No. 02-1606

In The Supreme Court of the United States

TENNESSEE STUDENT ASSISTANCE CORPORATION,

Petitioner,

v.

PAMELA L. HOOD,

Respondent.

On Writ Of Certiorari To The United States Court Of Appeals For The Sixth Circuit

BRIEF OF RESPONDENT

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QUESTION PRESENTED

Whether the Eleventh Amendment allows a non-consenting state to bar a bankruptcy court from determining the dischargeability of a student loan?

TABLE OF CONTENTS

Page

QUESTION PRESENTED i

TABLE OF CONTENTS ii

TABLE OF AUTHORITIES iv

STATEMENT OF THE CASE 1

SUMMARY OF ARGUMENT 4

ARGUMENT 6

I. THE HISTORICAL RECORD REFLECTS THE SURRENDER OF THE SOVEREIGN IMMUNITY OF THE STATES UNDER THE BANKRUPTCY CLAUSE 6

II. THE UNIFORMITY REQUIREMENT OF THE BANKRUPTCY CLAUSE REQUIRES THE ABROGATION OF A STATE'S ELEVENTH AMENDMENT IMMUNITY 16

III. AS THIS COURT HAS RECOGNIZED, THE COLLECTIVE NATURE OF A BANKRUPTCY REQUIRES JURISDICTION OVER A STATE ... 22

A. An Inherent Conflict Exists Between the Eleventh Amendment and the Collective Nature of a Bankruptcy 22

B. The States Have Failed to Provide Any Viable Alternative Means for the Discharge of a Student Loan 27

C. The States' Comparisons of the Commerce Clause with the Bankruptcy Clause Fail to Demonstrate a Lesser Bankruptcy Power ... 31

TABLE OF CONTENTS – Continued

Page

IV. AS RECOGNIZED BY CIRCUIT COURTS OF APPEAL THROUGHOUT THE COUNTRY, A STATE'S SOVEREIGN IMMUNITY IS SUBORDINATE TO A BANKRUPTCY COURT'S *IN REM* JURISDICTION 34

V. USE OF AN ADVERSARY PROCEEDING IS NOT A BAR TO MS. HOOD'S REQUEST FOR A DISCHARGE 39

CONCLUSION 44

TABLE OF AUTHORITIES

Page

CASES

Acme Harvester Co. v. Beekman Lumber Co., 222 U.S. 300 (1911) 23, 34

Alabama v. Lewis, 279 B.R. 308 (S.D. Ala. 2002) 26

Alden v. Maine, 527 U.S. 706 (1999) .....*passim*

American Law Center PC v. Stanley (In re Jastrem), 253 F.3d 438 (9th Cir. 2001)..... 43

Bell v. Bell (In re Bell), 225 F.3d 203 (2d Cir. 2000) 43

Blanchette v. Connecticut Gen. Ins. Corp. (Regional Rail Reorganization Act Cases), 419 U.S. 102 (1974) 19

Buck v. Kuykendall, 267 U.S. 307 (1925)..... 31, 32

Burlingham v. Crouse, 228 U.S. 459 (1913)..... 15

Butner v. United States, 440 U.S. 48 (1979) 6, 30

California v. Deep Sea Research, Inc., 523 U.S. 491 (1998) 38

Camps Newfound/Owatonna, Inc. v. Harrison, 520 U.S. 564 (1997) 33

Cohen v. Bucci, 905 F.2d 1111 (7th Cir. 1990)..... 40

Department of Transp. and Dev. v. PNL Asset Management Co., LLC (In re Fernandez), 123 F.3d 241 (5th Cir. 1997)..... 36

FDIC v. Union Entities (In re Be-Mac Transp. Co.), 83 F.3d 1020 (8th Cir. 1996)..... 24

Ex parte Young, 209 U.S. 123 (1908)..... 29, 30

Federal Maritime Comm'n v. South Carolina State Ports Auth., 535 U.S. 743 (2002) 6

TABLE OF AUTHORITIES – Continued

Page

Gardner v. New Jersey, 329 U.S. 565 (1947)..... 24, 34, 35

Goldberg v. Ellett (In re Ellett), 46 Collier Bankr. Cas. 2d 1498 (9th Cir. 2001) 37

Green v. Mansour, 474 U.S. 64 (1985)..... 30

Hanover Nat'l Bank v. Moyses, 186 U.S. 181 (1902) 18, 19, 30, 34, 40

Harmon v. United States ex rel. FMHA (In re Harmon), 101 F.3d 574 (8th Cir. 1996)..... 43

Horwitz v. Zywiczynski (*In re Zywiczynski*), 210 B.R. 924 (Bankr. W.D.N.Y. 1997)..... 26

Hughes v. Oklahoma, 441 U.S. 322 (1979)..... 33

Idaho v. Coeur d'Alene Tribe of Idaho, 521 U.S. 261 (1997) 21, 44

In re Braniff Int'l Airlines, Inc., 164 B.R. 820, (Bankr. E.D.N.Y. 1994)..... 42

In re Command Services Corp., 102 B.R. 905 (Bankr. N.D.N.Y. 1989) 42

In re Christie, 222 B.R. 64 (Bankr. D.N.J. 1998)..... 26

In re Friedman, 184 B.R. 883 (Bankr. N.D.N.Y. 1994)..... 42

In re Fuller, 255 B.R. 300 (Bankr. W.D. Mich. 2000)..... 44

In re Gee, 124 B.R. 586 (Bankr. N.D. Okla. 1991) 42

In re Mark Twain Marine Indus., Inc., 115 B.R. 948 (Bankr. N.D. Ill. 1990)..... 42

In re Mitchell, 209 F.3d 1111 (9th Cir. 2000)..... 37

In re Perez, 220 B.R. 216 (Bankr. D. N.J. 1998)..... 26

In re Stewart, 215 B.R. 633 (Bankr. M.D. Fla. 1997) 42

TABLE OF AUTHORITIES – Continued

Page

In re Sun Healthcare Group, Inc., 245 B.R. 779 (Bankr. D. Del. 2000) 27

In re Wild Lilly, Inc., 51 B.R. 963 (Bankr. S.D.N.Y. 1985) 43

International Shoe Co. v. Pinkus, 278 U.S. 261 (1929) 17

Isaacs v. Hobbs Tie & Timber Co., 282 U.S. 734 (1931) 28

Katchen v. Landy, 382 U.S. 323 (1966) 34

Lathrop v. Drake, 91 U.S. (1 Otto) 516 (1875) 28

Maryland v. Antonelli Creditors' Liquidating Trust, 123 F.3d 777 (4th Cir. 1997) 35, 36

Missouri v. Fiske, 290 U.S. 18 (1933) 23, 24

Nelson v. La Crosse County Dist. Att'y (In re Nelson), 301 F.3d 820 (7th Cir. 2002) 37

New York v. Irving Trust Co., 288 U.S. 329 (1933) 23

Ogden v. Saunders, 25 U.S. (12 Wheat.) 213 (1827) ... 16, 17

Pennsylvania v. Union Gas Co., 491 U.S. 1 (1989) 5

Perez v. Campbell, 402 U.S. 637 (1971) 32

Perkins v. Coordinating Bd. for Higher Educ. (In re Perkins), 228 B.R. 431 (Bankr. E.D. Mo. 1998) 30

Railway Labor Executives' Ass'n v. Gibbons, 455 U.S. 457 (1982) 19

Ray v. Norseworthy, 90 U.S. (23 Wall.) 128 (1874) 25

Schlossberg v. Maryland (In re Creative Goldsmiths of Washington, D.C., Inc.), 119 F.3d 1140 (4th Cir. 1997) 35

TABLE OF AUTHORITIES – Continued

Page

Seminole Tribe of Fla. v. Florida, 517 U.S. 44 (1996)*passim*

Sproles v. Binford, 286 U.S. 374 (1932) 32

Stellwagen v. Clum, 245 U.S. 605 (1918)..... 17, 18, 21, 33

Sturges v. Crowninshield, 17 U.S. (4 Wheat.) 122 (1819) 16

Texas v. Walker, 142 F.3d 813 (5th Cir. 1998) 36

Thompson v. Magnolia Petroleum Co., 309 U.S. 478 (1940) 34

Toucey v. New York Life Ins. Co., 314 U.S. 118 (1941) 6

Tri-City Turf Club, Inc. v. Kentucky Racing Comm'n (In re Tri-City Turf Club, Inc.), 203 B.R. 617 (Bankr. E.D. Ky. 1996) 26

United States Steel Corp. Plan for Employee Ins. Benefits v. Musisko, 885 F.2d 1170 (3d Cir. 1989)..... 14

United States v. Fox, 95 U.S. 670 (1877)..... 27

United States v. Nordic Village Inc., 503 U.S. 30 (1992) 38

Van Huffel v. Harkelrode, 284 U.S. 225 (1931) 25

Vanston Bondholders Protective Comm. v. Green, 329 U.S. 156 (1946) 20

Virginia v. Collins (In re Collins), 173 F.3d 924 (4th Cir. 1999)..... 36, 37

West Lynn Creamery, Inc. v. Healy, 512 U.S. 186 (1994) 33

TABLE OF AUTHORITIES – Continued

Page

CONSTITUTION

art. I, §8, cl. 3 31-34
art. I, §8, cl. 4 ..... *passim*
art. I, §10, cl. 1 16

RULES REGULATIONS AND STATUTES

United States Bankruptcy Code:

11 U.S.C. §362(a) 26, 41
11 U.S.C. §363(f) 25
11 U.S.C. §507(a)(8) 14
11 U.S.C. §522(l) 43
11 U.S.C. §523(a)(1) 14
11 U.S.C. §523(a)(8) 1, 2
11 U.S.C. §524 37

Federal Rules of Bankruptcy Procedure:

Rule 1006(b) 43
Rule 3012 43
Rule 4003(b) 43
Rule 7001 ..... 40, 41, 43
Rule 7003 40
Rule 7004 40
Rule 7021 41
Rule 7025 41
Rule 7026 41

TABLE OF AUTHORITIES – Continued

Page

Rule 7028 41
Rule 7029 41
Rule 7030 41
Rule 7031 41
Rule 7032 41
Rule 7033 41
Rule 7034 41
Rule 7035 41
Rule 7036 41
Rule 7037 41
Rule 7038 41
Rule 7041 41
Rule 7042 41
Rule 7052 41
Rule 7054 41
Rule 7055 42
Rule 7056 42
Rule 7064 42
Rule 7069 42
Rule 7071 42
Rule 9014 ..... 41, 42

Other Rules and Regulations and Statutes:

20 U.S.C. §1095a..... 29
28 U.S.C. §157..... 34

TABLE OF AUTHORITIES – Continued

Page

28 U.S.C. §1334(e) 34

28 U.S.C. §2075..... 43

28 U.S.C. §2283..... 14

31 U.S.C. §3720A..... 29

34 C.F.R. §682.410(b)(6)(iv)..... 29

OTHER AUTHORITIES

Peter J. Coleman, DEBTORS AND CREDITORS IN AMERICA: INSOLVENCY, IMPRISONMENT FOR DEBT, AND BANKRUPTCY, 1607-1900 (1974) 7

COLLIER ON BANKRUPTCY (A. Resnick et al. ed., 15th ed. rev.)..... 25, 42

Edward Countryman, THE AMERICAN REVOLUTION (1985) 8

The Federalist Papers:

No. 6 8

No. 10 8

No. 21 8

No. 31 10

No. 32 .....11, 12

No. 81 .....10, 11, 12

Hon. Randolph J. Haines, *The Uniformity Power: Why Bankruptcy is Different*, 77 AMER. BANKR. L.J. 129 13

Bruce H. Mann, REPUBLIC OF DEBTORS: BANKRUPTCY IN THE AGE OF AMERICAN INDEPENDENCE (2002) 7

TABLE OF AUTHORITIES – Continued

Page

J. Moore, MOORE'S FEDERAL PRACTICE (3d ed. 2003) .. 22, 39

Kurt H. Nadelmann, *On The Origin of The Bankruptcy Clause*, 1 AMER. J. LEGAL HIST. 215 (1957).. 12, 13

Observations of the Federal Farmer, Letter XVIII dated January 25, 1788 (reprinted in 2 THE COMPLETE ANTI-FEDERALIST H. Storing ed. 1981)) 8

David P. Szatmary, SHAYS' REBELLION: THE MAKING OF AN AGRARIAN INSURRECTION (1980) 7

Charles J. Tabb, *The Historical Evolution of the Bankruptcy Discharge*, 65 AM. BANKR. L.J. 325 (1991) 6

Charles J. Tabb, *The History of the Bankruptcy Laws in the United States*, 3 AM. BANKR. INST. L. REV. 5 (1995) 9

Charles Warren, BANKRUPTCY IN UNITED STATES HISTORY (1935) 10

STATEMENT OF THE CASE

This matter arises out of the bankruptcy of Respondent, Pamela L. Hood ("Ms. Hood"). Petitioner, Tennessee Student Assistance Corporation ("TSAC"), guaranteed a student loan of Ms. Hood with an outstanding balance of $4,169.31. Jt. App. 9. The TSAC joined by *amici curiae*, Ohio and 47 Other States and Commonwealths (hereinafter the "48 States") and the Council of State Governments *et al*. (hereinafter the "Council" and with TSAC and the 48 States the "States") contends that the Eleventh Amendment bars the bankruptcy court from considering Ms. Hood's request for an "undue hardship" discharge of her student loan. Although this case involves the discharge of a student loan, if the TSAC's theory is sustained, it will enable states to opt out of federal bankruptcy proceedings at their election, and remain free to pursue their remedies against a debtor, regardless of any order of a bankruptcy court. For the reasons stated below, it is obvious that exemption of state entities from the jurisdiction of the federal bankruptcy courts would profoundly affect the operations of the bankruptcy system.

On February 26, 1999 Ms. Hood commenced a "no asset" chapter 7 case in the United States Bankruptcy Court for the Western District of Tennessee. Pet. App. 29. On June 4, 1999, Ms. Hood was granted a general discharge. On October 14, 1999, Ms. Hood filed a complaint against the United States of America, the Department of Education and Sallie Mae Service, Inc. for an undue hardship discharge of her student loan pursuant to section 523(a)(8) of the Bankruptcy Code. Jt. App. 5. On February 22, 2000 Ms. Hood filed an amended complaint for the discharge of her student loan in which she included the

TSAC and University Account Services as additional defendants and deleted Sallie Mae Service, Inc. Jt. App. 9.

Before any further action was taken in Ms. Hood's adversary proceeding, on May 12, 2000 the TSAC moved to dismiss the complaint in reliance on its claim of Eleventh Amendment immunity. The bankruptcy court held TSAC to be an instrumentality of the state, but determined that such immunity with respect to section 523(a)(8) had been abrogated pursuant to section 106(a) of the Bankruptcy Code. Relying upon the two prong test established by this Court in *Seminole Tribe of Fla. v. Florida*, 517 U.S. 44 (1996), the bankruptcy court found that there had been a valid abrogation of the TSAC's sovereign immunity pursuant to Congress' powers under the Fourteenth Amendment and Article I, section 8, clause 4 of the Constitution (the "Bankruptcy Clause"). Pet. App. 76-80.

The bankruptcy court's decision was affirmed by the Bankruptcy Appellate Panel of the Sixth Circuit on May 21, 2001. Jt. App. 3. After applying the "analytical framework" established in *Seminole Tribe*, the bankruptcy appellate panel held that the states had surrendered their sovereign immunity with respect to the discharge of a debt "as a part of the plan of the Constitutional Convention." Pet. App. 30.

After carefully analyzing the bankruptcy power according to the directives contained in this Court's decision in *Seminole Tribe*, Judge Karen Nelson Moore writing for the Sixth Circuit Court of Appeals affirmed the decision of the bankruptcy court. Pet. App. 9-10. Contrary to the claims of the TSAC, the Sixth Circuit's opinion focuses upon and is limited to the distinctive nature of the

Bankruptcy Clause and the bankruptcy power. *See* TSAC Brief at 17. It is particularly tailored to not upsetting the postulates which underlie the opinion in *Seminole Tribe.*

First, the Sixth Circuit determined that Congress clearly intended to abrogate a state's sovereign immunity in section 106(a) of the Bankruptcy Code. It then undertook a review of the text of the Bankruptcy Clause to secure an understanding of its place in the constitutional design. Pet. App. 11. After focusing upon the Bankruptcy Clause's requirement for uniformity, it traced the evolution of that mandate in this Court's past opinions and in the Framers' understanding of the bankruptcy power, particularly THE FEDERALIST PAPERS. It determined that the assertion of a state's sovereign immunity cannot be reconciled with the Bankruptcy Clause's requirement for uniformity.

At the end of its opinion the Sixth Circuit observed that rather than being a traditional lawsuit, Ms. Hood's complaint for an undue hardship discharge was more akin to a determination of an interest in a "*res*." It further observed that it was the state's choice as to whether it wished to assert an interest in the *res* in connection with the bankruptcy court's determination of the issue. If not, Ms. Hood still would have to convince the bankruptcy court that she was deserving of an undue hardship discharge. Pet. App. 22.

In the majority opinion below, Judge Moore declined to join with Judge Kennedy, in determining that the TSAC had waived its sovereign immunity by virtue of the assignment of a student loan proof of claim by Sallie Mae Servicing Corp. to the TSAC. Judge Moore determined that a failure to raise the issue of waiver below and the

nature of the facts made it an undesirable basis for a ruling. Pet. App. 7-8.

SUMMARY OF ARGUMENT

This case brings before the Court the most elementary of bankruptcy controversies: Does a bankruptcy court have the power to discharge a debt? The debt is a student loan and the entity challenging the bankruptcy court's jurisdiction is relying upon its rights under the Eleventh Amendment.

Unlike other recent cases, at issue is not the weighing of the choices of Congress under Article I and the requirements of the Eleventh Amendment, but instead the competing requirements of two constitutional mandates: the Bankruptcy Clause's requirement for uniform laws and the Eleventh Amendment's protection of a state's sovereign immunity. As set forth below, the language of the Bankruptcy Clause, its history, the collective nature of a bankruptcy and the past decisions of this Court, all demonstrate that when the states and the people adopted the Constitution, the states became subject to the jurisdiction of federal courts established to enforce "uniform Laws on the subject of Bankruptcies." U.S. CONST. art. I, §8, cl. 4.

Although this case involves the discharge of a student loan, if the States' theory is sustained, it will enable the states and all of their entities to opt out of federal bankruptcy proceedings. A bankruptcy court would thus be substantially hampered in developing an appropriate disposition or reorganization of the limited assets of a debtor and relieving a debtor from the weight of creditor

claims, substantially frustrating the design of the framers of the Constitution.

It was recognized in THE FEDERALIST PAPERS that a requirement for uniformity necessitated the abrogation of a state's sovereign immunity. Over the last two centuries this Court's opinions have recognized the significance of the Bankruptcy Clause's uniformity requirement, and have barred the assertion of a state's sovereign immunity, where it would undermine the operation of the bankruptcy system.

This Court's ruling in *Seminole Tribe* has created serious problems in the operation of the bankruptcy system. Such problems will grow exponentially, if the position of the TSAC is adopted. The collective nature of a bankruptcy cannot tolerate a rule which allows the states to exclude themselves from the bankruptcy process. This Court's past rulings have recognized that truth. That truth also is reflected in the recent inability of bankruptcy courts to exercise their most basic functions, when the Eleventh Amendment has been improperly interpreted to bar any relief against a non-consenting state.

Seminole Tribe sought to repair an "unworkable" doctrine created by *Pennsylvania v. Union Gas Co.*, 491 U.S. 1 (1989). *Seminole Tribe*, 517 U.S. at 63. Bankruptcy is now suffering under an equally unworkable burden. Such unworkability is reflected in the inconsistent opinions of those circuit courts of appeal which first ostensibly adopted the *Seminole Tribe* doctrine in bankruptcy, but then later recognized an *in rem* exception to a state's Eleventh Amendment rights. Even the narrowest of

exceptions is sufficient to grant Ms. Hood the limited relief that she seeks – the discharge of her student loan.

In bankruptcy "[p]roperty interests are created and defined by state law – [u]nless some federal interest requires a different result." *Butner v. United States*, 440 U.S. 48, 55 (1979). This is just one example of the ideal balance of state and federal rights exemplified by our bankruptcy system. The Eleventh Amendment also is directed at establishing a balance between state and federal rights. *See, e.g., Federal Maritime Comm'n v. South Carolina State Ports Auth.*, 535 U.S. 743, 769 (2002). In *Toucey v. New York Life Ins. Co*., 314 U.S. 118 (1941), this Court recognized "the delicate adjustments required by our federalism." *Id.* at 141. This delicate balancing will be undone in bankruptcy, if the Eleventh Amendment is allowed to bar a bankruptcy court from discharging a debt to a state.

ARGUMENT

I. THE HISTORICAL RECORD REFLECTS THE SURRENDER OF THE SOVEREIGN IMMUNITY OF THE STATES UNDER THE BANKRUPTCY CLAUSE

Bankruptcy is defined by its collective nature. Charles J. Tabb, *The Historical Evolution of the Bankruptcy Discharge*, 65 AM. BANKR. L.J. 325, 328 (1991). The first English Bankruptcy Act of 1542 arose from a developing economy's need to have an alternative to individual debt collection remedies. *Id.* at 328-329.

The impetus for the Bankruptcy Clause in the Constitution also arose from the economy's need for enhanced

debtor/creditor laws. Creditors needed a better collective mechanism for the recovery of their claims, and entrepreneurs needed enhanced protection from the greater risks of failure presented by the changing economy. *See* Bruce H. Mann, REPUBLIC OF DEBTORS: BANKRUPTCY IN THE AGE OF AMERICAN INDEPENDENCE 82-83 (2002) (hereinafter "Mann"). Merchants and traders who suffered major reverses were unwilling to settle with their creditors unless they knew their debts would be discharged upon the relinquishment of all of their property. *Id.* at 205. Disparate bankruptcy and insolvency laws among the different states were viewed as a major impediment to commerce under the Articles of Confederation. *Id.* at 80-81 & 185-186. *Accord*, Peter J. Coleman, DEBTORS AND CREDITORS IN AMERICA: INSOLVENCY, IMPRISONMENT FOR DEBT, AND BANKRUPTCY, 1607-1900 at 16-17 (1974).

The significance of debtor/creditor issues was reflected in the numerous references to Shays' Rebellion in THE FEDERALIST PAPERS. This armed uprising by Massachusetts farmers in 1786-1787 was precipitated by aggressive debt collection actions in the courts and the jailing of those who could not satisfy the claims of their creditors. David P. Szatmary, SHAYS' REBELLION: THE MAKING OF AN AGRARIAN INSURRECTION 29-35 (1980) (hereinafter "Szatmary"). Shays' Rebellion continued through the time of the Constitutional Convention. George Washington believed that the fears the rebellion stirred were central to the agreement by the various state legislatures to send representatives to the Constitutional Convention. *Id.* at 127.

The first of five references to Shays' Rebellion in THE FEDERALIST PAPERS highlights the debtor roots of the conflict:

> If SHAYS had not been a *desperate debtor* it is much to be doubted whether Massachusetts would have been plunged into a civil war.

THE FEDERALIST NO. 6 at 31 (A. Hamilton) (J. Cooke ed. 1961). Shays' Rebellion also is the first example provided in THE FEDERALIST NO. 21 to illustrate the dangers created by a lack of a strong central government under the Articles of Confederation. THE FEDERALIST NO. 21 at 131 (A. Hamilton).

Madison saw debtors and creditors as one of the major schisms in American society. He considered the tendency of people to coalesce into selfish "factions" as a primary vice of popular government, and considered conflicting creditor and debtor interests as one of the most likely bases for such factions. THE FEDERALIST NO. 10 at 59-60 (J. Madison). If the states continued to be loosely organized under the Articles of Confederation, he feared the enactment of dangerous state laws for "abolition of debts." *Id.* at 65.

Madison's fears and Shays' Rebellion also highlighted the basic conflict between local and nationalist interests which dominated the Constitutional Convention. "Would independent America be organized around law, contract, and the needs of large-scale commerce? Or would it be organized around custom and the needs of local community?" Edward Countryman, THE AMERICAN REVOLUTION 201 (1985). A leading opponent to ratification of the Constitution warned that the power to make uniform laws would destroy the differing state practices "respecting credit, and the mode of making men's property liable for paying their debts." *Observations of the Federal Farmer, Letter XVIII dated January 25, 1788* (reprinted in 2 THE COMPLETE

ANTI-FEDERALIST 344 (H. Storing ed. 1981)). The uniformity requirement in the Bankruptcy Clause was a victory for the commercially oriented nationalist forces.

This country's first national bankruptcy law, the Bankruptcy Act of 1800 (repealed in 1803) applied only to merchants and a bankruptcy case had to be commenced by a creditor, which creditors often were friendly to a debtor. Charles J. Tabb, *The History of the Bankruptcy Laws in the United States*, 3 AM. BANKR. INST. L. REV. 5, 14 (1995). The next bankruptcy law, the Bankruptcy Act of 1841 (repealed in 1843), applied to all persons and could be commenced voluntarily by a debtor, a significant break with English precedent. *Id.* at 16-17. The next bankruptcy law, the Bankruptcy Act of 1867 (repealed in 1878) applied to corporations, *Id.* at 19, and a provision for composition agreements (the forerunner of chapter 11 plans) was enacted in 1874. *Id.* at 20-21. The next national bankruptcy law, the Bankruptcy Act of 1898 continued for eighty years until it was replaced by the Bankruptcy Reform Act of 1978, this country's existing system. The existing Bankruptcy Code, in addition to chapter 7 liquidations and chapter 11 reorganizations, has separate provisions for municipalities (chapter 9), family farmers (chapter 12) and individual person reorganizations (chapter 13).

The states contend that the absence of a national bankruptcy law for most of the first one hundred years of our country's existence is evidence of the issue's relative lack of importance. *See* 48 States brief at 12-14. Such a history, of course, does not demonstrate a lack of Congress's power to subject a state to a bankruptcy court's jurisdiction. In his history of the bankruptcy laws, Charles Warren identifies opposition to a stronger union, as a

crucial factor in the defeat of bankruptcy legislation in the 1790s. Charles Warren, BANKRUPTCY IN UNITED STATES HISTORY 18 (1935). Given the continued opposition of states rights' advocates to the enactment of national legislation, *Id.* at 33, 49, 66 & 114, the absence of a national bankruptcy law provides further proof of the feared encroachments on state sovereignty that such laws would entail.

The Framers' intent in establishing a national bankruptcy system is reflected in the separate grant of a bankruptcy power in Article I of the Constitution, (rather than incorporating that power as an element in the Commerce Clause), and the requirement that the bankruptcy laws be "uniform." The need to abrogate state sovereign immunity in order to satisfy the Bankruptcy Clause's mandate for uniformity is described in THE FEDERALIST NO. 81 and THE FEDERALIST NO. 31.

THE FEDERALIST NO. 81 is a primary authority for this Court's understanding of Eleventh Amendment immunity. For example, it is cited in the majority opinion in *Seminole Tribe* at least three times. *Seminole Tribe*, 517 U.S. at 54, 69, 70, n.13. THE FEDERALIST NO. 81 states in pertinent part:

> It is inherent in the nature of sovereignty, not to be amenable to the suit of an individual *without its consent*. This . . . exemption, as one of the attributes of sovereignty, is now enjoyed by the government of every state in the union. Unless therefore, there is a surrender of this immunity in the plan of the convention, it will remain with the states . . . The circumstances which are necessary to produce an alienation of state sovereignty, were discussed in considering

> the article of taxation [The Federalist No. 32], and need not be repeated here. A recurrence to the principles there established [in The Federalist No. 32] will satisfy us, that there is . . . no right of action . . . to authorise suits against states, for the debts they owe . . .

THE FEDERALIST NO. 81 at 548-549 (A. Hamilton).

Hamilton explicitly qualified his description of the breadth of sovereign immunity in THE FEDERALIST NO. 81 by the limitations on sovereignty described in THE FEDERALIST NO. 32. Included in those limitations are those areas, such as bankruptcy, in which Congress is granted the power to make uniform laws. THE FEDERALIST NO. 32 states in pertinent part:

> But as the plan of the Convention aims only at a partial union or consolidation, the State Governments would clearly retain all the rights of sovereignty which they before had and which were not by that act exclusively delegated to the United States. This *exclusive* delegation, or rather this alienation of State sovereignty would only exist in three cases; . . . The third will be found in that clause, which declares that Congress shall have power "to establish an UNIFORM RULE of naturalization throughout the United States." This must necessarily be exclusive; because if each State had power to prescribe a DISTINCT RULE there could be no UNIFORM RULE.

THE FEDERALIST NO. 32 at 200-201 (A. Hamilton).

The states argue that as THE FEDERALIST NO. 32 addresses the issue of state sovereignty, while THE FEDERALIST NO. 81 addresses a sovereign's immunity to suit, the

limitations on state sovereignty identified in THE FEDERALIST NO. 32 are inapplicable to the discussion of state sovereign immunity in THE FEDERALIST NO. 81. *See* TSAC brief at 19 and Council brief at 8-9. As recognized by the Sixth Circuit in its opinion below, *see* App. 17-19, such an analysis simply ignores the clear intent of Hamilton in making explicit reference to THE FEDERALIST NO. 32 in THE FEDERALIST NO. 81.

Rather than being a distinct and unrelated doctrine, sovereign immunity has been viewed by this Court as "a fundamental aspect" of state sovereignty. *Alden v. Maine*, 527 U.S. 706, 713 (1999). Accordingly, it is unsurprising that Hamilton referred his readers to THE FEDERALIST NO. 32 rather than providing a separate discussion of the limits being placed on a state's sovereign immunity in THE FEDERALIST NO. 81. Why weigh down a paper meant to assuage fears of suits against a state for unpaid debts with a detailed discussion of limitations upon immunity in areas that did not encompass such suits, where a reference alone would suffice?

Contrary to the claims of the States, the surrender of a state's legislative sovereignty with respect to the enactment of bankruptcy laws was not enough. In order for a national bankruptcy law to function, states also had to relinquish their sovereign immunity in the operation of those laws.

At the time of the Constitutional Convention, this need arose particularly in connection with the widespread imprisonment of debtors for unpaid debts, which has been described as "one of the great plagues of the time." Kurt H. Nadelmann, *On The Origin of The Bankruptcy Clause* 1 AMER. J. LEGAL HIST. 215, 223-224 (1957). Imprisoned

debtors found themselves in circumstances inferior to those of even common criminals. Their prison terms were indeterminate and the government had no obligation to provide food, heat or clothing. Mann at 104. Imprisoned debtors lived in fear of starvation, disease and violence in dangerously overcrowded conditions. The historical records of the time are filled with accounts of their suffering. *Id.* at 87-90. Once insolvency stopped being considered a reflection of moral failure and instead became recognized as a product of business adversity, the potential for a national bankruptcy law arose.

Such a change in the law required that limitations be imposed upon the sovereign immunity of a state. For example, according to Blackstone, the primary source of English law at the time of the Constitution, *Alden*, 527 U.S. at 715, the issuance of writs of *habeas corpus* was a prime example of a limitation on sovereign immunity. Hon. Randolph J. Haines, *The Uniformity Power*: *Why Bankruptcy is Different*, 77 AMER. BANKR. L.J. 129, 183 (2003). Therefore, in an exercise of that power over the states, the Bankruptcy Act of 1800 granted federal bankruptcy courts the authority to issue writs of *habeas corpus* for the release of debtors held in other states, once their debts had been federally discharged. *Id.* at 178. In contrast, the Judiciary Act of 1789 banned federal courts from issuing writs freeing state prisoners in non-bankruptcy matters. *Id.* at 179-181. Opposition to the Bankruptcy Act of 1800 arose, in part, from a fear of expanding the size and powers of the federal judiciary to the detriment of state courts. Mann at 219. This willingness to grant federal courts in bankruptcy a power denied to federal judges in other matters affecting the states further exemplifies the

exceptional limitations on a state's sovereignty that national bankruptcy legislation entailed.

The fact that state tax claims were excepted from discharge in the early federal bankruptcy laws does not mean that states were not a part of the bankruptcy process. Congressional restraint in exercising the full extent of its powers granted under the Constitution does not equate to a lack of such power. Even today, the Bankruptcy Code excepts most tax claims from discharge under section 523(a)(1) and provides such claims with priority treatment under section 507(a)(8). *See* TSAC Brief at 26. The first exception granted by Congress to the Anti-Injunction Act, currently 28 U.S.C. §2283, was an 1874 amendment authorizing the issuance of injunctions by federal courts to stay state court actions related to bankruptcy proceedings. *United States Steel Corp. Plan for Employee Ins. Benefits v. Musisko*, 885 F.2d 1170, 1174 (3d Cir. 1989), *cert. denied*, 493 U.S. 1074 (1990). At the time of the Constitutional Convention the most fearful and oppressive danger that insolvency brought was imprisonment. That critical threat was addressed by the Bankruptcy Act of 1800. Moreover, as reflected in the decisions discussed in the subsequent portions of this brief, for the last one hundred years this Court repeatedly has ruled on issues involving the states in bankruptcy. The 48 States themselves have emphasized the significant role they play in contemporary bankruptcy cases. 48 States brief at 1.

The absence of limitations upon the discharge of government claims (both federal and state) obviously does not mean a lack of concern for giving debtors a "fresh start". As described in the quotation below and in the *amicus curiae* brief of Bruce H. Mann, it was the absence of a debt discharge provision in state insolvency laws or

the inability of the few true state bankruptcy laws in existence to be effective across state boundaries, which made a national bankruptcy act of critical importance at the time of the Constitutional Convention:

> Many of those imprisoned could have been released under state insolvency laws, which varied in detail but which shared the common requirement that the insolvent debtor assign all but a small amount of exempt personal property to his creditors. Although some eventually did so, most of the major speculators refused. Insolvency acts freed them from jail, not from their debts. Entrepreneurs to the bitter end, they were not willing to purchase their liberty at the cost of the lands that had been their downfall but that still represented their hope. Stripped of their land, they would never have the means to repay their debts and return to wealth. The loss of independence, which they could pretend was temporary as long as they held on to their land, would become permanent.

Mann at 205. History would be misused, if it were employed to deny a debtor what this Court described almost one hundred years ago as one of bankruptcy's two basic purposes – "a fresh start." *Burlingham v. Crouse*, 228 U.S. 459, 473 (1913).

Ultimately, of course, in addressing the Eleventh Amendment immunity of the states, the importance of history is to "make clear that the immunity exists today by constitutional design." *Alden*, 527 U.S. at 733. Thus, it is in the language of the Bankruptcy Clause and the operation of the bankruptcy system that the abrogation of a state's sovereign immunity is most apparent.

II. THE UNIFORMITY REQUIREMENT OF THE BANKRUPTCY CLAUSE REQUIRES THE ABROGATION OF A STATE'S ELEVENTH AMENDMENT IMMUNITY

The Bankruptcy Clause's requirement for uniformity was the subject of this Court's first major opinion on the bankruptcy power in *Sturges v. Crowninshield*, 17 U.S. (4 Wheat.) 122 (1819). Chief Justice Marshall recognized that uniformity might require that the power of Congress be exclusive:

> The peculiar terms of the grant certainly deserve notice. Congress is not authorized merely to pass laws, the operation of which shall be uniform, but to *establish* uniform laws on the subject throughout the United States. This *establishment* of *uniformity* is, perhaps, incompatible with State legislation, on that part of the subject to which the acts of Congress may extend.

Id. at 193-194. However, he also recognized that in the absence of any federal legislation on the subject, state bankruptcy or insolvency laws were a practical necessity in order to avoid punishing "honest insolvency by imprisonment for life." *Id.* at 200. Marshall resolved the problem by invalidating the New York bankruptcy law at issue, because it violated the Constitution's prohibition against state laws which impair the obligations of contract, rather than relying upon the uniformity requirement in the Bankruptcy Clause.

Like the statement by Marshall in *Crowninshield*, eight years later in *Ogden v. Saunders*, 25 U.S. (12 Wheat.) 213 (1827), the Court stated that the Framers believed "that the power to pass bankrupt laws was intended by the authors of the constitution to be exclusive

in Congress, or, at least, that they expected the power vested in that body would be exercised, so as effectually to prevent its exercise by the States." *Id.* at 267. Again, as in *Crowninshield*, the majority in *Saunders* allowed for the existence of state bankruptcy laws, but only to the extent that they discharged contractual obligations created after the law's passage. Such discharge also applied only to contracts governed by the laws of the state that enacted the bankruptcy legislation, rather than having any extra-territorial effect.

The references to uniformity and exclusivity in the opinions in *Crowninshield* and *Saunders* reflect this Court's understanding that the Framers believed that the bankruptcy power had been fully surrendered to the national government. As the Sixth Circuit recognized in its opinion below, the failure of this Court to fully embrace that view in the decades that followed arose from "the necessity of having *some* system in place when Congress could not enact bankruptcy legislation." Pet. App. 16.

The opinions in *Crowninshield* and *Saunders* left open the question of the constitutionality of state laws, when a national bankruptcy law was in effect. That question was answered in *Stellwagen v. Clum*, 245 U.S. 605 (1918), in which it was determined that a state's fraudulent conveyance law could operate in tandem with the Bankruptcy Act of 1898. In keeping with its earlier opinions, the Court ruled that the Bankruptcy Clause's uniformity requirement did not suspend all insolvency related state laws: "It is only state laws which conflict with the bankruptcy laws of Congress that are suspended; those which are in aid of the Bankruptcy Act can stand." *Id.* at 615. *See also, International Shoe Co. v. Pinkus*, 278 U.S. 261, 265 (1929) ("uniformity necessarily excludes" operation of conflicting

state insolvency law in the distribution of a debtor's property).

In contrast to the situation in *Clum*, the exercise of the TSAC's sovereign immunity, rather than aiding in the operation of the Bankruptcy Code, would bar Ms. Hood from obtaining a discharge of her student loan. Thus, rather than being in furtherance of the bankruptcy laws, the States are urging the adoption of a rule of sovereign immunity which would undermine a basic operation of the bankruptcy system.

After a permanent Bankruptcy Act was finally enacted in 1898, the issue revolving around uniformity changed. Rather than exclusivity, the question was whether Congress had the flexibility under the Bankruptcy Clause to allow differences in state law to be incorporated into the operation of the bankruptcy system.

Immediately after the Bankruptcy Act went into effect, it was asserted in *Hanover Nat'l Bank v. Moyses*, 186 U.S. 181 (1902), that a debtor's right to use state law exemptions under the Bankruptcy Act violated the Bankruptcy Clause's requirement for uniformity. The Court rejected the challenge and ruled "that uniformity is geographical and not personal." *Id.* at 188. Grounding itself in our tradition of federalism, so as to avoid displacing longstanding local differences, the Court wrote:

> [T]he system is, in the constitutional sense, uniform throughout the United States, when the trustee takes in each State whatever would have been available to the creditors if the bankrupt law had not been passed. The general operation of the law is uniform although it may result in certain particulars differently in different States.

Id. at 190. Thus, the ability of the bankruptcy system to respect local differences was maintained, provided that the general operation of the bankruptcy law remained uniform.

When the issue is not respecting local differences, but instead the isolated exercise of the bankruptcy power, this Court has not been equally tolerant. In *Blanchette v. Connecticut Gen. Ins. Corp. (Regional Rail Reorganization Act Cases)*, 419 U.S. 102 (1974), the Court considered the enactment of the "Rail Act" under the Bankruptcy Clause. The Rail Act provided for the establishment of Conrail, a quasi-public entity formed to address the problems of eight railroads in the Northeast and Midwest, which were then undergoing reorganization under §77(a) of the Bankruptcy Act. The Court justified the regional scope of the Rail Act by first determining that no other railroads were undergoing reorganization at that time. *Id.* at 159-160. It was this initial determination that allowed it to find that "the Rail Act in fact operates uniformly upon all bankrupt railroads then operating in the United States and uniformly with respect to all creditors of each of these railroads." *Id.* at 160.

Eight years later in *Railway Labor Executives' Ass'n v. Gibbons*, 455 U.S. 457 (1982), Congress enacted legislation addressing the problems of employees of only a single bankrupt railroad at a time when other railroads also were undergoing reorganization. *Id.* at 470. Under those circumstances, the Court found that the uniformity requirement of the Bankruptcy Clause was violated.

The opinion in *Gibbons* reflects the limits on the Court's willingness to allow Congress to provide separate treatment for a single debtor under the bankruptcy laws.

The Court also has set limits upon its willingness to allow local practices to interfere with the uniform operation of the bankruptcy laws.

These limits were identified in the opinion below in its analysis of *Vanston Bondholders Protective Comm. v. Green*, 329 U.S. 156 (1946), in which the Sixth Circuit rejected TSAC's claim that the uniformity requirement was limited to geographic uniformity. In his concurring opinion in *Vanston*, Justice Frankfurter had rejected a claim that interest on interest was payable on a creditor's claim on the basis that such interest payments were prohibited under New York law. That analysis of geographic uniformity upon which TSAC relies, *see* TSAC Brief at 23, was rejected by the majority in *Vanston*. Instead, it ruled that a rejection of a creditor's interest on interest claim was more properly based upon the uniformity requirement of the Bankruptcy Clause. The following analysis by the Sixth Circuit aptly identifies the pertinent issue in *Vanston*:

> [T]he majority in *Vanston* found no reason to inquire whether state law had created any valid claim, because the asserted claim was inconsistent with federal bankruptcy policies and thus could not be asserted – regardless of its status under state law. *See Vanston*, 329 U.S. at 163-64. On the majority's reasoning, federal courts must do more than treat state laws uniformly, federal courts must enforce federal bankruptcy law.

Pet. App. 13. Ultimately, the majority in *Vanston* determined that different state practices could not be tolerated, where the bankruptcy system's essential operations required a uniform rule.

The absolute uniformity which the Framers envisioned has been modified to allow for the continued expression of state and regional differences. This pattern reflects federalism at its best. What has not been modified is a requirement that local differences not be allowed to undermine the essential operations of the bankruptcy system; in such circumstances, the federal interest prevails. This is the lesson of *Clum* and the lesson of *Vanston*. This principle also must serve as the guiding light in this Court's consideration of a state's exercise of its sovereign immunity in bankruptcy.

Unlike our federal patent system, as the Sixth Circuit observed, *see* Pet. App. 14, uniformity in bankruptcy is not simply a reflection of Congressional policy. Uniformity is an explicit mandate included in the text of Article I, §8. *Cf. Idaho v. Coeur d'Alene Tribe of Idaho*, 521 U.S. 261, 283 (1997) ("a State's title to these sovereign lands . . . is 'conferred not by Congress, but by the Constitution itself.' "). The unfettered imposition of state sovereign immunity would not only violate that requirement, it would destroy the ideal balance of state and federal interests in bankruptcy that has been constructed over the last two centuries, as reflected in this Court's careful interpretation of the uniformity requirement.

III. AS THIS COURT HAS RECOGNIZED, THE COLLECTIVE NATURE OF A BANKRUPTCY REQUIRES JURISDICTION OVER A STATE

A. An Inherent Conflict Exists Between the Eleventh Amendment and the Collective Nature of a Bankruptcy

A court expresses itself through its orders. A court's orders are ineffective against a party unless it has sufficient jurisdiction – the power to issue orders that bind that party. J. Moore, 16 MOORE'S FEDERAL PRACTICE §108.03[1] (3d ed. 2003) (hereinafter "Moore's"). The Eleventh Amendment bars a court from asserting jurisdiction over a non-consenting state. A state's assertion of its Eleventh Amendment rights, therefore, strikes at the heart of the bankruptcy system.

In essence, bankruptcy entails bringing all of a debtor's property into one forum, dividing that property among all who can demonstrate a lawful claim to it under the Bankruptcy Code and allowing the debtor to continue its existence relieved of that burden (or at least having such debt limited by the terms of a plan).

States are major players in that system. Actions in bankruptcy are not simply individual suits against a state. Instead, they are part of a collective process in which all creditors of a debtor, including very often the federal government, have an interest:

> It is the purpose of the Bankruptcy Law, passed in pursuance of the power of Congress to establish a uniform system of bankruptcy throughout the United States, to place the property of the

> bankrupt under the control of the court, wherever it is found, with a view to its equal distribution among the creditors. The filing of the petition is an assertion of jurisdiction with a view to the determination of the status of the bankrupt and a settlement and distribution of his estate. The exclusive jurisdiction of the bankruptcy court is so far in rem that the estate is regarded as in custodia legis from the filing of the petition.

Acme Harvester Co. v. Beekman Lumber Co., 222 U.S. 300, 307 (1911). Accordingly, this Court repeatedly has refused to allow states to insulate themselves from a bankruptcy court's jurisdiction.

For example, in *New York v. Irving Trust Co.*, 288 U.S. 329 (1933), New York claimed that its sovereign immunity caused it not to be subject to a bankruptcy court order which set a deadline for filing claims. This Court rejected New York's position. It ruled that "orderly and expeditious proceedings would be impossible and a fundamental purpose of the Bankruptcy Act would be frustrated," if New York's views of sovereign immunity were accepted. *Id.* at 333.

In contrast to its decision in *Irving Trust*, in *Missouri v. Fiske*, 290 U.S. 18, 27-28 (1933), the Court ruled that the Eleventh Amendment barred a private individual from seeking any type of relief against a state in federal court, even if the relief sought involved the enforcement of a federal court's prior judgment. The opinions in *Irving Trust* and *Fiske* were both unanimous decisions by the Supreme Court, and both were issued in the same year. The willingness of this Court to uphold the power of the bankruptcy court in *Irving Trust*, as compared to its

refusal to allow a suit against a state in *Fiske* in a non-bankruptcy case, reflects the inherently different status accorded a state's Eleventh Amendment immunity in bankruptcy.

This Court has recognized that the collective nature of a bankruptcy necessarily alters a state's ability to assert its sovereign immunity. For example, in *Gardner v. New Jersey*, 329 U.S. 565 (1947), the State of New Jersey challenged the "constitutional authority of Congress to grant the bankruptcy court power to deal with the lien of a State." *Id.* at 578. The *Gardner* Court held that a bankruptcy court's "jurisdiction over all of the property of the debtor . . . [encompassed] the power of the court to deal with . . . the lien which New Jersey claims." *Id.* The *Gardner* Court observed:

> If the reorganization court lacked the power to deal with tax liens of a State, the assertion by a State of a lien would pull out chunks of an estate from the reorganization court and transfer a part of the struggle over the corpus into tax bureaus and other state tribunals.

Id. at 577.

The assertion of a state's sovereign immunity would be particularly harmful, if it were applicable in situations involving the liens held by a state on a bankrupt debtor's property. If a lien holder is not made a party to a bankruptcy, it may wait until a bankruptcy case has concluded, and then bring a foreclosure action in state court to fully recover its debt. *See, e.g., FDIC v. Union Entities (In re Be-Mac Transp. Co.)*, 83 F.3d 1020, 1025 (8th Cir. 1996) (FDIC lien passed through bankruptcy unaffected). Thus, unlike other creditors, a state would be able to avoid a

bankruptcy, and recover its claim after the financial strength of the debtor has been restored by the sacrifices which other creditors have been forced to bear in a bankruptcy case.

The need for a bankruptcy court to assert jurisdiction in situations involving a state's lien also arises when a debtor's property is sold pursuant to section 363(f) of the Bankruptcy Code and the proceeds distributed among a debtor's creditors. Of critical importance to this process is the ability of a court to transfer a debtor's property free and clear of all liens and other interests, which liens and interests instead attach to the proceeds of the sale. If a state were able to avoid a bankruptcy court's jurisdiction, a bankruptcy court could not sell goods free and clear of all liens and security interests. *Cf. Ray v. Norseworthy*, 90 U.S. (23 Wall.) 128 (1874) (secured creditor's lien continued to encumber property sold at bankruptcy sale, where secured creditor not made party to the sale proceeding). This essential power was found to exist by this Court even under the Bankruptcy Act of 1898, which included no provision granting a bankruptcy court the explicit authority to order the sale of a debtor's property free and clear of all liens. *See Van Huffel v. Harkelrode*, 284 U.S. 225, 227-228 (1931).

If a bankruptcy court lacked the power to provide for a sale free of all liens and encumbrances, the value of a debtor's assets would be greatly decreased. The clouds on the title of the property being sold would remain, and a secured creditor would retain its right to recover its debt from its continued recourse to the collateral. 7 COLLIER ON BANKRUPTCY, §1129.05[2][b][iv] (A. Resnick et al. ed., 15th ed. rev.). Thus, a critical means by which distributions to creditors are maximized in a bankruptcy would be lost. *Id.*

In total, if a state were free to exercise its sovereign immunity in bankruptcy, it would be able to use this power, not as a means of protecting itself, but as a mechanism for gaining an unfair advantage at the expense of other creditors, as well as the debtor.

The case law is replete with recent examples of states using their sovereign immunity to thwart the bankruptcy process at its most elemental level. For example, in *In re Perez*, 220 B.R. 216 (Bankr. D.N.J.), *aff'd*, 1998 U.S. Dist. LEXIS 21513 (D.N.J. 1998), the bankruptcy court found that the Eleventh Amendment barred a motion by a chapter 13 debtor seeking the restoration of his driver's license. The debtor's license had been suspended for nonpayment of parking violation fines, which were being repaid pursuant to the debtor's chapter 13 plan. A municipal judge had refused to take cognizance of the plan, and instead incarcerated the debtor until the fines were paid. Similarly, in *Tri-City Turf Club, Inc. v. Kentucky Racing Comm'n (In re Tri-City Turf Club, Inc.)*, 203 B.R. 617 (Bankr. E.D. Ky. 1996), the bankruptcy court ruled that notwithstanding its past determination that the state had violated the automatic stay, 11 U.S.C. §362(a), sovereign immunity barred the court from ordering the restoration of the debtor's license to operate its racetrack and the award of attorneys fees. *See also, e.g., Alabama v. Lewis*, 279 B.R. 308 (S.D. Ala. 2002) (sovereign immunity barred holding state in contempt for wrongful garnishment of debtor's wages in violation of the automatic stay); *Horwitz v. Zywiczynski (In re Zywiczynski)*, 210 B.R. 924 (Bankr. W.D.N.Y. 1997) (sovereign immunity barred bankruptcy court from determining state's ownership rights in certificate of deposit of debtor); *In re Christie*, 222 B.R. 64 (Bankr. D.N.J. 1998) (sovereign immunity barred bankruptcy court

from avoiding state tax lien as an impairment to debtors' homestead exemption).

In *In re Sun Healthcare Group, Inc.*, 245 B.R. 779 (Bankr. D. Del. 2000), *aff'd, Eleven State Medicaid Agencies v. CIT Group/Business Credit, Inc. (In re Sun Healthcare Group, Inc.)*, 2002 U.S. Dist. LEXIS 18128 (D. Del. 2002), a group of states claimed that their sovereign immunity barred a provision in a $200 million debtor-in-possession financing order, which limited the states' postpetition recoupment rights in connection with various Medicaid contracts with the debtors. The bankruptcy court overruled the objection on the basis that the states' recoupment rights were already limited by the automatic stay and that the states were not being ordered to make any payments to the debtors under the debtor-in-possession financing order. If the arguments by the States are adopted in the instant case, the opinion in *Sun Healthcare* would not be sustainable. Without the consent of a state, a bankruptcy court would not have the required jurisdiction to alter a state's legal rights. This case law illustrates the dangers which would arise from a blanket assertion of a state's sovereign immunity in bankruptcy. The States have failed to demonstrate how these dangers can be avoided.

B. The States Have Failed to Provide Any Viable Alternative Means for the Discharge of a Student Loan

The Framers sought to establish a centralized bankruptcy system, and this Court has continued to recognize the need for a "complete and effective bankrupt system." *United States v. Fox*, 95 U.S. (5 Otto) 670, 672 (1877). For

example, in upholding the rights of an assignee under the Bankruptcy Act of 1867 (the approximate equivalent of a modern day trustee), to bring suit in federal court, the Court wrote:

> The State courts may undoubtedly be resorted to in cases of ordinary suits for the possession of property or the collection of debts; and it is not to be presumed that embarrassments would be encountered in those courts in the way of a prompt and fair administration of justice. But a uniform system of bankruptcy, national in its character, ought to be capable of execution in the national tribunals, without dependence upon those of the States in which it is possible that embarrassments might arise.

Lathrop v. Drake, 91 U.S. (1 Otto) 516, 518 (1875). *Accord, Isaacs v. Hobbs Tie & Timber Co.*, 282 U.S. 734, 737 (1931) ("the bankruptcy court has exclusive jurisdiction to deal with the property of the bankrupt estate"). The States now seek to undo this longstanding policy of providing a central federal forum for resolving controversies in bankruptcy, and instead leave hapless debtors without a real opportunity for relief.

TSAC asserts in its brief before this Court that its state court system provides a satisfactory alternative venue for Ms. Hood. TSAC brief at 30. *Accord*, Council brief at 27-28. However, as set forth in the *amicus curiae* briefs of the National Association of Consumer Bankruptcy Attorneys (hereinafter "NACBA") and Donald J. Spring, state courts do not provide a viable alternative for such a discharge determination.

First, in its brief in support of its motion to dismiss in the bankruptcy court, the TSAC claimed that such a suit

would be barred in any "'court in the state.'" TSAC Student Assistant Corporation's Brief in Support of Motion to Dismiss served on May 11, 2000 at 8 (quoting TCA §20-13-102). Second, in addition to the sovereign immunity provided by its own laws, a state is protected by the Eleventh Amendment from the adjudication of federal causes of action in its own courts without its consent. *Alden*, 527 U.S. at 755. The TSAC therefore argues that Ms. Hood can wait until the state initiates a collection action and at that juncture raise undue hardship as a defense. Such a course of action, of course, leaves a debtor without its most basic entitlement under the Bankruptcy Code – a fresh start, as a state could wait for years before commencing a collection action.

Most importantly, as more fully described in the NACBA's brief, the student loan system is organized in a manner which avoids the need for commencing a collection action in state court. Instead, a student's wages may be garnished without court authorization pursuant to 20 U.S.C. §1095a. In fact, the applicable regulations bar a collection action, where a wage garnishment is a viable alternative. 34 C.F.R. §682.410(b)(6)(iv). In addition, a debtor's tax refunds may be intercepted to obtain repayment of a student loan pursuant to 31 U.S.C. §3720A, an experience repeatedly suffered by *amicus* Donald Spring. In total, an essential function of the bankruptcy system – the discharge of a student loan – may not be available, if it is dependent upon access to state courts.

The two methods suggested in *Seminole Tribe* as alternative means for vindicating a private individual's rights – suits by the federal government or the *Ex parte Young*, 290 U.S. 123 (1908) doctrine, *see Seminole Tribe*, 517 U.S. at 71 n.14, as more fully described in the brief

filed on behalf of Donald Spring, also fail to provide viable alternatives for the discharge of a student loan. First, as the federal government is the ultimate guarantor of a student loan, it is not reasonable to expect that the federal government would bring suit against a state on behalf of a debtor in order to obtain the discharge of the loan. Nor is an action under *Ex parte Young* available, because the requirement for an a "'a continuing violation of federal law,'" *Seminole Tribe*, 517 U.S. at 73 (quoting *Green v. Mansour*, 474 U.S. 64, 68 (1985)), cannot be satisfied. Before a discharge order can be violated by a state, a discharge order first has to be granted. *E.g., Perkins v. Coordinating Bd. for Higher Educ. (In re Perkins)*, 228 B.R. 431 (Bankr. E.D. Mo. 1998). However, it is precisely such an order which the TSAC is seeking to bar in this proceeding. Therefore, it is obvious that no viable alternative exists to the determination of an undue hardship discharge by a bankruptcy court.

The absence of a viable state court remedy highlights in certain respects the most troublesome aspect of upholding a state's Eleventh Amendment immunity in bankruptcy. The operation of our bankruptcy system reflects a careful balancing of federal and state interests. For example, bankruptcy is a federal program for the relief of the poor which uses state property law to determine debtor and creditor property interests, "[u]nless some federal interest requires a different result." *Butner*, 440 U.S. at 55. In addition, bankruptcy uses state exemptions to define those property interests which may be retained by a debtor. *See, Moyses*, 186 U.S. at 189. The Eleventh Amendment also plays a major role in our system of federalism. Yet, the TSAC now seeks to use the Eleventh Amendment to undermine the careful balancing of state

and federal interests in bankruptcy that this Court has helped to construct over the last two hundred years in furtherance of the federalist ideal.

C. The States' Comparisons of the Commerce Clause with the Bankruptcy Clause Fail to Demonstrate a Lesser Bankruptcy Power

TSAC confuses the issue by making distorted comparisons between the bankruptcy power and Congress's power to regulate interstate commerce. TSAC brief at 10-13. As previously discussed, it is the collective nature of a bankruptcy and the Bankruptcy Clause's requirement for uniformity that require that bankruptcy be treated differently than other Article I powers with respect to the Eleventh Amendment. The relative breadth of the bankruptcy power is not the issue. In the opinion below the Sixth Circuit appropriately dismissed the TSAC Commerce Clause argument in a footnote, *see* Pet. App. 12 n.2, but the TSAC has raised it again in a different guise.

The insubstantial nature of TSAC's position is reflected in the Court's contrasting responses to challenges to state highway safety laws based upon alleged violations of the Interstate Commerce Clause, as compared to challenges based upon alleged violations of the Bankruptcy Clause.

For example, in *Buck v. Kuykendall*, 267 U.S. 307 (1925), Justice Brandeis wrote:

> [A]ppropriate state regulations adopted primarily to promote safety upon the highways and conservation in their use are not obnoxious to the Commerce Clause, where the indirect burden

> imposed upon interstate commerce is not unreasonable.

Id. at 315. Thus, in *Sproles v. Binford*, 286 U.S. 374 (1932), the Court upheld a Texas statute which limited the size and weight of vehicles on Texas highways, as an appropriate measure for furthering highway safety and minimizing highway repair costs. *Id.* at 385-386.

In contrast to this willingness of the Court to allow the states to impose reasonable burdens upon interstate commerce, in *Perez v. Campbell*, 402 U.S. 637 (1971), the Court ruled that highway safety laws which required a debtor to satisfy any outstanding motor vehicle judgments before his license could be returned were in conflict with the bankruptcy law's provisions for discharging a debtor from all obligations. The Court stated that "any state legislation which frustrates the full effectiveness of federal law is rendered invalid by the Supremacy Clause." *Id.* at 652.

The contrasting opinions in *Kuykendall, Sproles* and *Campbell* demonstrate the fallacy of TSAC's position that the bankruptcy power is of lesser magnitude than Congress' power to regulate interstate commerce. Equally fallacious is TSAC's assertion that the Bankruptcy Clause is of lesser force than the Commerce Clause, because there is no doctrine in bankruptcy which is equivalent to the "dormant" Commerce Clause. *See*, TSAC brief at 13.

When no applicable federal legislation has been enacted, the dormant Commerce Clause bars state actions which place an undue burden on interstate commerce. The absence of an equivalent doctrine in bankruptcy is unsurprising, because if there is no federal bankruptcy legislation in effect, there is no bankruptcy system upon which a

state can impose an undue burden. In contrast, a burden on interstate commerce occurs whether or not Congress has acted, because it is the product of state laws acting on economic activity rather than the product of Congress' exercise of its legislative power. In addition, in the cases cited by TSAC to support it position, *see* TSAC brief at 11, state laws were invalidated because they discriminated against interstate commerce. *See, Hughes v. Oklahoma,* 441 U.S. 322, 336-337 (1979) (Oklahoma law barring transport of natural minnows for out of state sale is discriminatory on its face); *West Lynn Creamery, Inc. v. Healy*, 512 U.S. 186, 194 (1994) (Massachusetts tax discriminates against out of state milk dealers, as revenue from tax used to subsidize higher cost Massachusetts dairy farmers in competition with lower cost, out of state dairy farmers); *Camps Newfound/Owatonna, Inc. v. Harrison*, 520 U.S. 564 (1997) (Maine real estate tax exemption which provides a lesser exemption to non-profits servicing primarily out of state residents is facially discriminatory). It is obvious that such discrimination against a national bankruptcy law cannot exist, unless there is a national bankruptcy law in existence.

Finally, while the power to "regulate" commerce logically encompasses the power to bar discriminatory state actions, the power to "establish" bankruptcy laws is literally of a different nature. The closest analogy would be the invalidation of state statutes which discriminate or otherwise interfere with the operation of a national bankruptcy law, which of course was the Court's holding in *Clum*. *See*, *supra* at 17.

Ultimately, the issue is not the relative magnitude of these powers, but the nature of these powers. While the assertion of a state's sovereign immunity generally only

affects interstate commerce in a tangential manner, the assertion of Eleventh Amendment immunity strikes at the core of a bankruptcy's collective nature. In total, TSAC's dormant Commerce Clause argument is a "red herring."

IV. AS RECOGNIZED BY CIRCUIT COURTS OF APPEAL THROUGHOUT THE COUNTRY, A STATE'S SOVEREIGN IMMUNITY IS SUBORDINATE TO A BANKRUPTCY COURT'S *IN REM* JURISDICTION

This Court has stated that bankruptcies are "in the nature of proceedings *in rem*." *Moyses*, 186 U.S. at 192. *Accord, Katchen v. Landy*, 382 U.S. 323, 336 (1966) ("bankruptcy . . . converts the creditor's legal claim into an equitable claim to a pro rata share of the *res*"); *Gardner*, 329 U.S. at 574 (the claims process in bankruptcy constitutes "an adjudication of interests claimed in a *res*"); *Acme Harvester Co. v. Beekman Lumber Co.*, 222 U.S. 300, 307 (1911) ("jurisdiction of the bankruptcy court is . . . *in rem")*. Prior to the enactment of the Bankruptcy Code in 1978, a bankruptcy court's summary jurisdiction generally was limited to administrative matters, property owned by a debtor and "controversies relating to property over which they [debtors] have actual or constructive possession." *Thompson v. Magnolia Petroleum Co*., 309 U.S. 478, 481 (1940). A bankruptcy court pursuant to 28 U.S.C. §1334 and §157 continues to "have exclusive jurisdiction of all of the property, wherever located, of the debtor." 28 U.S.C. §1334(e).

The critical relationship between a bankruptcy's collective nature and the jurisdiction of a bankruptcy court was recognized by the Sixth Circuit in its opinion below.

Citing this Court's opinion in *Gardner*, it concluded its analysis by defining the relief being sought by Ms. Hood as a determination of TSAC's interest in *a res*. Pet. App. 22.

In *Seminole Tribe*, this Court stated in a footnote that Congress's inability to abrogate a state's sovereign immunity under Article I extended to its powers in bankruptcy. *Seminole Tribe* at 73 n.16. Of course, this Court would be unwilling to allow a footnote to govern such a critical matter, unless it had an opportunity to separately consider the interplay between the Eleventh Amendment and the Bankruptcy Clause in a separate case, as provided hereby. If this Court believes that the abrogation of a state's sovereign immunity under the Bankruptcy Code extends too far, it should still affirm the decision below as an appropriate exercise of a bankruptcy court's *in rem* jurisdiction.

The divergence in opinion among the federal circuit courts of appeal on the extent of Congress's power to abrogate a state's sovereign immunity in bankruptcy masks an almost universal agreement that a debt to a state may be discharged by a bankruptcy court. The jurisdictional basis for such power has been implicitly or explicitly recognized as a form of *in rem* jurisdiction by the circuit courts of appeal who have attempted to apply the holding in *Seminole Tribe* in bankruptcy.

For example, the Fourth Circuit Court of Appeals in *Schlossberg v. Maryland (In re Creative Goldsmiths of Washington, D.C., Inc.)*, 119 F.3d 1140 (4th Cir. 1997), *cert. denied*, 523 U.S. 1075 (1998), ruled that Congress lacked the power to abrogate a state's Eleventh Amendment immunity in a trustee's action for the recovery of a preference. Nevertheless, a few weeks later it found in *Maryland*

v. Antonelli Creditors' Liquidating Trust, 123 F.3d 777 (4th Cir. 1997), that Maryland was bound by a recording and transfer tax exemption included in an order confirming a chapter 11 plan. The Fourth Circuit determined in *Antonelli Creditors*' that a bankruptcy court's authority "derives not from jurisdiction over the state or other creditors, but rather from jurisdiction over debtors and their estates." *Id.* at 787.

Notwithstanding the Fifth Circuit's earlier acceptance of the *Seminole Tribe* doctrine in bankruptcy in *Department of Transp. and Dev. v. PNL Asset Management Co., LLC (In re Fernandez)*, 123 F.3d 241 (5th Cir. 1997), that court later adopted the *Antonelli Creditors in rem* analysis in *Texas v. Walker*, 142 F.3d 813 (1998), *cert denied*, 525 U.S. 1102 (1999). In *Walker* the issue was "whether the Eleventh Amendment prevents the discharge of a debt owed to a state in a bankruptcy proceeding in which the state does not participate in any fashion." *Id.* at 820. Judge Edith Jones, quoting *Antonelli Creditors*, found that the Supremacy Clause, the collective nature of a bankruptcy and a bankruptcy court's jurisdiction over a debtor and its estate provided the requisite jurisdiction to discharge a debt owed to a state. *Id.* at 822. Of course, the Supremacy Clause itself provides no basis for overcoming a state's Eleventh Amendment immunity. *See Alden*, 527 U.S. at 731-732. Thus, the only real justification for the ruling in *Walker* is the power of Congress under the Bankruptcy Clause.

The rationale adopted by the Fourth Circuit in *Antonelli Creditors* and the Fifth Circuit in *Walker* was then utilized by the Fourth Circuit in *Virginia v. Collins (In re Collins)*, 173 F.3d 924 (4th Cir. 1999), *cert. denied*, 528 U.S. 1073 (2000). In *Collins*, Virginia argued that the

Eleventh Amendment barred a bankruptcy court from determining whether a bail bondsman's debt to the state had been discharged in his bankruptcy. The Court in *Collins* wrote:

> [T]he bankruptcy court did not need to assert jurisdiction over the Commonwealth to determine the dischargeability of the bail bond debt in conjunction with its decision to reopen. The court had the power to do that because it had jurisdiction over the debtors and their case.

Id. at 931.

Next, in *Goldberg v. Ellett (In re Ellett)*, 46 Collier Bankr. Cas. 2d 1498, 2001 U.S. App. LEXIS 19184 (9th Cir. 2001), *cert. denied*, 543 U.S. 1127 (2002), California claimed that the Eleventh Amendment barred a bankruptcy court from determining whether a personal income tax debt had been discharged and therefore was encompassed by the discharge injunction provided by section 524 of the Bankruptcy Code. Notwithstanding its prior determination in *In re Mitchell*, 209 F.3d 1111 (9th Cir. 2000), that supported the state's position, the Ninth Circuit ruled in *Ellet* that the Eleventh Amendment was not a bar to such relief, as "the bankruptcy court exercises jurisdiction over the res of the bankruptcy estate when it issues its discharge order, not in personam jurisdiction over the estate's creditors." *Ellet*, 46 C.B.C. 2d at 1504, 2001 U.S. App. LEXIS at *14.

Finally, in the Seventh Circuit case relied upon by TSAC*, Nelson v. La Crosse County Dist. Att'y (In re Nelson)*, 301 F.3d 820 (7th Cir. 2002), *see* TSAC brief at 14, the court explicitly recognized the existence of an *in rem* exception to state sovereign immunity in bankruptcy. In upholding an Eleventh Amendment defense to an action to

enjoin a criminal prosecution against a debtor for embezzlement, the Court wrote:

> Unlike the State of California in *Deep Sea* and the Commonwealth of Virginia in *Collins*, Mrs. Nelson's adversary proceeding was brought against the defendants to prevent them from prosecuting her, and they are necessary, named, parties in the action. Accordingly, we conclude that the *in rem* "exception" to Eleventh Amendment immunity is not applicable in the present case.

Id. at 838.

This Court determined in *California v. Deep Sea Research, Inc.*, 523 U.S. 491 (1998), that an *in rem* exception to a state's Eleventh Amendment immunity exists in admiralty actions, where the state is not in possession of the *res*. As the Seventh Circuit recognized in *Nelson*, an analysis of this nature also is applicable in bankruptcy.

Of course, this Court also has recognized that there are limits upon a bankruptcy court's *in rem* jurisdiction. For example, in *United States v. Nordic Village Inc.*, 503 U.S. 30 (1992), a bankruptcy trustee commenced an action against the United States to recover $20,000 in corporate funds that were allegedly misappropriated to satisfy an individual shareholder's tax liability. The Court denied the trustee's belated argument for an *in rem* exception, but carefully limited its denial to actions seeking a monetary judgment, where there was no identifiable *res*. *Id.* at 38-39.

Given the narrow nature of Ms. Hood's request for relief – i.e. the discharge of her debt to TSAC, and given the absence of any request for any monetary recovery or

any other form of affirmative relief, the bankruptcy court's *in rem* jurisdiction provides an alternative basis for affirming the decision below.

The uniformity requirement of the Bankruptcy Clause and a bankruptcy case's collective nature demonstrate that an exception to a state's sovereign immunity in bankruptcy is required. The method for delineating that exception may vary, but the need for its existence is unassailable.

V. USE OF AN ADVERSARY PROCEEDING IS NOT A BAR TO MS. HOOD'S REQUEST FOR A DISCHARGE

Unlike the circuit court of appeals cases cited above, Ms. Hood initiated her request for relief from her student loan by service of a complaint. Service of process has been identified as a factor in determining whether an Eleventh Amendment violation has occurred, *see, e.g., Antonelli Creditors*, 123 F.3d at 786-787, but such analyses have not taken into account the peculiar jurisdictional character of a case in bankruptcy.

Service of a complaint is the means by which a court obtains jurisdiction over a person. 1 MOORE'S at §4.02(1). However, as described in the prior discussion of *in rem* jurisdiction, *supra* at 36-38, a bankruptcy court's ability to discharge a debt may be found to arise from a court's jurisdiction over a debtor and its estate, rather than personal jurisdiction over a state. Consequently, in an action for a discharge, service of a complaint simply fulfills a notice requirement.

For example, in *Moyses*, the creditor contended that the Bankruptcy Act violated the Fifth Amendment's requirement for due process, because the discharge of a debt required notice to a creditor by personal service. *Moyses*, 186 U.S. at 191-192. The *Moyses* Court ruled that notice by mail and publication was sufficient, as the power to discharge a debt did not require a court to obtain personal jurisdiction over a creditor; bankruptcy proceedings were "in the nature of proceedings *in rem*." *Id.* at 192.

This more limited function of service of process in a bankruptcy is consistent with the difference between an action brought within and outside of a bankruptcy. In a bankruptcy case, requests for relief from a court may be brought by motion or by adversary proceeding. A motion is the usual manner in which a request for relief is made to a bankruptcy court. An adversary proceeding is used when Rule 7001 of the Federal Rules of Bankruptcy Procedure requires that such method be utilized. A distinctive aspect of an adversary proceeding is the requirement for the filing and service of a complaint. *See,* Bankruptcy Rules, 7003 and 7004. However, "[a]dversary proceedings in bankruptcy are not distinct pieces of litigation; they are components of a single bankruptcy case." *Cohen v. Bucci,* 905 F.2d 1111, 1112 (7th Cir. 1990).

Other than being set forth in Bankruptcy Rule 7001, there appears to be no substantive basis for requiring a request to a bankruptcy court to be made by adversary proceeding, rather than motion. The usual lack of any jurisdictional significance to the filing of a complaint in a bankruptcy is reflected in the official explanation for why that requirement has been eliminated in making a request for relief from the automatic stay:

> Unlike former Bankruptcy Rule 701, requests for relief from an automatic stay do not commence an adversary proceeding. Section 362(e) of the Code and Rule 4001 establish an expedited schedule for judicial disposition of requests for relief from the automatic stay. The formalities of the adversary proceeding process and the time for servicing pleadings are not well suited to the expedited schedule. The motion practice prescribed in Rule 4001 is best suited to such requests because the court has the flexibility to fix hearing dates and other deadlines appropriate to the particular situation.

FED. R. BANKR. P. 7001, 1983 advisory committee note.

A change in the rules allowing for commencement of a proceeding by motion rather than by adversary proceeding is generally not of great consequence, because once an objection is filed, the motion becomes a "contested matter." *Id.* As a contested matter, Bankruptcy Rule 9014 provides that the rules applicable to an adversary proceeding generally govern a motion and those rules replicate the Federal Rules of Civil Procedure in most respects.[1]

[1] The applicable Bankruptcy Rules include: 7021 (misjoinder and non-joinder of parties), 7025 (substitution of parties), 7026 (general provisions governing discovery), 7028 (persons before whom depositions may be taken), 7029 (stipulations regarding discovery procedure), 7030 (depositions upon oral examination), 7031 (deposition upon written questions), 7032 (use of depositions in adversary proceedings), 7033 (interrogatories to parties), 7034 (production of documents and things and entry upon land for inspection and other purposes), 7035 (physical and mental examination of persons), 7036 (requests for admission), 7037 (failure to make discovery: sanctions), 7041 (dismissal of adversary proceedings), 7042 (consolidation of adversary proceedings; separate trials), 7052 (findings by the court), 7054 (judgments; costs),

(Continued on following page)

The great overlap in the rules governing adversary proceedings and contested motions has resulted in a common practice by courts of allowing a party to proceed by motion, even when the Bankruptcy Rules require the commencement of an adversary proceeding. The leading treatise on bankruptcy law states:

> Occasionally, a party who should have commenced an adversary proceeding may instead file a motion under Rule 9014. In such cases, so long as due process has been afforded to the responding party, the courts will apply the harmless error rule and not force the parties to start all over again.

10 *Collier on Bankruptcy* §9014.01 (footnotes omitted). *See also, e.g., In re Stewart*, 215 B.R. 633, 635 (Bankr. M.D. Fla. 1997) (validity of lien allowed to be determined by motion); *In re Friedman*, 184 B.R. 883 (Bankr. N.D.N.Y. 1994) (validity of lien allowed to be determined by motion), *aff'd*, 184 B.R. 890 (N.D.N.Y. 1995); *In re Braniff Int'l Airlines, Inc.*, 164 B.R. 820, 831 (Bankr. E.D.N.Y. 1994) (validity of lien allowed to be determined by motion); *In re Gee*, 124 B.R. 586, 590 (Bankr. N.D. Okla. 1991) (determination of creditor's interest in debtor's annuity payment allowed to proceed by motion); *In re Mark Twain Marine Indus., Inc.*, 115 B.R. 948, 949 n.1 (Bankr. N.D. Ill. 1990) (request for turnover of funds allowed to proceed by motion); *In re Command Services Corp.*, 102 B.R. 905 (Bankr. N.D.N.Y. 1989) (validity of lien allowed to be

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7055 (default), 7056 (summary judgment), 7064 (seizure of person or property), 7069 (execution), and 7071 (process in behalf of and against persons not parties).

determined by motion); *In re Wild Lilly, Inc.*, 51 B.R. 963 (Bankr. S.D.N.Y. 1985) (request for turnover of goods allowed to proceed by motion).

Similarly, a very fine line may distinguish situations in which the Bankruptcy Rules require the filing of an adversary proceeding rather than a motion. For example, a motion is sufficient to determine the value of a lien pursuant to Bankruptcy Rule 3012, but an adversary proceeding is required to determine "'the basis of the lien itself.'" *Harmon v. United States ex rel. FMHA (In re Harmon)*, 101 F.3d 574, 585 (8th Cir. 1996) (quoting FED. R. BANKR. P. 3012 advisory committee note).

Of course, if this Court determines that use of an adversary proceeding is a bar to a discharge of a student loan, then the potential remains for Ms. Hood to seek such relief by motion, notwithstanding the requirements of Bankruptcy Rule 7001. The statute which authorizes this Court to promulgate the Bankruptcy Rules, also states that "[s]uch rules shall not abridge, enlarge, or modify any substantive right." 28 U.S.C. §2075. Thus, a bankruptcy rule will not be interpreted so as to bar a party's substantive rights under the Bankruptcy Code. *See, e.g., American Law Center PC v. Stanley (In re Jastrem)*, 253 F.3d 438, 441 (9th Cir. 2001) (§2075 bars interpretation of Bankruptcy Rule 1006(b) that would create an exception to the automatic stay); *Bell v. Bell (In re Bell)*, 225 F.3d 203, 218 (2d Cir. 2000) (§2075 bars interpretation of Bankruptcy Rule 4003(b) which would alter a debtor's exemption rights under section 522(l) of the Bankruptcy Code). Accordingly, it would appear appropriate that in the event the opinion below is reversed that Ms. Hood be provided with the opportunity to request a discharge of her student loan by motion.

In total, serving a complaint rather than requesting relief by motion, is not a sufficient basis for denying a debtor the opportunity to have her debt discharged. Instead, in the context of a bankruptcy, it simply is a heightened form of notice provided in the interest of the non-debtor party. *In re Fuller*, 255 B.R. 300, 304-305 (Bankr. W.D. Mich. 2000). What is important for Eleventh Amendment purposes is "'the essential nature and effect of the proceeding.'" *Coeur d' Alene*, 521 U.S. at 277 (1997). "The real interests served by the Eleventh Amendment are not to be sacrificed to elementary mechanics of captions and pleading." *Id.* at 270. Sovereign immunity is a doctrine whose purpose in certain circumstances is to bar a court from asserting jurisdiction over a non-consenting state; it is not a doctrine intended to bar a state from being provided with the augmented protection of enhanced notice by use of an adversary proceeding.

CONCLUSION

State sovereign immunity is not an end in itself. Instead, as this Court previously has recognized, it is a means of "strik[ing] the proper balance between the supremacy of federal law and the separate sovereignty of the States." *Alden*, 527 U.S. at 757. As it has developed over the centuries under the direction of Congress and this Court, the bankruptcy system has epitomized federalism at its best, a collective federal process that is grounded in the property law of the individual states. That balance, however, cannot be maintained, if the states have the option of excluding themselves from the bankruptcy process. In such an event, sovereign immunity would be transformed from a device for the protection of the states

into a mechanism which is destructive to an important component of our modern economic system.

For the foregoing reasons, the judgment of the United States Court of Appeals for the Sixth Circuit should be affirmed.

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