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Benjamin Weintraub

Alan N. Resnick

*Maurice A. Deane School of Law at Hofstra University*

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# From the Bankruptcy Courts

*Benjamin Weintraub\* and Alan N. Resnick\*\**

## **BANKRUPTCY COURT JURISDICTION UNDER THE JUDICIAL CONFERENCE EMERGENCY RULE**

Bankruptcy practitioners were thrust into a state of shock and confusion when the Supreme Court held in *Northern Pipeline Construction Co. v. Marathon Pipe Line Co.*<sup>1</sup> that the Reform Act's broad grant of jurisdiction made to bankruptcy courts was unconstitutional because bankruptcy judges were not given life tenure and the protection against salary reduction, which must be given to federal judges pursuant to Article III of the Constitution. In particular, the Court objected to the bankruptcy court's power to adjudicate disputes "relating to" a bankruptcy case merely because one of the parties involved in the nonbankruptcy matter decided to file a bankruptcy petition. Such power vests judges with the "judicial power of the United

States"<sup>2</sup> and, therefore, must be accompanied with Article III tenure and antisalary reduction protections. In a plurality decision, the Supreme Court held that the bankruptcy court's jurisdiction was invalid in its entirety, instead of attempting to sever the unconstitutional aspects of the court's jurisdiction from the constitutional ones.

Although the Supreme Court's decision was rendered in the summer of 1982, the effect of the holding was stayed until October 4, 1982, to give Congress an opportunity to reconstitute the bankruptcy court in a manner that would pass the test of constitutionality. Although other alternatives might be conceived, in essence Congress had the choice of either creating a new Article III bankruptcy court, complete with life tenure and protections against salary reduction or establishing a non-Article III bankruptcy court with limited jurisdiction, similar to that of the bankruptcy judges under the former Bankruptcy Act. When Congress failed to remedy the situation, the stay was extended to December 24, 1982. Nonetheless, Congress again

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\* Counsel to the law firm of Levin & Weintraub & Crammes, New York City; member of the National Bankruptcy Conference.

\*\* Professor of Law, Hofstra University School of Law, Hempstead, New York; associated with the law firm of Moritt, Wolfeld & Resnick, Garden City, New York; associate member of the National Bankruptcy Conference.

<sup>1</sup> 102 S. Ct. 2858 (1982).

<sup>2</sup> U.S. Const., art. III, § 1.

failed to act by the December 24 deadline, and the Supreme Court denied another request to further extend the stay.

### The Emergency Model Rule

Despite the Supreme Court's refusal to extend the stay and Congress' inaction, the life of the bankruptcy court was extended beyond Christmas Day by an unexpected source. On December 3, the Judicial Conference of the United States proposed an emergency model rule, which was approved by every judicial circuit for adoption by district courts as a local court rule.<sup>3</sup> The purpose and effect of the Model Rule is to keep the bankruptcy courts operating and to avoid chaotic disruption in the administration of bankruptcy cases. By its own terms, the Model Rule is to operate only until Congress enacts appropriate remedial legislation in response to the Supreme Court's decision in *Northern Pipeline* or until March 31, 1984, whichever occurs first.

The Model Rule is predicated on the district court's finding that "exceptional circumstances" exist, including the unanticipated unconstitutionality of the grant of power to bankruptcy judges, the "clear intent of Congress to refer bankruptcy matters to bankruptcy judges," the "specialized exper-

tise necessary to the determination of bankruptcy matters," and the administrative difficulty of the district courts' assuming the existing bankruptcy caseload on short notice. "Therefore, the orderly conduct of the business of the [district] court requires this referral of bankruptcy cases to the bankruptcy judges."<sup>4</sup>

The essence of the emergency Model Rule is that it refers to bankruptcy judges, all bankruptcy cases, and all civil proceedings arising in or related to a bankruptcy case.<sup>5</sup> Thus, it permits bankruptcy judges to entertain all matters that it could have decided under the Reform Act prior to *Northern Pipeline*. On a timely motion by any party or on its own motion, the district court may withdraw the reference of any matter,<sup>6</sup> but it is anticipated that such withdrawals will be rare.

### Limitations on the Court's Powers

The significant distinction between the Model Rule and the Reform Act, however, is the limitation that the rule places on the bankruptcy court's powers so that the court's jurisdiction will satisfy the constitutional objections sustained by the Supreme Court. In general, bankruptcy courts have jurisdiction to enter orders and

<sup>4</sup> Model Rule § (a).

<sup>5</sup> *Id.* § (c)(1).

<sup>6</sup> *Id.* § (c)(2); see *In re Manville Corp.*, Index No. 82B 11656-11676, Adv. Proc. No. 82-6608 A (S.D.N.Y. Feb. 8, 1983).

<sup>3</sup> Practitioners should consult local rules to determine the status of the Model Rule in their district and to discover local court variations.

judgments in bankruptcy cases and in civil proceedings, which, in the absence of bankruptcy, could not have been brought in a district or state court.<sup>7</sup> The rule contains a nonexclusive list of core matters in which the bankruptcy judge may enter orders and judgments, including

contested and uncontested matters concerning the administration of the estate; allowance of and objection to claims against the estate; counterclaims by the estate in whatever amount against persons filing claims against the estate; orders in respect to obtaining credit; orders to turn over property of the estate; proceedings to set aside preferences and fraudulent conveyances; proceedings in respect to lifting of the automatic stay; proceedings to determine dischargeability of debts; proceedings to object to discharge; proceedings in respect to the confirmation of plans; orders approving the sale of property where not arising from proceedings resulting from claims brought by the estate against parties who have not filed claims against the estate; and similar matters.<sup>8</sup>

The rule, however, carves out a separate category of proceedings, in contradistinction to the core matters, designated as "related proceedings," in which the bankruptcy court has no power to enter dispositive orders or judgments. Instead, the bankruptcy judge

hears these matters and submits findings, conclusions, and a proposed judgment or order to a district court judge, unless the parties to the proceedings consent to the entry of the judgment or order by the bankruptcy judge.<sup>9</sup> This category of related proceedings includes "those civil proceedings that, in the absence of a petition in bankruptcy, could have been brought in a district court or a state court." The rule provides that claims brought by the estate against parties who have not filed claims against the estate are "related proceedings."<sup>10</sup> It was the extension of the bankruptcy court's jurisdiction over this category of proceedings that resulted in the *Northern Pipeline* decision and, therefore, the rule's requirement that only district court judges enter dispositive orders and judgments on these matters in the absence of consent of the parties should satisfy the Supreme Court's constitutional objections.

Moreover, the Model Rule further limits the power of bankruptcy judges by prohibiting them from conducting a proceeding to enjoin a court or a proceeding to punish a criminal contempt either not committed in the judge's presence or warranting a punishment of imprisonment. Bankruptcy judges are also prohibited from conducting jury trials or from

<sup>7</sup> Model Rule § (d).

<sup>8</sup> *Id.* § (d)(3)(A).

<sup>9</sup> *Id.* § (d)(3)(B).

<sup>10</sup> *Id.* § (d)(3)(A).

hearing any appeal from another bankruptcy judge.<sup>11</sup>

### The Role of the District Court

The role of the district court is also described in the Model Rule.<sup>12</sup> A district judge must review orders or judgments entered by a bankruptcy judge if a timely notice of appeal has been filed or if a timely application for leave to appeal an interlocutory order has been granted. A notice of appeal is not timely unless it is filed within ten days of the date of entry of the judgment or order. The rule also permits a bankruptcy judge to certify that "circumstances require that the order or judgment [entered by the bankruptcy judge] be approved by a district judge, whether or not the matter was controverted before the bankruptcy judge or any notice of appeal or application for leave to appeal was filed."<sup>13</sup> Upon such certification, a district court must review the matter and enter its own judgment or order "as soon as possible." Although a party may file a notice of appeal from a proposed order or judgment of a bankruptcy judge in a "related proceeding" if done within ten days of its lodgment, the rule nonetheless requires that the district judge review the pro-

posed order or judgment whether or not any notice of appeal or application for leave to appeal has been filed.

In conducting any review of a final, interlocutory or proposed order or judgment, the district judge may hold a hearing and may receive appropriate evidence. The court may accept, reject, or modify, in whole or in part, the order or judgment of the bankruptcy court, "and need give no deference to the findings of the bankruptcy judge."<sup>14</sup> At the conclusion of the review, the district court judge enters an appropriate order or judgment. Any party who wishes to challenge a determination with regard to whether a proceeding is "related" must do so, if at all, prior to the time of the entry of the order or judgment of the district judge after review.

When the Model Rule was first proposed for adoption by district courts, the Judicial Conference justified its validity by expressing the view that the Supreme Court in *Northern Pipeline* intended only to invalidate the bankruptcy court's jurisdiction over "related" proceedings under 28 U.S.C. § 1471(c),<sup>15</sup> while leaving undisturbed the jurisdictional grant to Article III district court

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<sup>11</sup> *Id.* § (d)(1).

<sup>12</sup> The role of the district court is set forth in Model Rule § (e).

<sup>13</sup> Model Rule § (e)(2) (A)(ii).

<sup>14</sup> *Id.* § (e)(2)(B).

<sup>15</sup> 28 U.S.C. § 1471(c) provides: "The bankruptcy court for the district in which a case under title 11 is commenced shall exercise all of the jurisdiction conferred by this section on the district courts."

judges under Sections 1471(a) and 1471(b).<sup>16</sup> This Judicial Conference view was expressed by the Administrative Office of the United States Courts in a letter to all federal judges.<sup>17</sup> This view also was adopted by the Court of Appeals for the Fifth Circuit in *In re Braniff Airways, Inc.*,<sup>18</sup> and by a district court in *In re Northern Point Partners*,<sup>19</sup> when these courts upheld the Model Rule as constitutional and valid.<sup>20</sup>

<sup>16</sup> 28 U.S.C. § 1471(a) provides that "the district courts shall have original and exclusive jurisdiction of all cases under title 11." Section 1471(b) grants district courts "original but not exclusive jurisdiction of all civil proceedings arising under title 11 or arising in or related to cases under title 11."

<sup>17</sup> Letter by William E. Foley, Director, Administrative Office of the United States Courts (Sept. 27, 1982).

<sup>18</sup> — F.2d — (5th Cir. 1983). The court of appeals affirmed the decision of the district court judge upholding the validity of the Model Rule. *In re Braniff Airways, Inc.*, No. 482-00369 (Bankr. N.D. Tex. Jan. 14, 1983); *American v. Braniff, cert. denied*, Sup Ct. Dkt. No. 82-1623 (U.S. May 23, 1983).

<sup>19</sup> 9 B.C.D. 1412 (E.D. Mich. 1983). The court also based its decision on 11 U.S.C. § 105(a), which gives the bankruptcy court the power to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title." Alternatively, the court cited 28 U.S.C. § 1334 and Bankruptcy Rule 927.

<sup>20</sup> Cf. *In re Schear Realty & Inv. Co.*, 9 B.C.D. 1210 (S.D. Ohio 1982), where a bankruptcy judge rejected the Judicial Conference view and ruled that the Model Rule was invalid because a literal reading of *Northern Pipeline* led to the conclusion that 28 U.S.C. § 1471 in its entirety was held unconstitutional so that neither the district nor the bankruptcy courts had jurisdiction over bankruptcy matters.

Although the Supreme Court did not issue an opinion on the merits of the rule, it is interesting to note that the Court, on February 22, 1983, denied a request for the issuance of writs of mandamus and prohibition to prevent all federal courts from exercising jurisdiction over bankruptcy cases on the ground that the Judicial Conference rule is inconsistent with *Northern Pipeline*;<sup>21</sup> and accordingly, the bankruptcy courts are continuing to operate under the Model Rule.

## Conclusion

In the meantime, the Supreme Court has approved Bankruptcy Rules to govern the practice and procedure in bankruptcy cases which became effective August 1, 1983 unless Congress modifies or rejects the rules.<sup>22</sup> These rules were submitted to the Supreme Court for approval prior to *Marathon* and are applicable to the Bankruptcy Code. Additionally, the Omnibus Bankruptcy Improvement Act of 1983 approved by the Senate Judiciary Committee deals with such di-

<sup>21</sup> *Keene Corp., GAF Corp. and Pacor, Inc.*, No. 82-1242, Bankr. Law. Rpt. (CCH) ¶ 31,103. This request arose in connection with *In re Manville Corp.*, a chapter 11 case pending in the Southern District of New York. The petitioners were co-defendants with Manville in asbestos injury cases and sought to lift the automatic stay to permit the continued prosecution of these cases with Manville as a party.

<sup>22</sup> 28 U.S.C. § 2075.

verse problems as consumer credit amendments, abandonment of grain from bankrupt elevators, time-sharing agreements, fisherman's rights, repurchase agreements, drunken driving exclusions from discharge, shopping center leases, and a host of technical amendments.<sup>23</sup>

In response to the need for a new bankruptcy court structure, the Committee on the Judiciary of the Senate reported a bill, the Bankruptcy Court and Federal Judgeship Act of 1983, which inter alia repeals Section 241 of the Act of November 6, 1978 and adds a new Chapter 90, i.e., amendments to Sections 1471-1477.<sup>24</sup>

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<sup>23</sup> S. Rep. No. 65, 98th Cong., 1st Sess. (1983); S. 445, 98th Cong., 1st Sess. (1983).

<sup>24</sup> S. Rep. No. 55, 98th Cong., 1st Sess.

As stated in the Committee's Report, the "bill represents a proposed permanent response to the *Marathon* case by the Committee on the Judiciary. It would continue the use of Article I bankruptcy courts as adjuncts to Article III. . . . Under this measure, core bankruptcy cases would continue to be decided by an Article I bankruptcy court while *Marathon*-type State law cases would be decided in such a forum only upon consent of the parties." Absent such consent, "these cases must be 'recalled' and decided by the district court." Until the House responds, the fate of the bankruptcy court as an Article III court remains uncertain.

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(1983); S. 1013, 98th Cong., 1st Sess. (1983).