining the bankruptcy courts as second class courts, under the control through the appointment and appellate processes of the district courts, giving them less jurisdiction than they need to do a complete job, keeping the salaries of the judges at lower levels, and withholding from the bankruptcy judges necessary support services and a voice in their own government through the Judicial Conference, makes it difficult if not impossible to interest capable, qualified persons to serve on the court. The Report and the proposals of the Judicial Conference would retain all of these disadvantages but one (appointment).

The suggestion at p. 4 of the Report that the problem presently before Congress is a direct consequence of "specialized advocacy" warrants elaboration and clarification. During the years of study of the bankruptcy system by the Congressionally created Commission on the Bankruptcy Laws in 1971-73 and the Judiciary Committees of the House and the Senate, with extensive hearings conducted by both Committees in 1975-78, there was virtual unanimity in the opinion expressed by witnesses and communications received that litigation of questions of jurisdiction of the bankruptcy court was a blight on the administration of the bankruptcy laws that required resolution in any meaningful reform. That reform was effected by 28 U.S.C. §1471. The House Judiciary Committee and the House itself recognized the constitutional problem presented by a pervasive grant of jurisdiction

to an Article I court and proposed to create an Article III court in H.R. 8200, which passed the House on February 1, 1978. As the Report acknowledges, the Judicial Conference opposed the establishment of the bankruptcy court as an Article III court, and that opposition was at least influential in the ultimate Congressional choice of court structure made in the Bankruptcy Reform Act. To suggest that specialized advocacy is responsible for the problem now confronting the Congress is correct, but it is the specialized advocacy that opposed the creation of an Article III court.

We suggest to the Congress that the sole purpose of the Judicial Conference's proposals is to maintain as elite a group as possible of district court judges. There exists a fear that upgrading the bankruptcy court to an Article III court will dilute the prestige of the district court. Whether this fear is realistic or not, the actual needs as found throughout the process leading to enactment of the 1978 bankruptcy law are of greater importance and significance.

Conclusion

The only possible response to the Supreme Court's decision is Northern Pipeline is an Article III bankruptcy court.

Respectfully submitted,

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cc: Honorable William French Smith
Attorney General of the United States

Honorable Jonathan C. Rose
Assistant Attorney General

MEMORANDUM

file
(1) Bankruptcy
(2) folder

THE WHITE HOUSE

WASHINGTON

September 30, 1982

FOR: EDWIN L. HARPER

FROM: WILLIAM P. BARR

SUBJECT: Update on Bankruptcy

Ed Schmults and Jon Rose have been negotiating with Senators Dole, Thurmond, and East Wednesday night and Thursday.

Late Thursday a package was put together and agreed to which includes the Article III court that we want, several general court reform measures, and several substantive changes to the bankruptcy law that are important to Senator Dole and the commercial credit sector.

The chances are exceedingly remote that we will be able to get this to the floor on Friday. Senator Baker has announced that he will not take up anything unless there is a unanimous consent agreement. As of 6:30 Thursday evening, it appeared that Senator Metzenbaum would refuse to consent because he objects to some of the substantive changes being sought by Senator Dole. Justice is planning to go in to ask for an extension of the stay either late Friday or over the weekend.

MEMORANDUM

THE WHITE HOUSE

WASHINGTON

October 13, 1982

FOR: EDWIN L. HARPER

FROM: MICHAEL M. UHLMANN

SUBJECT: Status of Bankruptcy Court Legislation

Justice has been trying to forge a compromise among the diverse factions on the Hill. The package is still rough at the edges, but Justice believes that a consensus can be created along the following lines:

- Create a Bankruptcy Division within each federal district court.
- Create 227 Article III bankruptcy judges, distributed throughout the nation as the anticipated needs of the district courts may require.
- In addition to their bankruptcy duties, these judges would be free to accept extraneous assignments from the Chief Judge of the district courts.
- A package of amendments to substantive bankruptpcy law, of which the most important deal with:
  - -- grain elevators (in effect permitting farmers to extract their commodities in case an elevator company threatens to go under);
  - -- shopping center lessees (in case the center itself threatens to go under);
  - -- requiring those with likelihood of future earnings to file a schedule of repayments as a condition of getting bankrupt status (strongly pushed by the consumer credit folks).

Beyond these features, which we either support or can live with, diverse representatives of the people on the Hill are trying to add Christmas ornaments, some or all of which are likely to cause us problems -- e.g., a re-do of the bill vetoed by the President last year that would grant special relief to the creditors of W. T. Grant.

The critical question during the lame duck session will be how many of these obnoxious pills we will have to swallow as a condition for getting what we do want.

FYI, the Supreme Court granted an extension of the October 4 deadline until December 24, a date pregnant with possibilities for Christmas cheer of the sort that has given us a $170 billion deficit.

MEMORANDUM

THE WHITE HOUSE

WASHINGTON

December 1, 1982

FOR: EDWIN L. HARPER

FROM: MICHAEL M. UHLMANN

SUBJECT: Status of Bills Concerning Bankruptcy Courts

Although a number of bills have been introduced on the subject, two are of primary importance:

- Rodino's bill in the House, which has been reported out of committee, will establish new Article III judges to handle bankruptcy cases.
  - -- It is not yet clear what type of rule Rodino will get from the Rules Committee, whether amendments will be offered on the floor, or whether the bill will likely pass the House in its present form.
- Senate bill S.2000, pushed by Senators Dole and Thurmond, creates new Article III judges as in the House bill, contains a provision allowing the new judges to hear certain non-bankruptcy cases (the so-called "fungibility provision"), and contains substantive amendments to existing bankruptcy law.

Position of Key Players

- The Administration supports the Dole/Thurmond proposal, which was developed jointly with the Justice Department.
- The Judicial Conference continues to push for alternatives to making Title III judges to handle bankruptcy cases.
- Consumer finance companies continue to oppose any bill that does not substantively amend bankruptcy law concerning future earnings of persons adjudged bankrupt.
- Senator Metzenbaum says he will filibuster any bill that changes substantive bankruptcy law in ways favored by the consumer finance industry.

Recent Developments in Senate

- Senators Thurmond and Dole have written to Senator Baker proposing to bring up their bill next week (more specifically, a series of amendments in the nature of a substitute for their bill).

- o They do not expect to be able to get a time agreement because of opposition by Metzenbaum and others.

- o Dole is trying to work matters out with Metzenbaum.

- o Tentative plan is to bring the bill up for one hour next week and perhaps file a cloture petition.

- o Senator Dole will meet with the Chief Justice tomorrow.

- o The Attorney General will meet with Senators Baker, Thurmond, and Dole on Friday.

Additional Matters of Concern

- o Democratic attempt to roll over judicial appointments into 1984 and 1985, authorizing the President to make only a portion of them in 1983.

- o It is not possible to predict whether or for how long the Supreme Court will grant another extension if the lame duck session fails to act.

- o We will need an additional extension in any event, since it will take 8-9 months to get the new bankruptcy court system in place.