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Fighting Fiction with Fiction—The New Federalism in (a Tobacco Company) Bankruptcy

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FIGHTING FICTION WITH FICTION—THE NEW FEDERALISM IN (A TOBACCO COMPANY) BANKRUPTCY

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When we risk no contradiction, it prompts the tongue to deal in fiction.[1]

Tobacco, divine, rare, superexcellent Tobacco, . . . a sovereign remedy to all diseases.[2]

I. INTRODUCTION

If, as the Supreme Court has recently and repeatedly held, states are to be treated as true "sovereigns," immune from a broad range of judicial actions, we should then ask what will happen to the more than $200 billion in claims held by states if, or perhaps when, major tobacco companies seek to subordinate or discharge those claims in federal bankruptcy court?

Since the mid-1990s, a slender but resilient majority of the Court has held, pursuant to the "new federalism," that states should not be subject to judicial power against their will.[3] The sovereign immunity of the new federalism has been characterized by certain Justices[4] and commentators[5] as a "fiction" because, among other reasons, it rests on a monarchical and anachronistic vision of the states. Although a rapidly developing body of thoughtful scholarship has discussed the effect that the fiction of the new federalism will have on bankruptcy court jurisdiction generally,[6] few have

1. John Gay, *The Elephant and the Bookseller*, *in* FABLES 32, 33 (George Fuggey et al. eds., 1967).

2. ROBERT BURTON, THE ANATOMY OF MELANCHOLY 577 (Floyd Dell & Paul Jordan-Smith eds., 1927).

3. *See* Seminole Tribe of Fla. v. Florida, 517 U.S. 44, 54 (1996) (stating that "'"[I]t is inherent in the nature of sovereignty not to be amenable to the suit of an individual without its consent."'") (quoting Hans v. Louisiana, 134 U.S. 1, 13 (1890) (quoting THE FEDERALIST NO. 81, at 487 (Alexander Hamilton) (C. Rossiter ed., 1961))). *See also* Alden v. Maine, 527 U.S. 706 (1999); Coll. Sav. Bank v. Fla. Prepaid Postsecondary Educ. Expense Bd., 527 U.S. 666 (1999); Fla. Prepaid Postsecondary Educ. Expense Bd. v. Coll. Sav. Bank, 527 U.S. 627 (1999).

4. *See* Idaho v. Couer d'Alene Tribe, 521 U.S. 261 (1997); Okla. Tax Comm'n v. Citizen Band Potawatomi Indian Tribe, 498 U.S. 505, 514 (1991) (Stevens, J., concurring) ("The doctrine of sovereign immunity is founded upon an anachronistic fiction."); Pennhurst State Sch. & Hosp. v. Halderman, 465 U.S. 89, 105 (1984).

5. *See, e.g.*, Ann Althouse, *When to Believe a Legal Fiction: Federal Interests and the Eleventh Amendment*, 40 HASTINGS L.J. 1123, 1135 n.48 (1989); Robert A. Schapiro, *Polyphonic Federalism: State Constitutions in the Federal Courts*, 87 CAL. L. REV. 1409, 1436-59 (1999).

6. *See* Leonard H. Gerson, *A Bankruptcy Exception to Eleventh Amendment Immunity: Limiting the* Seminole Tribe *Doctrine*, 74 AM. BANKR. L.J. 1 (2000); S. Elizabeth Gibson, *Sovereign Immunity in Bankruptcy: The Next Chapter*, 70 AM. BANKR. L.J. 195 (1996); Kenneth N. Klee et al., *State Defiance of Bankruptcy Law*, 52 VAND. L. REV. 1527, 1578 (1999); Richard Lieb, *Bankruptcy After Seminole Tribe—New Currents of Legal Thought*, NORTON BANKR. L. ADVISER, Aug. 1998, at 4; Richard Lieb, *Eleventh Amendment Immunity of a State in Bankruptcy Cases: A New Jurisprudential Approach*, 7 AM. BANKR. INST. L. REV. 269 (1999); Joseph F. Riga, *State Immunity in Bankruptcy*

considered the effect this fiction will have on perhaps the most economically vital facet of bankruptcy—reorganizations under Chapter 11 of the United States Bankruptcy Code (the Bankruptcy Code).[7]

If the new federalism applies to reorganizations under Chapter 11 of the Bankruptcy Code, then the claims of nonconsenting states[8] should be immune from subordination or discharge. While states can and do have claims in many contexts, the most important are those arising under the Master Settlement Agreement (MSA) dated November 23, 1998 among forty-six states and the nation's major tobacco companies.[9] If immune from

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After Seminole Tribe v. Florida, 28 SETON HALL L. REV. 29, 64-74 (1997); Justin v. Switzer, *Did They Really Think This Over?* Seminole Tribe v. Florida *and the Bankruptcy Code*, 34 HOUS. L. REV. 1243 (1997); Troy A. McKenzie, Note, *Eleventh Amendment Immunity in Bankruptcy: Breaking the* Seminole Tribe *Barrier*, 75 N.Y.U. L. REV. 199 (2000). There is also an enormous body of scholarship on the new federalism generally, too broad and deep to cite usefully here.

7. *See* 11 U.S.C. §§ 101-1330 (1994). The phrase "Chapter 11" refers to 11 U.S.C. §§ 1101-1146 as well as certain rules in the Federal Rules of Bankruptcy Procedure that apply only or largely to Chapter 11 reorganizations. *See, e.g.*, FED. R. BANKR. P. 3003 (filing proof of claim or interest in Chapter 11 reorganization); FED. R. BANKR. P. 3016 (filing of Chapter 11 plan of reorganization and related disclosure statement); FED. R. BANKR. P. 3017 (providing for court consideration of disclosure statement); FED. R. BANKR. P. 3018 (acceptance or rejection of Chapter 11 plans); FED. R. BANKR. P. 3020 (confirmation of Chapter 11 plan of reorganization); FED. R. BANKR. P. 3021 (providing for distributions under confirmed Chapter 11 plan); FED. R. BANKR. P. 3022 (providing for final decree in Chapter 11 reorganization case). The Federal Rules of Bankruptcy Procedure are prescribed by the Supreme Court pursuant to 28 U.S.C. § 2075 (1994).

8. By "nonconsenting," I mean that a state has neither explicitly nor implicitly waived its sovereign immunity. Thus, I posit the existence of an "aggressive attorney general" who would resist all participation in a debtor's bankruptcy case. This attorney general might, for example, refuse to file a proof of the state's claims in order to resist any suggestion that the state waived immunity. If the new federalism did not apply, the risk of such inaction would be full discharge of the claim. *See* 11 U.S.C. §§ 501, 502, 1141 (governing the filing of proofs of claim and allowance and discharge of claims whether or not filed). Yet, an aggressive attorney general may succeed in preserving state immunity even if the attorney general filed proof of the state's claim, as *College Savings Bank v. Florida Prepaid Postsecondary Education Expense Board*, 527 U.S. 666 (1999), has put the question of waiver in play. States have typically been viewed as waiving immunity by filing a proof of claim. *See, e.g.*, *In re* Platter, 140 F.3d 676, 678 (7th Cir. 1998). *Compare* Wyo. Dep't of Transp. v. Straight (*In re* Straight), 143 F.3d 1387, 1392 (10th Cir. 1998) (indicating that filing proof of claim by state agency not only waived Eleventh Amendment immunity for agency but also waived immunity of state, generally) *with* Schlossberg v. Maryland (*In re* Creative Goldsmiths), 119 F.3d 1140 (4th Cir. 1997) (concluding that state's filing of proof of claim for one type of tax due did not waive its Eleventh Amendment immunity as to other claims). In *College Savings Bank*, however, the Court held that states can no longer be deemed to have "constructively waived" sovereign immunity. 527 U.S. at 682 (overruling Parden v. Terminal Ry. of the Ala. State Docks Dep't, 377 U.S. 184 (1964)). This suggests that aggressive states may be able to file proofs of claim without waiving their immunity.

9. The MSA may be found at the website of the National Association of Attorneys General, *available at* http://www.naag.org/tobac/cigmsa.rtf (last visited Feb. 2, 2001) [hereinafter NAAG]. A summary and explanation of the MSA may be found at the website of the National Conference of State Legislatures, *available at* http://www.ncsl.org/statefed/tmsasumm.htm (last visited Feb. 2, 2001) [hereinafter NCSL]. Although I focus on tobacco companies, I do not suggest that they are the only important class of debtors whose debts create difficult sovereign immunity questions. However, since states' claims against the tobacco companies are embodied in a public contract, these claims are

subordination or discharge, such claims will survive bankruptcy undiluted, unlike the claims of virtually all of a tobacco company's other unsecured creditors. While tobacco companies may be among the least sympathetic debtors one can imagine,[10] the important collateral victims of sovereign immunity in this context would be other unsecured creditors of the tobacco company including, most importantly, individual tobacco tort plaintiffs.

Yet, a bankruptcy court could easily come to the opposite conclusion and hold that states lack immunity from bankruptcy court jurisdiction for purposes of subordinating or discharging claims under the MSA. In order to do so, a court would have to embrace one or more of three countervailing doctrines developed to limit state sovereign immunity in bankruptcy cases: (1) the doctrine of *Ex parte Young*,[11] which empowers federal courts to enjoin state actors prospectively, even if the court lacks power over the nonconsenting state *per se*; (2) the "*in rem*" doctrine, which presumes that a bankruptcy court has jurisdiction only over the debtor and its assets and not over nonconsenting creditors (including nonconsenting states);[12] or (3) the "nonsuit" doctrine, which construes the discharge of claims as an "interpretive," rather than adjudicative, judicial function.[13]

None of these three countervailing doctrines is terribly persuasive, as they all rest on fictions as flimsy as that of the new federalism. The *Young* doctrine assumes that a meaningful distinction exists between an incorporeal legal entity (such as a state, which cannot be subject to federal court jurisdiction) and the agents through which it acts (such as an attorney general, who can be subject to such jurisdiction).[14] This distinction is unrealistic and, in any case, losing force, as the Court continues to narrow *Ex parte Young*.[15] The *in rem* doctrine may make sense where a debtor is

comparatively easy to analyze.

An issue not addressed here is the securitization of claims arising under the MSA. In a securitization, a state would sell its right to payment under the MSA to a trust or other entity that would then issue securities backed by the stream of payments under the MSA. *See, e.g.*, Standard & Poor's, *Overview of S&P's Tobacco Securitization Rating Methodology*, *at* http://www.standardandpoors.com/ratings/publicfinance/S&Ptobacco.htm (last visited Feb. 19, 2001). Once sold into a securitization, claims under the MSA would presumably not benefit from the immunity and other principles of the new federalism discussed in this Article.

10. *See* Richard A. Daynard, *Lawyer Management of Systems of Evil: The Case of the Tobacco Industry*, 5 ROGER WILLIAMS U. L. REV. 117 (1999).

11. 209 U.S. 123 (1908). *See infra* Part IV.C.1.

12. *See* 28 U.S.C. § 1334(e) (1994); Gardner v. New Jersey, 329 U.S. 565 (1947). *See also infra* Part IV.C.2.

13. *See* NVR Homes, L.P. v. Clerks of the Circuit Courts (*In re* NVR, L.P.), 189 F.3d 442 (4th Cir. 1999). *See also infra* Part IV.C.3.

14. *See infra* notes 288-93 and accompanying text.

15. *See infra* notes 295-301 and accompanying text.

liquidating, thereby reflecting the bankruptcy axiom that one "cannot get blood from a stone." But where a debtor is reorganizing, the *in rem* doctrine makes no sense. The debtor's management, not the court, has possession and control of the debtor's assets during and after the bankruptcy case (assuming a successful reorganization).[16] Similarly, the nonsuit doctrine has equally fictitious roots, because it works only if one believes that a judicial process that permanently enjoins the collection of claims is not, in fact, a "suit" for sovereign immunity purposes.[17]

This Article analyzes the new federalism's impact on Chapter 11 reorganizations. The thesis of this Article is that the fictive nature of the new federalism and the three countervailing doctrines renders them highly unstable in the reorganization context. This instability will inevitably and needlessly distort the negotiations that shape Chapter 11 reorganizations. This Article focuses primarily, but not exclusively, on the effect that the new federalism would have on a tobacco company bankruptcy, because that example impresses these problems into starkest relief. Other Chapter 11 reorganizations could create similar problems, including cases in which the debtor is a gun or lead-paint manufacturer, or a healthcare or educational services provider.[18]

This Article offers a solution to this instability: federal bankruptcy courts should, as a constitutional matter, have the power under the Bankruptcy Clause to subordinate or discharge claims held by states, as provided in the Bankruptcy Code. The Bankruptcy Clause, contained in Article I, Section 8, Clause 4 of the United States Constitution, empowers Congress to make "uniform [l]aws on the subject of [b]ankruptcies throughout the United States."[19] If states' claims are immune from subordination or discharge in Chapter 11 reorganizations, they will likely receive better treatment than would other, similarly situated creditors. Uniformity in this constitutional context should require uniformity of result. The new federalism should tolerate the subordination and discharge of state claims because Congress carefully tailored the Bankruptcy Code to reflect the needs of the states by giving priority to, and exempting from discharge, a variety of state tax claims.[20]

Part II of this Article briefly describes the states' claims under the MSA.

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16. *See infra* Part IV.C.2.

17. *See infra* Part IV.C.3.

18. *See, e.g., In re* Sun Healthcare Group, Inc., 245 B.R. 779 (Bankr. D. Del. 2000) (overruling objections of states that healthcare debtor in possession financing facility would "prime" liens of state Medicaid agencies in violation of sovereign immunity of such agencies).

19. U.S. CONST. art. I, § 8, cl. 4.

20. *See infra* Part III.

Part III discusses how such claims would likely be treated in the absence of the new federalism. Part IV explores the new federalism and the three countervailing doctrines, focusing on the role that state power plays in this arena. Part V addresses the real problem with the current set of federalism alternatives—doctrinal instability—and argues that uniformity of result should trump concerns about state power.

II. THE MASTER SETTLEMENT AGREEMENT

The story of tobacco company liability has been well told elsewhere and warrants only a brief review here.[21] Until the 1990s, no smoker had recovered from a tobacco company for smoking-related claims. Nevertheless, since the 1950s, individual smokers have filed over 1,800 lawsuits against the industry for claims ranging from fraud and misrepresentation to strict products liability and defective design.[22] Although one plaintiff won a 1984 jury verdict against Liggett Group, Inc. in the *Cipollone* case,[23] the Court of Appeals for the Third Circuit and the U.S. Supreme Court eventually overturned that verdict.[24] Other cases had equally unsatisfactory outcomes for plaintiffs.[25]

Beginning in the 1990s, however, the fortunes of the tobacco companies began to change, as plaintiffs won several jury verdicts. Although these verdicts were often reduced or overturned on procedural grounds,[26] the recent *Engle v. R.J. Reynolds Tobacco Co.* class action produced a $145 billion verdict against the major tobacco companies.[27] Although *Engle* is unresolved

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21. *See, e.g.*, Hanoch Dagan & James J. White, *Governments, Citizens, and Injurious Industries*, 75 N.Y.U. L. REV. 354, 360-81 (2000); Richard P. Ieyoub & Theodore Eisenberg, *State Attorney General Actions, the Tobacco Litigation, and the Doctrine of* Parens Patriae, 74 TUL L. REV. 1859, 1860-62 (2000); Tucker S. Player, Note, *After the Fall: The Cigarette Papers, the Global Settlement, and the Future of Tobacco Litigation*, 49 S.C. L. REV. 311, 312-22 (1998).

22. Brown & Williamson, *Individual Cases Introduction*, *available at* http://www.brownandwilliamson.com (last visited Feb. 12, 2001).

23. Cipollone v. Liggett Group, Inc., 593 F. Supp. 1146 (D.N.J. 1984), *rev'd in part and aff'd in part*, 893 F.2d 541 (3d Cir. 1990), *aff'd in part and rev'd in part*, 505 U.S. 504 (1992).

24. *See Cipollone*, 893 F.2d at 583.

25. *See* Dagan & White, *supra* note 21, at 360 n.21 (citing Todd M. Blackmar, Note, Perez v. Brown & Williamson Tobacco Corp.*: The Validity of Seeking Protection from Ourselves*, 29 U. TOL. L. REV. 727, 735 (1998)).

26. A California jury returned a $51.5 million verdict and an Oregon plaintiff received an $80.3 million verdict. *See, e.g.,* Milo Geyelin, *Philip Morris Hit with Record Damages*, WALL ST. J., Mar. 31, 1999, at A3 (reporting on Oregon verdict against Philip Morris). The tobacco industry appealed and both verdicts were reduced. *See* Milo Geyelin, *Philip Morris Punitive Damages Cut 50% to $25 Million in California Case*, WALL ST. J., Apr. 7, 1999, at B6; Milo Geyelin, *Tobacco Firms Win a Verdict in Cancer Case*, WALL ST. J., July 12, 1999, at A24. *See also* Brown & Williamson Individual Case Courtroom, *supra* note 22.

27. *See* No. 94-8273 (Fla. Dade County Ct. Nov. 6, 2000) (denying motion to reconsider),

as of this writing, if the tobacco industry has to pay $145 billion to the *Engle* class, and perhaps, other class or individual plaintiffs in future cases as well, the tobacco companies will probably seek relief in a United States bankruptcy court.[28]

Private plaintiffs may owe their recent success to states' suits against the tobacco companies.[29] The states began suing big tobacco later than individual plaintiffs. The State of Mississippi was the first to sue tobacco companies, filing its complaint in 1994.[30] With private litigations pending around the nation, more states sued tobacco companies to recover funds expended for treating the tobacco-related illnesses of their states' residents.[31] Although the states asserted numerous causes of action, including fraud, antitrust, and conspiracy,[32] the primary basis for suit was indemnification for the additional health care costs incurred by the states because of their residents' smoking.[33] In 1997 and 1998, Minnesota, Florida, Texas, and Mississippi settled their claims against the tobacco companies,[34] and the other states suing the

available at http://tobacco.neu.edu/Extra/Engle/Kaye_11-6-00.htm (last visited Jan. 21, 2001). Although the *Engle* verdict is widely viewed as "record-smashing," Bob Van Doris, *$145 Billion to Send a Message*, NAT'L L.J. July 31, 2000, at A1, by itself, the verdict is not likely to be industry-threatening. Milo Geyelin & Gordon Fairclough, *Taking a Hit: Yes, $145 Billion Deals Tobacco a Huge Blow, But Not a Killing One*, WALL. ST. J., July 17, 2000, at A1.

28. *See, e.g.,* John Bacon & Patrick O'Driscoll, *Tobacco Ruling Could Cost Industry Billions*, USA TODAY, Oct. 21, 1999, at 3A. As of this writing, the tobacco companies have seen their immediate fortunes improve. *See, e.g.*, David Kathman, *Philip Morris Looks Attractive*, *available at* http://news.morningstar.com/news/Wire (last visited Feb. 1, 2001) (observing that Philip Morris's stock has risen more than 80% in the six months preceding January 2001).

Professors Dagan and White have taken a rather different view. They argue that "the holy grail for the tobacco manufacturers is federal protection *from* bankruptcy." *See* Dagan & White, *supra* note 21, at 378 (emphasis added). While it is undoubtedly true that management of tobacco companies would prefer not to commence a bankruptcy case, it is clear that if tort liability continues to accrue, bankruptcy will become the only rational choice.

29. *See* Dagan & White, *supra* note 21, at 361 (noting that state suits against tobacco companies were one of "several important changes that have significantly affected the tobacco companies' fortunes").

30. *See* NCSL, *supra* note 9.

31. *See, e.g.*, Massachusetts v. Philip Morris, Inc., 942 F. Supp. 690 (D. Mass. 1996); Junda Woo, *Mississippi Wants Tobacco Firms to Pay its Cost of Treating Welfare Recipients*, WALL ST. J., May 24, 1994, at A2.

32. A collection of pleadings by the States against the tobacco companies may be viewed at the website of the State Tobacco Information Center. *See* http://www.stic.neu.edu/Libraries.html (last visited Feb. 12, 2001) [hereinafter STIC].

33. The complaint filed by the State of Mississippi, for example, sought to recover "millions of dollars" paid by the state "for the provision of necessary medical care, facilities and services for certain of those aforementioned Mississippi citizens injured by the defendants' cigarettes and unable to afford and otherwise obtain such necessary medical care, facilities and services." STIC, *supra* note 32, *at* http://www.stic.neu.edu/MS/2moore.htm ¶ 5. *See also State Files Tobacco Suit*, WALL ST. J., Sept. 21, 1994, at B11 (regarding West Virginia suit).

34. *See* STIC, *supra* note 32, *at* http://www.stic.neu.edu/settlement/index.html. *See also* http://www.naag.org/media/111199.html (last visited Feb. 12, 2001).

tobacco companies followed shortly thereafter in the MSA.

In general terms, the MSA provides that the tobacco companies will pay the states approximately $200 billion over 25 years, beginning in the year 2000.[35] The MSA also restricts specified advertising and marketing practices of the tobacco companies and requires them to fund a number of antismoking initiatives, among other things.[36] The scheduled payments are subject to a number of monetary adjustments to compensate for inflation, for the volume of tobacco products sold (the greater the sales, the higher the increase), and for the effect that nonsettling tobacco companies have on the obligations of the settling companies under the MSA.[37]

The MSA also creates a fairly complex payment mechanism, including escrow agreements and orders to be entered by each of the state courts with jurisdiction over the applicable tobacco companies.[38] The MSA required the tobacco companies to make an initial payment of their pro rata share (based on market capitalization) of $2,472,000,000 on January 10, 2000.[39] Thereafter, the participating tobacco companies are to make payments of their pro rata share of between $2 billion and $3 billion on January 10 of each year through 2003.[40] Although the MSA creates an enormous financial obligation on the part of the tobacco companies, the MSA contemplates no collateral securing the MSA debt.[41]

The MSA is as interesting for what it lacks as for what it contains. Most importantly, the MSA lacks a waiver of sovereign immunity by the states. This may reflect a strategic decision by the states to preserve their power to challenge the subordination or discharge of their claims under the MSA if a tobacco company files for bankruptcy. If a tobacco company can subject MSA claims to the bankruptcy process, a bankruptcy court should have the power to subordinate some or all such claims to the claims of a lender who financed a tobacco-company debtor's reorganization case[42] and to discharge such claims under a confirmed plan of reorganization.[43] If not, then there would probably be no purpose to reorganization, because the new federalism would essentially immunize state claims from action by federal bankruptcy courts. The states' claims would theoretically survive forever, an albatross

35. *See* NCSL, *supra* note 9.
36. NAAG, *supra* note 9, §§ III(d), VI.
37. *Id*. § IX(c)(1).
38. *Id*. § IX(a).
39. *Id.* § IX(b).
40. *Id.*
41. *Id.*
42. 11 U.S.C. § 364 (1994). *See also* discussion *infra* Part III.B.1.
43. 11 U.S.C. §§ 1129, 1141 (1994). *See also* discussion *infra* Part III.B.2.

around the necks of the tobacco companies, rendering liquidation the only sensible alternative. In order to frame the potentially disruptive effect of the new federalism, the next section of this Article summarizes how MSA claims could be subordinated or discharged in a Chapter 11 reorganization assuming the states were not immune from the bankruptcy process.[44]

III. BANKRUPTCY FRAMEWORK

The Bankruptcy Code[45] creates the paramount framework for the resolution of claims against a financially distressed debtor.[46] The Bankruptcy

44. The MSA creates a number of other interesting bankruptcy issues not considered in-depth here because they do not address the gating issue: Whether a tobacco company can subject MSA claims to the bankruptcy process? These other issues include:

(1) To what extent, if any, could prebankruptcy divestitures and spinoffs of nontobacco affiliates be avoided and recovered as preferential or fraudulent transfers? *See* 11 U.S.C. §§ 544, 547, 548 (1994). *See also Spin Off of Philip Morris' Tobacco Unit?*, RICH. TIMES-DISP., Apr. 19, 1997, at C1.

(2) Could or should tobacco companies and their nontobacco affiliates be substantively consolidated with one another? Substantive consolidation is a way that separate corporate entities may be disregarded for purposes of consolidating assets and liabilities. *See, e.g*, Union Sav. Bank v. Augie/Restivo Baking Co. (*In re* Augie/Restivo Baking Co.), 860 F.2d 515, 518-20 (2d Cir. 1988); Flora Mir Candy Corp. v. R.S. Dickson & Co. (*In re* Flora Mir Candy Corp.), 432 F.2d 1060, 1062-63 (2d Cir. 1970), Chemical Bank N.Y. Trust Co. v. Kheel (*In re* Seatrade Corp.), 369 F.2d 845, 847 (2d Cir. 1966).

(3) Could the MSA be rejected as an executory contract under § 365 of the Bankruptcy Code? Under § 365(a), a trustee or debtor-in-possession may "reject" executory contracts which the debtor entered into before bankruptcy. 11 U.S.C. § 365(a) (1994). What would make a contract such as the MSA a "rejectable" executory contract might trouble courts and scholars. *See generally In re* Columbia Gas Sys., Inc., 50 F.3d 233, 244 n.20 (3d Cir. 1995); Sharon Steel Corp. v. Nat'l Fuel Gas Distribution Corp., 872 F.2d 36, 39-41 (3d Cir. 1989); Michael T. Andrew, *Executory Contracts in Bankruptcy: Understanding "Rejection*," 59 U. COLO. L. REV. 845 (1988); Vern Countryman, *Executory Contracts in Bankruptcy: Part I*, 57 MINN. L. REV. 439, 460-69 (1973).

(4) How would the bankruptcy of fewer than all tobacco companies that are parties to the MSA affect the other tobacco companies (and the states' claims) under, for example, contribution and indemnification principles?

(5) How could a tobacco company's reorganization plan be "feasible" if the tobacco company debtor continues to engage in the conduct that created liability in the first place (manufacturing and distributing cigarettes)? Under § 1129(a)(11), a plan of reorganization may be confirmed only if, among other things, it is feasible, which is to say "not likely to be followed by the liquidation, or the need for further reorganization, of the debtor." 11 U.S.C. § 1129(a)(11) (1994).

(6) How, in good faith, could a tobacco company file for bankruptcy, given that it would do so largely—if not exclusively—to evade tort and/or regulatory liability? *Compare In re* SGL Carbon Corp., 200 F.3d 154 (3d Cir. 1999) (dismissing Chapter 11 case of debtor that was filed primarily to evade regulatory liability and thus was not filed in "good faith") *with* Kane v. Johns-Manville Corp. (*In re* Johns-Manville Corp.), 843 F.2d 636, 639 (2d Cir. 1988) (stating that "the anticipation of massive personal liability in the future" is reason to reorganize in bankruptcy).

My summary of some of these issues appears in Jonathan Lipson, *Corporate Brief: Bankruptcy: Tobacco Companies*, NAT'L L.J., Dec. 6, 1999, at B6.

45. *See supra* note 7.

46. *See* NAT'L BANKR. REV. COMM'N, BANKRUPTCY: THE NEXT TWENTY YEARS, FINAL REPORT 898-99 (1997) (explaining that single forum and set of procedural rules ensures uniform

Code seeks to channel all claims against a debtor through a single forum—a federal bankruptcy court—and to provide a single, effective mechanism through which such claims are treated.[47] The framework establishes rules on the priority,[48] processing, payment,[49] and discharge of claims.[50] The Bankruptcy Code provides special treatment for certain kinds of state claims. State tax claims, for example, often enjoy priority in payment over other claims[51] and cannot be discharged.[52] States, however, can hold any type of claim against a debtor,[53] even claims not given special statutory treatment.[54]

A. Jurisdiction

Absent a claim of sovereign immunity, bankruptcy court jurisdiction is quite broad. Article I, Section 8 of the Constitution delegates to the U.S. government the power "to establish . . . uniform Laws on the subject of Bankruptcies throughout the United States."[55] Under the Supremacy Clause,[56] the bankruptcy power contained in Article I should cause the Bankruptcy Code to trump any state law, claim, or action to the contrary.[57] Subject to certain limitations, the net effect of the complex bankruptcy jurisdiction provisions is that bankruptcy courts—which are Article I, not Article III, courts—"may hear and determine all cases under [the Bankruptcy Code]."[58] In practical terms, this means that bankruptcy courts may enter

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treatment of every type of claimant).

47. *Id.*

48. *See, e.g.*, 11 U.S.C. § 507 (1994).

49. *See, e.g.*, *id.* §§ 501, 502, 503, 1123.

50. *See, e.g.*, *id.* §§ 727, 1141.

51. *See id.* § 507(a)(8) (giving priority to claims of "governmental units," including states, for certain classes of taxes). Those classes of taxes include income taxes, *id.* § 507(a)(8)(A), property taxes, *id.* § 507(a)(8)(B), employment taxes, *id.* § 507(a)(8)(D), and excise taxes, *id.* § 507(a)(8)(E).

52. *See id.* § 523(a)(1) ("A discharge under section . . . 1141 . . . of this title does not discharge a debtor from any debt . . . for a tax.").

53. The Bankruptcy Code defines "claim" broadly as a "right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured." *Id.* § 101(5).

54. *See supra* note 46, at 900 ("States play an important role in the bankruptcy process, appearing in many bankruptcy cases in a myriad of roles—as priority tax creditor, secured creditor, unsecured creditor, police and regulatory authority, environmental creditor, landlord, guarantor, bondholder, leaseholder, and equity interest holder.").

55. U.S. CONST. art. I, § 8, cl. 4.

56. U.S. CONST. art. VI, cl. 2.

57. For emphasis, the Supremacy Clause notes that "the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding." *Id.*

58. 28 U.S.C. § 157(b) (1994). Strictly speaking, United States district courts have exclusive jurisdiction of bankruptcy cases and proceedings, *id.* § 1334(e), and may "refer[]" bankruptcy cases or proceedings to bankruptcy courts. *Id.* § 157(a).

final, appealable orders that allow or disallow claims,[59] resolve disputes regarding the automatic stay,[60] discharge claims,[61] and confirm plans of reorganization under Chapter 11.[62]

The Bankruptcy Reform Act of 1978[63]—which gave us the current Bankruptcy Code—originally contemplated a very broad grant of jurisdiction to bankruptcy courts and theoretically permitted bankruptcy courts to resolve disputes in which the debtor was only tangentially involved.[64] In 1982, in the controversial *Northern Pipeline Construction Co. v. Marathon Pipe Line Co.* decision, the Supreme Court held that the jurisdiction granted to bankruptcy courts through the Bankruptcy Reform Act of 1978 was unconstitutionally broad because Article I judges lack the independence of Article III judges.[65] In response to *Marathon*, Congress amended the Bankruptcy Code in 1984 to limit the powers of bankruptcy courts in certain classes of disputes.[66] The general relationship between bankruptcy court jurisdiction and Article III power has been well developed elsewhere,[67] with most commentators

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59. *See* 28 U.S.C. § 157(b)(2)(B) (1994).

60. *See id.* § 157(b)(2)(G).

61. *See id*. § 157(b)(2)(I)-(J).

62. *Id*. § 157(b)(2)(L).

63. Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, § 241(a), 1978 U.S.C.C.A.N. (92 Stat.) 2549, 2668-69 (codified at 28 U.S.C. § 1471(c) (repealed 1984)).

64. This is known as "related-to" jurisdiction under 28 U.S.C. § 1334(b) (1994). It has been construed to confer bankruptcy jurisdiction over disputes in which "the outcome . . . could concievably have any effect on the estate being administered in bankruptcy." Pacor, Inc. v. Higgins, 743 F.2d 984, 994 (3d Cir. 1984). The Court of Appeals for the Seventh and Second Circuits have used slightly different tests. *See* Elscint, Inc. v. First Wis. Fin. Corp. (*In re* Xonics, Inc.), 813 F.2d 127, 131 (7th Cir. 1987) (holding "related-to" jurisdiction depends on whether "it affects the amount of property available for distribution or the allocation of property among creditors"); Turner v. Ermiger (*In re* Turner), 724 F.2d 338, 341 (2d Cir. 1983) (holding related-to jurisdiction over third parties requires "significant connection" to debtor's bankruptcy case). *See also* Ralph Brubaker, *On the Nature of Federal Bankruptcy Jurisdiction: A General Statutory and Constitutional Theory*, 41 WM. & MARY L. REV. 743, 862-77 (2000) (criticizing *Pacor*).

65. 458 U.S. 50 (1982).

66. Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, 1984 U.S.C.C.A.N. 333 (codified as amended in scattered sections of Titles 5, 11 & 28 U.S.C. (1988)). The Court appears to have limited the holding of *Marathon* to the facts of that case, as it has otherwise upheld Article I jurisdiction in other contexts. *See, e.g.,* Commodity Futures Trading Comm'n v. Schor, 478 U.S. 833 (1986) (upholding the power of the Commodity Futures Trading Commission to hear counterclaims based on state law); Thomas v. Union Carbide Agric. Products Co., 473 U.S. 568, 569 (1985) (characterizing *Northern Pipeline* as holding that Congress cannot give Article I courts authority to finally determine state law contract actions where the parties have not consented and where review is by traditional appeal).

67. For more information on bankruptcy court jurisdiction, see, for example, Brubaker, *supra* note 64; Erwin Chemerinsky, *Ending the Marathon: It Is Time to Overrule* Northern Pipeline, 65 AM. BANKR. L.J. 311 (1991); Vern Countryman, *Scrambling to Define Bankruptcy Jurisdiction: The Chief Justice, the Judicial Conference, and the Legislative Process*, 22 HARV. J. ON LEGIS. 1 (1985); Philip J. Hendel & Joseph H. Reinhardt, *Attempting to Define the Scope of Bankruptcy Court Jurisdiction: No Miracle Drugs for the Patient*, 92 COM. L.J. 350 (1987); Anthony Michael Sabino, *Jury Trials,*

questioning the wisdom of *Marathon* and arguing that bankruptcy courts should have the full panoply of powers associated with the allowance, disallowance, and payment of claims against a debtor who has sought bankruptcy protection.[68]

For purposes of this Article, it is worth noting simply that bankruptcy courts apparently have some, but not all, of the powers of Article III courts. If *Marathon* is to be a guide, the most important aspect of Article III courts is the independence of federal district court judges. In contrast to Article III judges, who enjoy life tenure at a fixed salary, subject to good behavior, bankruptcy judges are appointed for fourteen year terms and receive salaries subject to reduction by Congress.[69] Thus, bankruptcy judges are viewed as less independent than district court judges.

Despite the fact that they may lack the independence of Article III judges, bankruptcy judges nevertheless wield enormous economic powers. Chief among these are the powers to prioritize and discharge claims.[70] The power to determine the priority of claims is often the power to determine whether and how much of a claim will be paid back to a creditor.[71] Where a debtor has limited resources, the subordination of one claim to another may mean that only the senior claim is paid. The bankruptcy court's power to discharge claims is also the power to enjoin creditors from collecting amounts they are otherwise lawfully owed.[72] Subordination and discharge of claims are perhaps the greatest powers granted to bankruptcy courts. Once subordinated or discharged, a claim is often worth far less than its face amount.

Bankruptcy Judges, and Article III: The Constitutional Crisis of the Bankruptcy Court, 21 SETON HALL L. REV. 258 (1991). For more information on Article III powers, see, for example, Jeffrey H. Bush, *Toward a Theory of Public Rights: Article III and the Bankruptcy Amendments and Federal Judgeship Act of 1984*, 70 NEB. L. REV. 555 (1991); Judith Resnik, *The Mythic Meaning of Article III Courts*, 56 U. COLO. L. REV. 581 (1985); Mark Tushnet & Jennifer Jaff, *Why the Debate Over Congress' Power to Restrict the Jurisdiction of the Federal Courts is Unending*, 72 GEO. L.J. 1311 (1984).

68. *See, e.g.*, Chemerinsky, *supra* note 67, at 311 ("It is time for the Supreme Court to recognize that *Northern Pipeline* was a mistake and to allow bankruptcy courts the authority accorded them under the 1978 Act.").

69. *See* U.S. CONST. art. 3, § 1; 28 U.S.C. § 152(a)(1) (1994) ("Each bankruptcy judge shall be appointed for a term of fourteen years . . . ."); *Id*. § 153(a) ("Each bankruptcy judge . . . shall receive as full compensation for his services, a salary at an annual rate that is equal to 92 percent of the salary of a judge of the district court of the United States . . . ."). Because the salaries of bankruptcy judges are provided by a statute, rather than the Constitution, they can presumably be changed simply by amending Title 28.

70. *See* discussion *infra* Part III.B.

71. *See generally* GEORGE M. TREISTER ET AL., FUNDAMENTALS OF BANKRUPTCY LAW (4th ed. 1996).

72. 11 U.S.C. § 1141 (1994).

B. Chapter 11 Reorganizations

Chapter 11 of the Bankruptcy Code is the principal means by which a financially troubled business can reorder its affairs. Bankruptcy reorganization stands in contrast to bankruptcy liquidation, which is governed chiefly by Chapter 7 of the Bankruptcy Code.[73] While many features of bankruptcy liquidation apply in reorganization, a debtor that successfully reorganizes under Chapter 11 does not usually liquidate (distribute its assets and cease operations) at the end of the case. Rather, the ultimate goal in a Chapter 11 case is to formulate and confirm a plan of reorganization, pursuant to which the debtor will emerge in a new form. In order to reorganize, a Chapter 11 debtor typically faces two critical economic hurdles: (1) obtaining financing for the case (which often requires the subordination of existing claims), and (2) confirming the plan of reorganization (which often results in the discharge of a substantial portion of unsecured claims).

1. Subordination—Chapter 11 Case Financing

Practically speaking, the first important economic event in a large corporate reorganization is obtaining financing. Without financing during the case, known otherwise as "debtor-in-possession" (DIP) financing, the case will end almost as quickly as it began, as a liquidation of the debtor. Bankruptcy Code § 364 governs obtaining credit and incurring debt by the DIP.[74] It applies only to postpetition extensions of new credit,[75] although prebankruptcy lenders are often postpetition DIP financers as well.[76]

In theory, bankruptcy courts have a wide array of powers to encourage DIP lenders to finance a Chapter 11 debtor.[77] Probably the most potent is the power to grant liens with priority equal or senior to existing claims and liens.[78] Bankruptcy Code § 364(d) permits the bankruptcy court to authorize

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73. 11 U.S.C. §§ 701-728 (1994).

74. 11 U.S.C. § 364 (1994).

75. *See In re* 360 Inns, Ltd., 76 B.R. 573, 578 (Bankr. N.D. Tex. 1987) (holding that cash collateral creditor cannot use Bankruptcy Code § 364(c)(1) to elevate its claim to administrative super priority).

76. It is thus possible that prebankruptcy lenders to a large tobacco company would simply continue to extend credit under existing credit facilities. Such lenders would have, among other things, special protections granted to holders of secured claims in "cash collateral" under 11 U.S.C. §§ 361, 363 (1994).

77. *See, e.g.*, *In re* Defender Stores, Inc., 145 B.R. 312 (9th Cir. 1992) (authorizing contingent fee arrangement for DIP financer).

78. *See* 11 U.S.C. § 364(c) (1994). This section provides as follows:

> (c) If the trustee is unable to obtain unsecured credit allowable under section 503(b)(1) of this

the debtor to borrow money secured by a senior or equal lien on property of the estate that is subject to a valid lien.[79] The conditions to such relief are strict. The DIP must establish that it is unable to obtain such credit otherwise[80] and that holders of existing liens are "adequately protected."[81]

Alternatively, DIP financing may be unsecured[82] and enjoy priority equal or senior to other (first priority) administrative expenses under Bankruptcy Code § 503(b)(1).[83] Thus, even if not secured by a senior lien, DIP financing

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> title as an administrative expense, the court, after notice and a hearing, may authorize the obtaining of credit or the incurring of debt—
>
> (1) with priority over any or all administrative expenses of the kind specified in section 503(b) or 507(b) of this title;
>
> (2) secured by a lien on property of the estate that is not otherwise subject to a lien; or
>
> (3) secured by a junior lien on property of the estate that is subject to a lien.

Id.

79. Section 364(d) provides as follows:

> (d)(1) The court, after notice and a hearing, may authorize the obtaining of credit or the incurring of debt secured by a senior or equal lien on property of the estate that is subject to a lien only if—
>
> (A) the trustee is unable to obtain such credit otherwise; and
>
> (B) there is adequate protection of the interest of the holder of the lien on the property of the estate on which such senior or equal lien is proposed to be granted.
>
> (2) In any hearing under this subsection, the trustee has the burden of proof on the issue of adequate protection.

11 U.S.C. § 364(d) (1994).

80. *Id*. § 364(d)(1)(A).

81. *Id*. § 364(d)(1)(B). *See also In re* 495 Cent. Park Ave. Corp., 136 B.R. 626 (Bankr. S.D.N.Y. 1992) (holding court must make a qualitative assessment of the proposed loan in light of any possible alternative sources of credit before approving the senior liens); *In re* Aqua Assocs., Ltd., 123 B.R. 192 (Bankr. E.D. Pa. 1991) (finding senior liens will not be approved merely because credit is not available elsewhere).

82. Bankruptcy Code §§ 364(a) and (b) provide as follows:

> (a) If the trustee is authorized to operate the business of the debtor under section 721, 1108, 1203, 1204, or 1304 of this title, unless the court orders otherwise, the trustee may obtain unsecured credit and incur unsecured debt in the ordinary course of business allowable under section 503(b)(1) of this title as an administrative expense.
>
> (b) The court, after notice and a hearing, may authorize the trustee to obtain unsecured credit or to incur unsecured debt other than under subsection (a) of this section, allowable under section 503(b)(1) of this title as an administrative expense.

11 U.S.C. §§ 364(a), (b) (1994).

Bankruptcy Code § 503(b)(1) provides that only the "actual necessary costs and expenses of preserving the estate" are allowable as administrative expenses. 11 U.S.C. § 503(b)(1) (1994). Claims under Bankruptcy Code § 503(b)(1)—expenses of administering the bankruptcy case—are generally entitled to first priority under Bankruptcy Code § 507(a)(1). *Id*. § 507(a)(1). *See In re* Allen Carpet Shops, Inc., 27 B.R. 354, 358 (Bankr. E.D.N.Y. 1983) (finding clear intent of Bankruptcy Code § 364(a) is to allow the trustee or DIP to use the administrative priority of Bankruptcy Code § 507(a)(1) as an inducement to entities to open lines of credit to the debtor for purposes of reorganization).

83. 11 U.S.C. § 503(b)(1) (1994).

would be paid well before general unsecured claims—including claims under the MSA.[84]

Even if the new federalism discussed in Part IV does not displace the Bankruptcy Code as to the states, the priority of MSA claims is unclear. For instance, it is not known whether or to what extent a tobacco debtor with large state claims could obtain senior DIP financing. Although claims under the MSA are not characterized as a tax, they may be treated as such under the Bankruptcy Code. Section 507(a)(8) of the Bankruptcy Code creates an eighth level priority over general unsecured claims for "excise" taxes and taxes on income and sales.[85] Although the Bankruptcy Code does not define the various priority taxes, the Supreme Court recently held that tax claims should be viewed functionally, as any "'pecuniary burden laid upon individuals or property for the purpose of supporting the government.'"[86] To the extent MSA claims are considered to be tax claims, they would be entitled to priority over general unsecured claims and to be paid in full over six years under a confirmed plan of reorganization.[87] Similarly, states have historically enjoyed a common law priority in a debtor's unencumbered assets,[88] although the force of this priority is unclear.

2. Discharge—Plan of Reorganization

DIP financing is only the first of two critical phases of a Chapter 11 case. The second, and ultimately more important phase of a Chapter 11 reorganization, is the development, promulgation, and confirmation of a plan of reorganization for the debtor. Plans of reorganization perform several functions, including the classification of claims against and interests in the debtor for purposes of voting on the plan and receiving distributions

84. Bankruptcy courts also have the power to authorize the issuance of unregistered debt securities in connection with such financing notwithstanding the requirements of the Securities Act of 1933. 11 U.S.C. § 364(f) (1994).

85. 11 U.S.C. § 507(a)(8)(A), (E) (1994).

86. United States v. Reorganized CF & I Fabricators of Utah, Inc., 518 U.S. 213, 224 (1996) (quoting New Jersey v. Anderson, 203 U.S. 483, 492 (1906)). For example, it may be possible to characterize certain payments or payment adjustments under the MSA as an excise tax. The legislative history of § 507(a)(8)(E) suggests that sales taxes, estate taxes, gasoline and special fuel taxes are examples of excise taxes. *See* 124 CONG. REC. H1113 (Sept. 28, 1978); 124 CONG. REC. S17430 (Sept. 28, 1978). *See also* LAWRENCE P. KING, 4 COLLIER ON BANKRUPTCY ¶ 507.10[6][a] (2000). The MSA is unclear as to the basis for the claims to be paid thereunder. Nevertheless, to the extent that payments under the MSA are tied to cigarette sales or to the continued privilege to sell cigarettes, they may be characterized as excise taxes. *See* NAAG, *supra* note 9, §§ IX(c)-(d) (setting forth amounts to be paid and adjustments thereto).

87. 11 U.S.C. § 1129(a)(9)(C) (1994).

88. *See, e.g.,* Marshall v. New York, 254 U.S. 380, 383-84 (1920) (holding that states have common law priority in unencumbered assets of debtor).

thereunder.[89] Stakeholders within a given class must be treated alike under the plan,[90] although debtors (or others who propose plans) have a fair amount of discretion in how to classify claims.[91] Most importantly, the plan must provide for the treatment of claims and interests.[92] Such treatment may include payment of less than the full amount owed, payments over time, or payment in currency other than U.S. dollars, such as in stock of the reorganized debtor.[93] Under Chapter 11, the confirmation of a plan "discharges the debtor from any debt that arose before the date of such confirmation."[94] Absent the new federalism, this discharge is effective whether or not proof of a claim evidencing such debt has been filed or deemed filed, whether or not the claim has been allowed, and whether or not the holder of such claim has accepted the debtor's plan of reorganization.[95]

Stakeholders in the debtor have two basic, related protections in a Chapter 11 reorganization, one procedural and the other substantive.[96] If stakeholders in the debtor lose confidence in the debtor's management, they may be able to oust management directly or indirectly.[97] For example, if management

89. 11 U.S.C. § 1122 (1994).

90. *Id*. § 1123(a)(4) ("[A] plan shall . . . provide the same treatment for each claim or interest of a particular class, unless the holder of a particular claim or interest agrees to a less favorable treatment of such particular claim or interest.").

91. Bankruptcy Code §§ 1122 and 1123 give the plan proponent (the DIP during the exclusive period) wide range to create classes of stakeholders in the debtor. The only limit is that, to be classified together, claims or interests must be substantially similar. Plan proponents can obtain significant strategic advantages by classifying stakeholders creatively, although they are prohibited from "gerrymandering" the classification of claims in order to obtain a favorable plan vote. *See* John Hancock Mut. Life Ins. Co. v. Route 37 Bus. Park Assocs. (*In re* Route 37 Bus. Park Assocs.), 987 F.2d 154, 159 (3d Cir. 1993); *In re* Greystone III Joint Venture, 948 F.2d 134 (5th Cir. 1991). *See also* G. Eric Brunstad, Jr. & Mike Sigal, *Competitive Choice Theory and the Unresolved Doctrines of Classification and Unfair Discrimination in Business Reorganizations Under the Bankruptcy Code*, 55 BUS. LAW. 1 (1999).

92. 11 U.S.C. § 1123(a)(3) (1994) ("[A] plan shall . . . specify the treatment of any class of claims or interests that is impaired under the plan."). Under § 1124 of the Bankruptcy Code, a class of claims or interests is impaired under a plan "unless, with respect to each claim or interest of such class, the plan . . . leaves unaltered the legal, equitable, and contractual rights to which such claim or interest entitles the holder of such claim or interest." *Id*. § 1124(1).

93. *See* Lynn M. LoPucki & William C. Whitford, *Bargaining Over Equity's Share in the Bankruptcy Reorganization of Large, Publicly Held Companies*, 139 U. PA. L. REV. 125, 135, 141 (1990).

94. 11 U.S.C. § 1141(d)(1)(A) (1994).

95. *Id.* The hypothetical aggressive state attorney general might not file a proof of claim, on the theory that doing so constitutes a waiver of immunity. *See supra* note 8. While the Bankruptcy Code would discharge such claim, the Bankruptcy Code's provisions on discharge may not apply to the claims of a nonconsenting state. *See supra* note 8; *infra* Part IV.

96. The terms "procedural" and "substantive" are shorthand. The latter more directly relates to interests that have a substantive character (property rights), while the former relates to control of the Chapter 11 process.

97. 11 U.S.C. § 1129(b) (1994). There is much thoughtful scholarship on the efficacy of

fails to remedy the debtor's problems quickly, stakeholders may well seek to liquidate the debtor or to have the court appoint a trustee to replace management.[98]

Stakeholders in the debtor also benefit from a substantive protection in the form of the absolute priority rule.[99] In its simplest form, this rule prohibits nonconsenting junior interests from receiving or retaining property of the debtor in satisfaction of such interests unless and until senior interests are either paid in full or the owners of such senior interests agree to a plan of reorganization under which they voluntarily accept less.[100] Chapter 11 implements the absolute priority rule in several ways, the most important being the "best interest of creditors" test. This test provides that no dissenting stakeholder shall receive less under the plan than the stakeholder would receive if the debtor were liquidated.[101] This substantive protection, in theory, assures all stakeholders that they will not be worse off by virtue of the Chapter 11 plan than if the debtor were liquidated.[102]

Somewhere between these substantive and procedural protections lies the heart of the plan confirmation process—creditor consent. Chapter 11 plans can be confirmed only if, among other things, the plan is supported by the vote of at least one impaired class of claims or interests.[103] A class of claims

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permitting management—who in many cases led the debtor to its financial peril in the first place—to remain in place, free (at least temporarily) of the "discipline" imposed by dunning lawsuits or shareholder derivative suits. *Compare* Michael Bradley & Michael Rosenzweig, *The Untenable Case for Chapter 11*, 101 YALE L.J. 1043, 1050 (1992) ("[T]he data show that Chapter 11 preserves and protects the jobs of corporate managers, not corporate assets.") *with* Lynn M. LoPucki, *Strange Visions in a Strange World: A Reply to Professors Bradley and Rosenzweig*, 91 MICH. L. REV. 79 (1992) (criticizing the methods and conclusions of Bradley and Rosenzweig). *See also* Douglas G. Baird, *A World Without Bankruptcy*, LAW & CONTEMP. PROBS, Spring 1987, at 173, 182; Lucian A. Bebchuk, *A New Approach to Corporate Reorganizations*, 101 HARV. L. REV. 775 (1988); Mark J. Roe, *Bankruptcy and Debt: A New Model for Corporate Reorganization*, 83 COLUM. L. REV. 527 (1983); Michelle J. White, *The Corporate Bankruptcy Decision*, J. ECO. PERSP., Spring 1989, at 129.

98. *See* 11 U.S.C. § 1112(b) (1994) (stating that a court may dismiss Chapter 11 reorganization or convert case to one under Chapter 7 "for cause" including continuing loss to or diminution of the estate or "unreasonable delay" that is "prejudicial to creditors").

99. *Id*. § 1129(b).

100. *Id*. § 1129(b); Walter J. Blum & Stanley A. Kaplan, *The Absolute Priority Doctrine in Corporate Reorganizations*, 41 U. CHI. L. REV. 651, 661 (1974). Much significant debate has centered around whether the absolute priority rule is a "rule," or has any special utility in Chapter 11 reorganizations. *Compare* Bradley & Rosenzweig, *supra* note 97, *with* LoPucki & Whitford, *supra* note 93. *See also* Allan C. Eberhart et al., *Security Pricing and Deviations from the Absolute Priority Rule in Bankruptcy Proceedings*, 45 J. FIN. 1457, 1458 (1990) (finding deviations from absolute priority rule represent 7.6% of total amount awarded to all claimants); Julian R. Franks & Walter N. Torous, *An Empirical Investigation of U.S. Firms in Reorganization*, 44 J. FIN. 747, 755 (1989) (noting Chapter 11 reorganization may result in "large deviations from absolute priority").

101. 11 U.S.C. § 1129(a)(7)(a)(ii) (1994).

102. *Id.*

103. *Id*. § 1129(a)(8), (10).

or interests is "impaired" unless the plan leaves unaltered the legal, equitable, and contractual rights with respect to such claim or interest.[104] A class of impaired claims is deemed to have accepted the plan if creditors holding at least two-thirds in amount and more than one-half in number of claims in such class vote to accept the plan.[105] A class of interests (for example, stockholders) on the other hand, is deemed to accept the plan if holders of at least two-thirds of the interests in such class vote to accept the plan.[106] Where a class of claims or interests rejects a plan, the substantive protections of the absolute priority rule activate and enable the plan proponent to "cram down" the plan.[107] If a plan is "crammed down," then the dissenting class of claims is either paid in full on the effective date of the plan or claims and interests junior to the dissenting class are eliminated.[108]

As with the priority of MSA claims, the ability to discharge these claims is unclear even within the bankruptcy framework. The MSA claims arose under state laws governing antitrust, consumer protection, and common law negligence, and include statutory, common law, and equitable claims for monetary, restitutionary, equitable, and injunctive relief.[109] Yet, the claims have been reduced to a contract (the MSA).[110] Claims embodied in the MSA may therefore be characterized by a bankruptcy court as nondischargeable claims for fraud[111] or for "willful and malicious injury"[112] or rather, as

104. *Id*. § 1124(1).

105. *Id*. § 1126(c).

106. *Id*. § 1126(d).

107. 11 U.S.C. § 1129(b) (1994).

108. *Id*. § 1129(b)(2)(B)(i)-(ii). As written, the cramdown rules require that the bankruptcy court confirm a plan if it "does not discriminate unfairly, and is fair and equitable with respect to each class of claims or interests impaired thereunder." *Id*. § 1129(b)(1). Bankruptcy Code § 1129(b)(2)(B)(ii) provides as follows:

> [T]he condition that a plan be fair and equitable with respect to a class includes the following requirements . . . . With respect to a class of unsecured claims [] (i) the plan provides that each holder of a claim of such class receive or retain on account of such claim property of a value, as of the effective date of the plan, equal to the allowed amount of such claim; or (ii) the holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan on account of such claim or interest any property.

Id. § 1129(b)(2)(B)(ii). The cram down provisions also establish parallel rules for the cramdown of plans against dissenting classes of secured claims and equity interests. *See In re* Koelbl, 751 F.2d 137, 140 (2d Cir. 1984) (discussing scope of "fair and equitable" standard); Union Trust Co. v. Wagner (*In re* Cent. Funding Corp.), 75 F.2d 256, 259 (2d Cir. 1935) (same).

109. *See* NAAG, *supra* note 9, § XVIII(d).

110. *See, e.g.*, Acequia, Inc. v. Prudential Ins. Co. of Am., 226 F.3d 798, 800 (7th Cir. 2000) ("[I]t is reasonable to treat . . . [settlement agreements] as contracts . . . , where they capture a negotiated agreement between two parties which fixes the rights and obligations of each.").

111. *See* 11 U.S.C. § 523(a)(2) (1994). This section states in part:

> A discharge under [e.g., Bankruptcy Code section 1141] does not discharge an individual debtor from any debt . . . for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by . . . false pretenses, a false representation, or actual fraud, other than a

dischargeable unsecured contract claims.[113]

Courts have taken two different approaches to determine whether tort claims embodied in a settlement agreement may be discharged. Those two approaches may apply to MSA claims by analogy. The majority approach, taken by cases such as *In re Spicer*,[114] holds that claims under a settlement agreement are not dischargeable if the claims in the settlement agreement "originated" in and were "derived" from the debtor's fraud.[115] The minority approach, taken chiefly by courts in the Court of Appeals for the Seventh Circuit,[116] views the settlement agreement as a novation under state law that frees the debtor from liability for wrongdoing where he or she has admitted no wrongdoing and has entered into an agreement or contract to pay to settle potential litigation over such claims.[117]

As a practical matter, it would seem virtually impossible to determine whether claims under the MSA would be dischargeable under the Bankruptcy Code. First, the MSA, by its terms, provides that none of its parties admits any wrongdoing, which may indicate a novation.[118] Second, because the MSA "chooses" to apply each settling state's laws to settle such state's claims, the individual law of every state should determine whether

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statement respecting the debtor's or an insider's financial condition . . . .

Id. § 523(a)(2)(A). The exception applies to §§ 727, 1141, 1228(a), (b) and 1328(b). *See id.* § 523(a).

112. *See id.* § 523(a)(6).

113. Professors Dagan and White have argued that the only legal basis for the states' claims against the tobacco companies would be under a theory of subrogation to the rights of the private tort plaintiffs who have yet to collect much on their claims against the tobacco companies. *See* Dagan and White, *supra* note 21, at 398 ("The governments' status as subrogees, according to our analysis, makes their rights derivative of those of the direct victims, due to and to the extent of the unsolicited benefits conferred.").

114. 57 F.3d 1152 (D.C. Cir. 1996).

115. *Spicer*, 57 F.3d at 1157. *See also* Greenberg v. Schools, 711 F.2d 152 (11th Cir. 1983) (holding debt embodied in settlement agreement nondischargeable); *In re* Marceca, 129 B.R. 371, 373 (Bankr. S.D.N.Y. 1991) (holding Chapter 7 debtor's alleged nondischargeable debt did not become a dischargeable contract claim when debtor signed a note to pay back money allegedly misappropriated); *In re* Carnahan, 115 B.R. 697, 699 (Bankr. D. Colo. 1990) (holding portion of a debtor's settlement agreement attributable to fraudulent conduct nondischargeable); *In re* Bobofchak, 101 B.R. 465, 468 (Bankr. E.D. Va. 1989) (holding settlement agreement dismissing creditor's claim of embezzlement against debtor does not change the underlying purpose of debtor's obligation to creditor, and that this debt was nondischargeable); *In re* Peters, 90 B.R. 588, 604-05 (Bankr. N.D.N.Y. 1988) (holding debtor's failure to make trust fund payments is nondischargeable debt); *In re* Pavelka, 79 B.R. 228, 231 (Bankr. E.D. Pa. 1987) (holding a settlement agreement does not erase a debtor's responsibility for nondischargeable debts).

116. *See* Fed. Sign v. Fultz (*In re* Fultz), 232 B.R. 709 (Bankr. N.D. Ill. 1999) (holding that under Illinois law, a settlement agreement constitutes a novation and discharges underlying fraud claims and that claims in a settlement agreement are dischargeable contract claims). *See also In re* West, 22 F.3d 775 (7th Cir. 1994); Md. Cas. Co. v. Cushing, 171 F.2d 257, 258 (7th Cir. 1948).

117. *See Fultz*, 232 B.R. at 721-22; *West*, 22 F.3d at 777.

118. NAAG, *supra* note 9, § XVIII(e).

there has been a novation.[119] Thus, the MSA could constitute a novation under the laws of some but not all states.[120] This could mean that claims under the MSA would be treated as nondischargeable as to certain states but not others.[121]

The MSA's application of each state's laws to such state's claims bespeaks the larger problem with treating MSA claims in bankruptcy: the bankruptcy treatment of these claims is wholly unclear. Since each of the forty states that are parties to the MSA asserted (or could have asserted) different kinds of claims against different tobacco companies, it would seem a Sysiphean task to unthread these claims for the purposes of determining whether or not they are dischargeable. Moreover, the MSA fails to establish how a bankruptcy court should address the contingent and future state claims that may arise from tobacco company conduct.[122] Although the MSA contains a release of future claims against tobacco companies,[123] the MSA also contains a mechanism by which the release would be rendered ineffective in the event of bankruptcy.[124] Depending on one's view of the

119. *Id.* § XVIII(n).

120. The cases discussed *supra* notes 115-16 on the dischargeability of debts arising from fraud do not appear to rely on state-law rules governing novations and releases. *See, e.g.*, *West*, 22 F.3d at 778; *Spicer*, 57 F.3d at 1156. Rather, they view the question as one of determining the intent of Congress with respect to the availability of a discharge, *Spicer*, 57 F.3d at 1156, or the existence and effect of a release, *West*, 22 F.3d at 777-78. Yet, if discharge turns on whether there has been an effective release or novation, different states may well have different rules. *Compare* Refuse Mgmt. Sys. v. Consol. Recycling and Transfer Sys., Inc., 671 A.2d 1140, 1145 (Pa. Super. Ct. 1996) (elements of novation under Pennsylvania law are "(1) the displacement and extinction of an existing valid contract; (2) the substitution for it of a valid new contract, whereby a new party replaces one of the original parties; (3) sufficient legal consideration for the new contract; and (4) the agreement or consent of all the parties to the new contract") *with* Walter Teobe & Co., v. Receiver of F. Yeager Bridge and Culvert Co., 389 N.W.2d 99, 109 (Mich. Ct. App. 1986) (stating that elements of novation under Michigan law are "(1) parties capable of contracting; (2) a valid obligation to be displaced; (3) consent of all parties to the substitution based upon sufficient consideration; and (4) the extinction of the old obligation and the creation of a valid new one").

121. Whether such claims could be separately classified and subordinated in a plan is another issue to consider.

122. The Bankruptcy Code permits a bankruptcy court to estimate contingent and unliquidated claims for allowance purposes. 11 U.S.C. § 502(c)(1) (1994). Bankruptcy courts, however, lack jurisdiction to estimate contingent or unliquidated personal injury tort claims. 28 U.S.C. § 157(b)(5) (1994) ("The district court shall order that personal injury tort and wrongful death claims shall be tried in the district court . . . .").

123. *See* NAAG, *supra* note 9, §§ XII (release), II(nn) (defining released claims to include claims for current and future liability).

124. *See* NAAG, *supra* note 9, § XVIII(w). If the Bankruptcy Code applies to the MSA, such a provision may be unenforceable under Bankruptcy Code § 365 as an "ipso facto" clause. *Compare* Riggs Nat'l Bank v. Perry, 729 F.2d 982, 984 (4th Cir. 1984) (holding "default-upon-filing clause[] unenforceable as a matter of law" for duration of case) (citations omitted) *with In re* Windham, 136 B.R. 878, 881 (Bankr. M.D. Fla. 1992) (acceleration of sums due under loan documents upon filing does "not put [the debtor] in any more jeopardy than that which existed prior to the filing of the

basis for tobacco company liability, tobacco companies could still be causing the harm that created liability in the first place.[125] On a more basic level, it will be difficult to know how to cut off liability for past harms not yet manifest at the commencement of the bankruptcy case.[126]

IV. THE NEW FEDERALISM—STATES IN FULL CONTROL?[127]

Problems with treating large, nontax state claims disappear if the new federalism displaces the Bankruptcy Code. The new federalism describes the Supreme Court's ongoing project to shift power away from the federal government (directly or through federally created citizen suits) and towards the states. From the New Deal until the mid-1990s, the Court viewed Congress as having broad power over states, including the power to create citizen suits against states.[128] Beginning with the 1995 decision in *United States v. Lopez*,[129] however, the Court began to shift power away from Congress by severely curtailing intrusions on state sovereignty.[130]

The new federalism contains at least three major strands[131] relevant to

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petition").

125. If, for example, one believed cigarettes were inherently dangerous products, their continued manufacture and sale would be an ongoing tort. As mentioned above, the problem of ongoing liability raises an issue of "feasibility." For a plan to be confirmed, it must, among other things, be feasible, meaning that it is not likely to be followed by the liquidation or further financial reorganization of the debtor. *See* 11 U.S.C. § 1129(a)(11) (1994). A tobacco company that bases its reorganization on the continued production of the very item that created its liability—cigarettes—may have difficulty showing that its plan is feasible.

126. *See, e.g.,* Daniel L. Keating, *Getting a Handle on Late-Manifesting Claims: A Comment*, 72 WASH. U. L.Q. 1095 (1994) (arguing contingent unliquidated claims in large Chapter 11 reorganizations present "a problem of timing and information that defies any neat solution").

127. This subheading is a play on Lynn M. LoPucki, *The Debtor in Full Control—Systems Failure Under Chapter 11 of the Bankruptcy Code?*, 57 AM. BANKR. L.J. pt. I, at 99, pt. II, at 247 (1983).

128. *See infra* notes 141-42 and accompanying text. One might conclude from the recent judicial disposition of the 2000 presidential election that the Supreme Court does not always side with states. In *Bush v. Gore*, 121 S. Ct. 525 (2000), the Supreme Court held that the Florida Supreme Court's interpretation of Florida's election law deserved little deference. *Id*. at 535 ("To attach definitive weight to the pronouncement of a state court, when the very question at issue is whether the court has actually departed from the statutory meaning, would be to abdicate our responsibility to enforce the explicit requirements of Article II.") (Rehnquest, C.J., concurring). Of course, *Bush v. Gore* may offer no principle of law at all, since it appears to be limited to the case of a presidential election. *See id*. at 534 ("In any election but a Presidential election, the Florida Supreme Court can give as little or as much deference to Florida's executives as it chooses, so far as Article II is concerned, and this Court will have no cause to question the court's actions.") (Rehnquist, C.J., concurring).

129. 514 U.S. 549 (1995).

130. *See generally infra* Part IV.A-B and accompanying text.

131. Other aspects of state and federal relations not considered here include: (1) the abstention doctrine, *see, e.g.,* Younger v. Harris, 401 U.S. 37 (1971); Burford v. Sun Oil Co., 319 U.S. 315 (1943); R.R. Comm'n of Tex. v. Pullman Co., 312 U.S. 496 (1941); (2) the Erie doctrine, *see, e.g.,* Erie R.R. Co. v. Tompkins, 304 U.S. 64 (1938); (3) the doctrine of adequate and independent state

Chapter 11 reorganization: (1) Congress should have no power to abrogate state sovereign immunity under its Article I enumerated powers,[132] and very limited power to do so under section 5 of the Fourteenth Amendment;[133] (2) Congress must have very good reasons for legislating in spheres of power traditionally arrogated to the states;[134] and (3) the federal government cannot "commandeer" the mechanisms of state government for its own ends.[135] Bankruptcy scholars and practitioners understandably tend to focus only on the first strand, debating whether or to what extent states can be subjected to the bankruptcy process under Congress's Article I powers.[136] Although immunity from suit is undoubtedly the most important element of the new federalism in bankruptcy reorganization, current immunity doctrine does not exist in a vacuum. Rather, immunity principles constitute part of a larger movement to empower states and treat them as sovereigns[137] whose rights and privileges are immune from a wide variety of federal insults.[138] While courts have so far concluded that the new federalism does not usually prevent the subordination or discharge of state claims,[139] the policies that animate the new federalism—state power in general, and state economic power, in particular—put the question into play.

A. Eleventh Amendment and State Sovereign Immunity

While other elements of the new federalism provide important background principles to understand the viability of Chapter 11 reorganizations involving significant state claims, the heart of the matter is

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grounds, *see, e.g.,* Michigan v. Long, 463 U.S. 1032 (1983); Murdock v. Memphis, 20 Wall. 590 (1875); (4) preemption doctrines, *see, e.g.,* Cipollone v. Liggett Group, Inc., 505 U.S. 504 (1992); Rice v. Santa Fe Elevator Corp., 331 U.S. 218 (1947); and (5) habeas jurisprudence, *see, e.g.,* Coleman v. Thompson, 501 U.S. 722 (1991); McCleskey v. Zant, 499 U.S. 467 (1991); Teague v. Lane, 489 U.S. 288 (1989); Rose v. Lundy, 455 U.S. 509 (1982); Wainwright v. Sykes, 433 U.S. 72 (1977).

132. *See* Alden v. Maine, 527 U.S. 706 (1999); Seminole Tribe of Fla. v. Florida, 517 U.S. 44 (1996).

133. *See* Kimel v. Fla. Bd. of Regents, 528 U.S. 62 (2000); Fla. Prepaid Postsecondary Educ. Expense Bd. v. Coll. Sav. Bank, 527 U.S. 627 (1999); Coll. Sav. Bank v. Fla. Prepaid Postsecondary Educ. Expense Bd., 527 U.S. 666 (1999).

134. *See, e.g.,* United States v. Morrison, 120 S. Ct. 1740 (2000); United States v. Lopez, 514 U.S. 549 (1995).

135. *See* Printz v. United States, 521 U.S. 898 (1997). *See also* New York v. United States, 505 U.S. 144 (1992). *Cf.* Reno v. Condon, 528 U.S. 141 (2000).

136. *See, e.g.,* Gerson, *supra* note 6; Klee, *supra* note 6; Leib, *supra* note 6.

137. Suzanna Sherry has nicely explored the anthropomorphication of states, suggesting that the Court believes states are increasingly entitled to the rights typically associated only with natural humans. Suzanna Sherry, *States Are People Too*, 75 NOTRE DAME L. REV. 1121 (2000).

138. *See infra* Part V.A-B.

139. *See* discussion *infra* Part IV.C.

sovereign immunity. From the New Deal until the 1996 *Seminole Tribe* decision,[140] the Court generally understood that Congress had the power to authorize citizen suits against the states, only grudgingly acknowledging the fiction of sovereign immunity.[141] Rather than asking whether Congress could abrogate state sovereign immunity, the question before 1996 was whether Congress had made its intention to do so sufficiently explicit.[142] *Seminole Tribe* and its successors, however, shifted the focus from the interpretation of statutory intent to the basic question of power.[143] In doing so, the Court returned the legal standard to an earlier vision of state immunity from suit, one rooted in nineteenth century visions of state sovereignty and the relationship of states to the federal government.[144]

While sovereign immunity may be "an anachronistic fiction,"[145] it has become a fiction with great force. If the question is one of power, the Court's posture regarding state sovereign immunity is no longer tethered to any constitutional text. Rather, the Court believes that "sovereign immunity derives not from the Eleventh Amendment but from the structure of the original Constitution itself."[146] The constitutional component of sovereign immunity resides in the Eleventh Amendment, which provides that "[t]he

140. 517 U.S. 44 (1996).

141. *See, e.g.,* P.R. Aqueduct & Sewer Auth. v. Metcalf & Eddy, Inc., 506 U.S. 139 (1993); Blatchford v. Native Vill. of Noatak and Circle Vill., 501 U.S. 775, 779 (1991); Port Auth. Trans-Hudson Corp. v. Feeney, 495 U.S. 299, 304 (1990); Welch v. Tex. Dep't of Highways & Pub. Transp., 483 U.S. 468, 472-74 (1987) (plurality opinion); Dellmuth v. Muth, 491 U.S. 223, 227-29 & n.2 (1989); Atascadero State Hosp. v. Scanlon, 473 U.S. 234, 237-38 (1985); Pennhurst State Sch. & Hosp. v. Halderman, 465 U.S. 89, 97-100 (1984); Fitzpatrick v. Bitzer, 427 U.S. 445 (1976); Cory v. White, 457 U.S. 85 (1982); Edelman v. Jordan, 415 U.S. 651, 662-63 (1974); Employees of Dep't of Pub. Health & Welfare of Mo. v. Dep't of Pub. Health & Welfare of Mo., 411 U.S. 279, 280 (1973); United States v. Mississippi, 380 U.S. 128, 140 (1965); Parden v. Terminal Ry. of the Ala. State Docks Dep't, 377 U.S. 184, 186 (1964); Ga. R.R. & Banking Co. v. Redwine, 342 U.S. 299, 304 n.13 (1952); Ford Motor Co. v. Dep't of Treasury of Ind., 323 U.S. 459, 464 (1945); Great N. Life Ins. Co. v. Read, 322 U.S. 47, 51 (1944). In a "sharp break with the past," *Seminole* effectively overruled these cases. *Seminole*, 517 U.S. at 77 (Stevens, J., dissenting).

142. *See, e.g., Scanlon*, 473 U.S. at 238-39.

143. *See Seminole,* 517 U.S. at 76 (Stevens, J., dissenting) ("This case is about power—the power of the Congress of the United States to create a private federal cause of action against a State, or its Governor, for the violation of a federal right.").

144. *See, e.g,*, Hans v. Louisiana, 134 U.S. 1 (1890). This nineteenth century locus of the new federalism is thoughtfully explored in Judith Olans Brown & Peter D. Enrich, *Nostalgic Federalism*, 28 HASTINGS CONST. L.Q. (forthcoming 2001) (manuscript on file with author). Brown and Enrich argue persuasively that the new federalism "looks backwards to what [the Court] perceives as the constitutional symmetry of nineteenth century notions of federalism, where state and federal governments each occupied separate and distinct 'spheres' of regulatory authority." *Id*. (manuscript at 6, on file with author).

145. Okla. Tax Comm'n v. Citizen Band Potowatomi Indian Tribe, 498 U.S. 505, 514 (1991) (Stevens, J., concurring).

146. Alden v. Maine, 527 U.S. 706, 728 (1999) (citations omitted).

Judicial power of the United States shall not be construed to extend to any suit in law or equity, commenced or prosecuted against one of the United States by Citizens of another State, or by Citizens or Subjects of any Foreign State."[147]

By its terms, the Amendment purports to deal only with "suits"[148] by "citizens" of one state against another state.[149] Yet, the Court has increasingly ignored the language of the Eleventh Amendment and has given constitutional dignity to states' common law immunity from citizen suits.[150] Thus, "[a]lthough the text of the [Eleventh] Amendment would appear to restrict only the Article III diversity jurisdiction of the federal courts," the Court has repeatedly held that "'we have understood the Eleventh Amendment to stand not so much for what it says, but for the presupposition . . . which it confirms.'"[151] In theory, Congress may defeat this "presupposition" and abrogate state immunity only if it: (1) "unequivocally expresses its intent"[152] to do so, and (2) abrogates immunity "pursuant to a valid exercise of power."[153] In the next two subsections, this Article considers how the reorganization provisions of the Bankruptcy Code fare in the face of these two elements.

1. Unequivocal Congressional Intent to Abrogate State Immunity

Prior to 1994, the Bankruptcy Code contained no express or unequivocal abrogation of state sovereign immunity. Rather, § 106(a) of the Bankruptcy Code, as enacted in 1978, contained a general abrogation of sovereign immunity as to governmental units at all levels (federal, state, and local).[154] In 1989, a plurality of the Supreme Court in *Hoffman v. Connecticut*[155] concluded that the Bankruptcy Code then in effect failed to use

147. U.S. CONST. amend. XI.

148. A reorganizing debtor seeking to counter a claim of sovereign immunity may assert that Chapter 11 reorganizations generally, and actions to subordinate or discharge claims, specifically, are not "suits." Some courts have been sympathetic to this argument. *See infra* Part IV.C.

149. *See* U.S. CONST. amend. XI.

150. *See* Hans v. Louisiana, 134 U.S. 1 (1890).

151. Seminole Tribe of Fla. v. Florida, 517 U.S. 44, 54 (1996) (quoting Blatchford v. Native Vill. of Noatak, 501 U.S. 775, 779 (1991)). For discussions of the "diversity" nature of the Eleventh Amendment, see William A. Fletcher, *A Historical Interpretation of the Eleventh Amendment: A Narrow Construction of an Affirmative Grant of Jurisdiction Rather Than a Prohibition Against Jurisdiction*, 35 STAN. L. REV. 1033 (1983), and John J. Gibbons, *The Eleventh Amendment and State Sovereign Immunity: A Reinterpretation*, 83 COLUM. L. REV. 1889 (1983).

152. *Seminole Tribe*, 517 U.S. at 55 (quoting Green v. Mansour, 474 U.S. 64, 68 (1985)).

153. *Id.*

154. *See* 11 U.S.C. § 106(a) (1984).

155. 492 U.S. 96 (1989).

"'unmistakably clear . . . language'" to abrogate state sovereign immunity and therefore flunked the unequivocal intent test.[156]

In *Hoffman*, a Chapter 7 bankruptcy trustee sued state agencies to recover property alleged to be wrongfully in state possession under § 542[157] and to avoid (and recover) preferential transfers under § 547.[158] Section 106 of the Bankruptcy Code then in effect purported to subject nonconsenting states to bankruptcy court "determinations" of "issues," but did not by its terms subject states to suits for money damages.[159] Because recovering property and money from the state was seen as requiring more than the determination of an "issue," and Bankruptcy Code § 106 then in effect did not expressly authorize such recoveries from states, the *Hoffman* Court concluded that the state was immune from this suit.[160] *Hoffman* contains five separate opinions; Justice Scalia's concurrence, stating that Congress lacked the power under the Eleventh Amendment to strip states of immunity in bankruptcy cases or proceedings produced the narrow holding.[161]

Since the decision in *Hoffman*, Congress has tried to make its intention to abrogate state immunity from bankruptcy court jurisdiction more explicit. In

156. *Hoffman*, 492 U.S. at 101 (quoting Atascadero State Hosp. v. Scanlon, 473 U.S. 234, 242 (1985)).

157. *See* 11 U.S.C. § 542(a) (1994). This section provides that an entity in possession of property that the trustee or debtor-in-possession "may use, sell or lease. . . shall deliver" such property to the trustee or debtor-in-possession. *Id.*

158. *See* 11 U.S.C. § 547(b) (1994). This section provides that the trustee (or DIP) may avoid any transfer of an interest of the debtor in property (1) to or for the benefit of a creditor, (2) for or on account of an antecedent debt, (3) made while the debtor was insolvent (a fact which is presumed for the ninety-day period prior to commencement of the case under § 547(f)), (4) on or within 90 days of the commencement of the case (or one year, if the creditor was an "insider" of the debtor), and (5) that enabled the creditor to receive more than the creditor would have received if the transfer had not been made and the debtor were liquidated under Chapter 7. *Id.*

159. *See Hoffman*, 492 U.S. at 102-03.

160. *See id.*

161. *See id.* at 105. Justice Scalia's concurrence rested on his broad reading of *Hans v. Louisiana*, 134 U.S. 1 (1890), which had, in turn, formed the basis for his separate opinion in *Pennsylvania v. Union Gas*, 491 U.S. 1, 35-42 (1989) (Scalia, J., concurring and dissenting). Justice O'Connor agreed with Justice Scalia that the Bankruptcy Clause did not authorize Congress to abrogate the sovereign immunity of the states. *See Hoffman*, 492 U.S. at 105 (O'Connor, J., concurring). However, Justice O'Connor also agreed with the plurality that Congress had not made plain its intention to abrogate state sovereign immunity in § 106. *Id.* Thus, four members of the Court construed § 106 as insufficiently explicit to abrogate, and two Justices concluded that Congress lacked power to abrogate acting pursuant to the Bankruptcy Clause. *Id*. at 98 (White, J., delivered the opinion in which Rehnquist, C.J., and O'Connor, Kennedy, J.J., joined) (concluding that Congress did not make its intention to abrogate Eleventh Amendment imunity unmistakeably clear); *id.* at 105 (O'Connor, Scalia, J.J., concurring seperately) (holding that Congress had no power to abrogate Eleventh Amendment immunity under the Bankruptcy Clause). Only Justice Scalia fully anticipated the *Seminole Tribe* rule, namely that Congress lacks the power to abrogate state sovereign immunity, whether or not it has expressed an intention to do so "unequivocally." *See also* Joanne C. Brant, *The Ascent of Sovereign Immunity*, 83 IOWA L. REV. 767, 821 (1998).

the Bankruptcy Reform Act of 1994, Congress amended § 106 of the Bankruptcy Code to provide that "[n]otwithstanding any assertion of sovereign immunity, sovereign immunity is abrogated as to a governmental unit [including a state] to the extent set forth in this section."[162] The 1994 amendments purport to subject states to bankruptcy court jurisdiction with respect to sixty enumerated provisions of the Bankruptcy Code.[163] The 1994 amendments also provide that a state will be deemed to have waived immunity for matters arising from the same transaction or occurrence as those reflected in a filed proof of claim.[164]

With the 1994 amendments, Congress succeeded in making explicit its intention to abrogate state sovereign immunity from many important provisions of the Bankruptcy Code. One commentator has observed that "the statutory language is unambiguous,"[165] and virtually every published decision considering the amendments agrees that the 1994 amendments expressly abrogate state sovereign immunity in many Bankruptcy Code provisions.[166] Thus, assuming Congress has power to do so, provisions of the

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162. 11 U.S.C. § 106(a) (1994). *See* H.R. REP. NO. 103-835, at 42 (1994), *reprinted in* 1994 U.S.C.C.A.N., 3340, 3350 (stating that the states and federal government will be deemed to have waived their sovereign immunity by enacting § 106(c) of the Bankruptcy Code). *See also In re* Mueller, 211 B.R. 737, 740 (Bankr. D. Mont. 1997) ("Congress enacted the latest embodiment of § 106 in direct response to the case of *Hoffman*."); *In re* NVR, L.P., 206 B.R. 831, 836 n.10 (Bankr. E.D. Va. 1997) ("Congress. . . amended § 106 with the express purpose of overruling . . . *Hoffman*. . . ."); *In re* Lush Lawns Inc., 203 B.R. 418, 421 (Bankr. N.D. Ohio 1996) ("[The] second purpose (of the amendments to § 106) was to legislatively overrule *Hoffman* . . . .") (citations omitted).

163. *See* 11 U.S.C. § 106(a)(1) (1994). *See also id.* § 362 (governing automatic stay); *id.* § 1141 (discharge under Chapter 11); *id.* § 547 (recovery of money judgments from the state as recipient of preferences); *id*. §§ 544, 548, 549 (fraudulent conveyances).

164. *See id.* § 106(b) ("A governmental unit that has filed a proof of claim in the case [has] . . . waived sovereign immunity . . . [from] a claim against . . . [it] that is property of the estate and that arose out of the same transaction or occurrence out of which the claim of such governmental unit arose."). The "deemed waiver" doctrine would appear to be another casualty of the new federalism. In *College Savings Bank v. Florida Prepaid Postsecondary Education Expense Board*, the Court held that states can no longer be deemed to have "constructively waived" sovereign immunity. 527 U.S. 682 (1999) (overruling Parden v. Terminal Ry. of the Ala. State Docks Dep't, 377 U.S. 184 (1964)). *See also* discussion *supra* note 8.

165. *See* Brant, *supra* note 161, at 821.

166. *See, e.g.*, *In re* Fernandez, 123 F.3d 241, 243 (5th Cir. 1997) (stating that "[s]ection 106(a) clearly expresses congressional intent to abrogate sovereign immunity"); *In re* Creative Goldsmiths, 119 F.3d 1140 (4th Cir. 1997) (agreeing that Congress clearly expressed its intent to abrogate sovereign immunity); *In re* Light, Nos. 94-16995, 94-16997, 1996 WL 341112 (9th Cir. June 20, 1996); Kish v. Verniero, 212 B.R. 808 (D.N.J. 1997) (same); *In re* C.J. Rogers, Inc., 212 B.R. 265 (Bankr. E.D. Mich. 1997) (same); *In re* Mueller, 211 B.R. 737 (Bankr. D. Mont. 1997) (same); *In re* NVR, L.P., 206 B.R. 831 (Bankr. E.D. Va. 1997) (same); *In re* Koehler, 204 B.R. 210 (Bankr. D. Minn. 1997) (same); *In re* Headrick, 203 B.R. 805 (Bankr. S.D. Ga. 1996) (same); *In re* Headrick, 200 B.R. 963 (Bankr. S.D. Ga. 1996) (same); *In re* Burke, 200 B.R. 282 (Bankr. S.D. Ga. 1996) (Ch. 7) (same); *In re* Burke, 203 B.R. 493 (Bankr. S.D. Ga. 1996) (same); *In re* Matter of Midland Mech. Contractors, Inc., 200 B.R. 453 (Bankr. N.D. Ga. 1996) (same); *In re* Tri-City Turf Club, Inc., 203

Bankruptcy Code that stay the collection of claims[167] and empower a bankruptcy trustee (or DIP under Chapter 11)[168] to recover preferential transfers,[169] fraudulent conveyances,[170] or other property of a debtor (or its estate) expressly apply to states as well as individuals.[171] Similarly, provisions discharging pre-petition claims under Chapter 7[172] and Chapter 11[173] expressly apply to state as well as individual creditors by virtue of the current version of § 106.[174]

It is, however, less clear that the provisions of the Bankruptcy Code governing the process of confirming plans of reorganization apply to nonconsenting states.[175] Notably absent from the sixty listed provisions in amended § 106 is § 1129 of the Bankruptcy Code, which governs confirmation of Chapter 11 reorganization plans.[176] Also absent from § 106 are other provisions governing the plan process, including sections regarding the treatment[177] and classification of claims,[178] the disclosures a debtor must

B.R. 617 (Bankr. E.D. Ky. 1996) (same); *In re* York-Hannover Devs., Inc., 201 B.R. 137 (Bankr. E.D.N.C. 1996) (same); *In re* Lush Lawns, Inc., 203 B.R. 418 (Bankr. N.D. Ohio 1996) (same); *In re* Martinez, 196 B.R. 225 (Bankr. D.P.R. 1996) (same).

167. *See, e.g.*, 11 U.S.C. § 362 (1994).

168. One of the many important distinctions between Chapter 7 liquidation and Chapter 11 reorganization is the role of the debtor-in-possession in Chapter 11. In a Chapter 7 liquidation, an "interim" trustee is appointed upon commencement of the Chapter 7 case. 11 U.S.C. § 701(a)(1) (1994). At the meeting of creditors held shortly after commencement of the case, a "permanent" trustee will be elected to administer the debtor's estate. *Id*. §§ 702, 704. The trustee's chief responsibilities will be to collect the debtor's property, liquidate such property, and distribute such property to creditors and other stakeholders in the debtor in accordance with their rights against the debtor. Although the Chapter 7 trustee is authorized to operate the debtor's business for a "limited period," it is unusual for a trustee to do so. *Id.* § 721. In a Chapter 11 reorganization, by contrast, a trustee is not ordinarily appointed to operate the debtor's business. In a Chapter 11 reorganization, management of the debtor retains control of, and continues to operate, the debtor, clothed with many of the powers and rights of a Chapter 7 trustee (other than the right to compensation for services as a trustee). *Id.* § 1107(a).

169. *Id.* § 547(b).

170. *Id.* §§ 544(b), 548, 549.

171. *Id.* § 106(a).

172. *Id.* § 727.

173. 11 U.S.C. § 1141 (1994).

174. *Id.* § 106(a).

175. For more information on the mechanics and nature of plan confirmation, see *supra* Part III.B.

176. 11 U.S.C. § 106(a) (1994). This section purports to subject states to the following provisions of Chapter 11: § 1107 (powers and duties of debtor in possession); § 1141 (effect of confirmation of plan, including discharge of claims pursuant to confirmed plan of reorganization); § 1142 (implementation of confirmed plan); § 1143 (methods of distribution under confirmed plan); and § 1146 (special tax provisions, exempting debtors under confirmed plans from paying certain state income and transfer or stamp taxes imposed in connection with transfers of property under confirmed plan). *Id*. §§ 1107, 1141, 1142, 1143, 1146.

177. *Id.* §§ 1123, 1124, 1129.

178. *Id.* § 1122.

make to have its plan considered by stakeholders and the court,[179] and the number and amount of creditors and equity holders that must support the plan for it to be confirmed.[180]

Nevertheless, Congress probably did intend to abrogate state sovereign immunity in the Chapter 11 plan process, although it is certainly not indicated in the statute or its legislative history. Congressman Brooks of Texas, in speaking in favor of H.R. 5116, which contains the final version of § 106, explained that Congress intended the amendment to overrule *Hoffman* and other cases in which the Court concluded that Congress failed to make "'unmistakably clear'" its intent to abrogate state sovereign immunity.[181] Thus, he explained,

> [T]he Committee[] inten[ds] to make section 106 conform to the Congressional intent of the Bankruptcy Reform Act of 1978 [which] waiv[es] the sovereign immunity of the States and the Federal Government . . . [and which applies] to governmental units where sovereign immunity is not or cannot be asserted. [S]ection 106(a)(1) specifically lists those sections of title 11 with respect to which sovereign immunity is abrogated.[182]

This statement, however, is not without ambiguity. As noted above, § 106 as originally enacted in 1978 made no distinction between states and other parties with respect to the "determination" of "issues."[183] Moreover, § 106 of the Bankruptcy Code originally did not, for example, expressly abrogate sovereign immunity with respect to reorganization—plan confirmation as provided in § 1129.[184] Rather, the original § 106 purported to apply all provisions of Chapter 11 to states, except any provisions that might have created the power to recover money judgments against the states.[185] Thus,

179. *Id.* § 1125.

180. *Id.* § 1126.

181. *See* 140 CONG. REC. H10752-01 (Oct. 4, 1994) (statement of Rep. Brooks), *available at* 1994 WL 545773 (citing United States v. Nordic Vill., Inc., 503 U.S. 30 (1992); Hoffman v. Conn. Dep't of Income Maint., 492 U.S. 96 (1989); Atascadero State Hosp. v. Scanlon, 473 U.S. 234 (1985)).

182. *See id.* Whether or not one views Representative Brooks' comments as supporting abrogation in the Chapter 11 plan process, the Justices most closely associated with the new federalism, in particular Justice Scalia, appear to take a dim view of legislative history as a decisional device. *See* Charles Tiefer, *The Reconceptualization of Legislative History in the Supreme Court*, 2000 WIS. L. REV. 205, 232-40 (providing an examination of judicial reliance on legislative histories as a guide to Congress's intent).

183. *See supra* note 156 and accompanying text.

184. 11 U.S.C. §§ 106, 1129 (1978).

185. *Id*. § 106(c)(2) ("[N]otwithstanding any assertion of sovereign immunity—(1) a provision of this title that contains 'creditor', 'entity', or 'governmental unit' applies to governmental units; and (2) a determination by the court of an issue arising under such a provision binds governmental units.").

four Justices in *Hoffman* concluded that Congress failed to make its "intent" to abrogate immunity "unequivocally clear."[186]

The fact that amended § 106 refers to some, but not all, sections of Chapter 11 creates the inference that sections not so listed do not apply to states. These would include §§ 1111 (governing the scheduling and allowance of unsecured claims), 1122 (governing classification of claims), 1125 (governing plan disclosure), and 1129 (governing plan confirmation).[187] The only important provision that "specifically" applies to states for reorganization purposes is § 1141 (discharging claims).[188] But that provision might not apply if the provisions regarding confirmation of the reorganization plan do not apply to states in the first place.

An aggressive state attorney general could plausibly argue that Congress's failure to include these provisions in § 106 shows that Congress was, in fact, "equivocal" about the extent to which Congress intended to subject states to Chapter 11 reorganizations. Thus, although there may be stronger arguments for state sovereign immunity, the state attorney general would ultimately contend that none of the provisions of a confirmed Chapter 11 plan apply to the state or its claim.

2. Power to Abrogate Immunity

An aggressive state attorney general's stronger argument is simply that Congress lacks power to abrogate state sovereign immunity in Chapter 11 reorganizations. Thus, even if one concludes that Congress "unequivocally" intended to apply Chapter 11 of the Bankruptcy Code to nonconsenting states, Congress lacked the power to do so. In a line of cases beginning with the 1996 *Seminole* decision, the Court has repeatedly held that Congress lacks power under Article I of the Constitution to subject nonconsenting states to federal court jurisdiction.[189] Congress's only alternative, the Court has held, is to abrogate immunity under section 5 of the Fourteenth Amendment, a provision with little relevance to Chapter 11 reorganizations.[190]

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186. *Hoffman*, 492 U.S. at 105.

187. 11 U.S.C. §§ 1111, 1122, 1125, 1129 (1994).

188. Section 364, which permits bankruptcy courts to subordinate claims to those of a lender to the debtor during its case, is also among those listed in § 106(a). *See* 11 U.S.C. § 106(a) (1994). The Bankruptcy Code therefore also purportedly abrogates immunity as to such financings.

189. *See infra* Part IV.A.1.

190. A nonconstitutional alternative would be to treat judicial action as not resulting from a "suit." I discuss this "nonsuit" doctrine in some detail *infra* Part IV.C.3.

In *Seminole Tribe of Florida v. Florida*,[191] the Supreme Court held that Congress could not require states to submit to a federal court's order for mediation under the Indian Gaming Regulatory Act (IGRA),[192] which was enacted pursuant to the Indian Commerce Clause.[193] The *Seminole* majority reasoned that "[t]he Eleventh Amendment restricts the judicial power under Article III, and Article I cannot be used to circumvent the constitutional limitations placed upon federal jurisdiction."[194] Because the *Seminole* Court believed that "'[i]t is inherent in the nature of sovereignty not to be amenable to the suit of an individual without its consent,'"[195] *Seminole* has been construed to mean that "a federal statute supported by only an Article I power cannot abrogate the state's sovereign immunity."[196]

Justice Stevens dissented in *Seminole*, arguing that its rule would impair the application of federal laws, such as the Bankruptcy Code, to the states, stating that "[t]he majority's opinion . . . prevents Congress from providing a federal forum for a broad range of actions against States, from those sounding in copyright and patent law, to those concerning bankruptcy, environmental law, and the regulation of our vast national economy."[197] Because, under the Supremacy Clause, federal courts have exclusive jurisdiction over cases arising under these federal laws, Justice Stevens reasoned that "the majority's conclusion that the Eleventh Amendment shields States from being sued under them in federal court suggests that persons harmed by state violations of federal copyright, bankruptcy, and antitrust laws have no remedy."[198]

Anticipating these concerns, Justice Rehnquist argued in the majority opinion that Justice Stevens' anxieties about bankruptcy were "exaggerated."[199] Justice Rehnquist observed that other remedies were available against the states, explaining that "an individual may obtain injunctive relief under *Ex parte Young* in order to remedy a state officer's ongoing violation of federal law."[200] Moreover, Justice Rehnquist claimed,

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191. 517 U.S. 44 (1996).

192. 25 U.S.C. §§ 2701-21 (1994).

193. *See Seminole Tribe*, 517 U.S. at 54. *See also* U.S. CONST. art. I., § 8, cl. 3 (giving Congress the power "[t]o regulate Commerce . . . with the Indian tribes").

194. *Seminole Tribe*, 517 U.S. at 72-73.

195. *Id.* at 54 (quoting Hans v. Louisiana, 134 U.S. 1, 13 (1890) (quoting THE FEDERALIST NO. 81, at 487 (Alexander Hamilton) (C. Rossiter ed. 1961))).

196. *See* Brant, *supra* note 161, at 802.

197. *Seminole Tribe*, 517 U.S. at 77.

198. *Id.* at 77-78 n.1 (citing Harris & Kenny, *Eleventh Amendment Jurisprudence After* Atascadero*: The Coming Clash With Antitrust, Copyright, and Other Causes of Action over Which the Federal Courts Have Exclusive Jurisdiction*, 37 EMORY L.J. 645 (1988)).

199. *Seminole Tribe*, 517 U.S. at 72-73 n.16.

200. *Id.* An *Ex parte Young* injunction is no longer a given in the light of *Idaho v. Coeur d'Alene*

"[I]t has not been widely thought that the federal antitrust, bankruptcy, or copyright statutes abrogated the States' sovereign immunity."[201] "There is," he argued, "no established tradition in the lower courts of allowing enforcement of those federal statutes against the States."[202]

Most bankruptcy scholars assessing the impact of *Seminole* appear to have agreed with Justice Rehnquist. Thus, they have viewed *Seminole* as leaving several avenues open to debtors who seek bankruptcy remedies against states. First, some suggest that in many instances debtors would be able to continue litigation against states in state courts.[203] Second, some claim that in many instances states would actually or constructively consent to bankruptcy court jurisdiction by, for example, filing a proof of claim.[204] Finally, some scholars note that *Ex parte Young* remains available to require a state officer to comply with a bankruptcy court order.[205]

These three avenues may no longer be open to much bankruptcy traffic. Indeed, the first two have been foreclosed. In *Alden v. Maine*, the Court concluded in 1999 that the common law nature of state sovereign immunity protects states from federal claims in state courts, as well as federal courts.[206] State courts therefore should no longer be a forum in which a debtor could seek to enforce a bankruptcy court order discharging or subordinating a state claim. Similarly, in *College Savings Bank v. Florida Prepaid Postsecondary Education Expense Board*, the Court held that states can no longer be deemed to have "constructively waived" sovereign immunity.[207] Finally, as

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Tribe, 521 U.S. 261 (1997). *See infra* Part IV.C.1.

201. *Seminole Tribe*, 517 U.S. at 72-73 n.16. Since *Seminole*, many bankruptcy courts have concluded that states are immune from suits under the Bankruptcy Code (although there may be limits to that immunity, for example, under *Ex parte Young*). *See, e.g.,* Franchise Tax Bd. v. Lapin (*In re* Lapin), 226 B.R. 637, 641 (B.A.P. 9th Cir. 1998); Mitchell v. California Franchise Tax Bd. (*In re* Mitchell), 222 B.R. 877, 883-84 (B.A.P. 9th Cir. 1998); Elias v. United States (*In re* Elias), 218 B.R. 80, 83-84 (B.A.P. 9th Cir. 1998); Morrell v. Franchise Tax Bd. (*In re* Morrell), 218 B.R. 87, 90 (Bankr. C.D. Cal. 1998); Ranstrom v. IRS (*In re* Ranstrom), 215 B.R. 454, 455-56 (Bankr. N.D. Cal. 1997); Koehler v. Iowa Coll. Student Aid Comm'n (*In re* Koehler), 204 B.R. 210, 216-17 (Bankr. D. Minn. 1997); Kish v. Verniero (*In re* Kish), 221 B.R. 118, 124 (Bankr. D.N.J. 1997); Rose v. United States Dep't of Educ. (*In re* Rose), 214 B.R. 372, 375 (Bankr. W.D. Mo. 1997). *But see* Dep't of Transp. & Dev. v. PNL Mgmt. Co. (*In re* Fernandez), 123 F.3d 241, 243-44 (5th Cir. 1997), *amended*, 130 F.3d 1138, 1139 (5th Cir. 1997).

202. *See Seminole Tribe*, 517 U.S. at 72-73 n.16.

203. *See* Gibson, *supra* note 6, at 203-08.

204. *See id.* at 208-12; Klee, *supra* note 6, at 1564-67; Lieb, *supra* note 6, at 313-19.

205. *See, e.g.,* Gibson, *supra* note 6, at 215; Klee, *supra* note 6, at 1589-90; Leib, *supra* note 6, at 319-20.

206. 527 U.S. 706 (1999) (holding State of Maine immune from Fair Labor Standards Act claim in state court).

207. 527 U.S. 666 (1999) (overruling Parden v. Terminal Ry. of the Ala. State Docks Dep't, 377 U.S. 184 (1964)). As discussed *supra* note 8 and Part IV.A, § 106(b) of the Bankruptcy Code purports to maintain a kind of constructive waiver of sovereign immunity, providing that a state shall be

discussed in Part IV.C.1, the Court narrowed *Ex parte Young*, and eliminated its rule as a source of federal court power where Congress has created a "detailed remedial scheme for the enforcement . . . of a statutorily created right,"[208] or where the law "implicates special sovereignty rights."[209]

If Congress lacks power to abrogate state sovereign immunity under its Article I powers, then the only remaining constitutional basis for doing so is under section 5 of the Fourteenth Amendment—an arena in which federal power has also been diminishing. Section 5 of the Fourteenth Amendment empowers Congress to enforce by appropriate legislation the guarantee that no state shall make or enforce any law depriving any person of "life, liberty, or property, without due process of law."[210] Since the 1997 decision in *City of Boerne v. Flores*,[211] however, the Court has restricted Congress's power under section 5 and required Congress to show that laws subjecting states to suit are congruent with, and proportional to, the identified harm.[212] This restrictive view of section 5 has foiled recent congressional attempts to abrogate state immunity from suit in connection with trademark,[213] patent,[214] and age and disability discrimination claims.[215] Although several bankruptcy courts have held that the Fourteenth Amendment supports bankruptcy court jurisdiction over nonconsenting states,[216] most courts of appeal considering

"deemed to have waived sovereign immunity with respect to a claim against such [state that] arose out of the same transaction out of which the claim of such governmental unit arose." 11 U.S.C. § 106(b) (1994). The overruling of *Parden* would seem to put this sort of constructive waiver in play.

208. Seminole Tribe of Fla. v. Florida, 517 U.S. 44, 74 (1994). The Indian gaming statute at issue in *Seminole*, the IGRA, set forth a fairly complex series of obligations to negotiate in good faith about establishing gaming and related contracts between tribes and states. *See* 25 U.S.C. § 2710(d)(3)(A) (1994). It authorized U.S. district court jurisdiction in the event that the state did not negotiate in good faith when requiring the state and tribe to mediate a settlement. *See id.* § 2710(d)(7). Under no circumstances could a U.S. district court award money damages against a state for violating the Indian gaming act. *See id*. § 2710.

209. Idaho v. Couer d'Alene Tribe, 521 U.S. 261 (1997).

210. City of Boerne v. Flores, 521 U.S. 507 (1997) (quoting U.S. CONST. amend. XIV, § 5).

211. 521 U.S. 507 (1997).

212. *Id.* at 519-20. *Boerne* held that the Religious Freedom Restoration Act of 1993 was "so out of proportion to a supposed remedial or preventive object that it cannot be understood as responsive to, or designed to prevent, unconstitutional behavior. It appears, instead, to attempt a substantive change in constitutional protections." *Id.* at 532.

213. *See* Coll. Sav. Bank v. Fla. Prepaid Postsecondary Educ. Expense Bd., 527 U.S. 666 (1999).

214. *See* Fla. Prepaid Postsecondary Educ. Expense Bd. v. Coll. Sav. Bank, 527 U.S. 627 (1999).

215. *See* Kimel v. Fla. Bd. of Regents, 528 U.S. 62 (2000) (holding states immune from Age Discrimination Employment Act of 1967 claims); Bd. of Trustees of the Univ. of Ala. v. Garrett, No. 99-1240, 2000 WL 33179681 (Feb. 21, 2001) (holding states immune from Americans with Disabilities Act of 1990 claims).

216. *See* Wyo. Dep't of Transp. v. Straight (*In re* Straight), 209 B.R. 540, 555 (D. Wyo. 1997), *aff'd*, 143 F.3d 1387 (10th Cir. 1998); Headrick v. Georgia (*In re* Headrick), 203 B.R. 805, 808 (Bankr. S.D. Ga. 1996); Burke v. Georgia (*In re* Burke), 203 B.R. 493, 497 (Bankr. S.D. Ga. 1996), *aff'd on other grounds*, 146 F.3d 1313, 1317 (11th Cir. 1998); Mather v. Employment Sec. Comm'n

the issue have concluded that congressional bankruptcy power arises only under Article I, and Congress lacks the power thereunder to abrogate state sovereign immunity.[217]

The sovereign immunity component of the new federalism is essentially about power. "It is inherent in the nature of sovereignty," the *Seminole* majority held, "not to be amenable to the suit of an individual without its consent."[218] "Sovereignty," the *Alden* Court reasoned, is "'pre-eminence.'"[219] Any court exercising jurisdiction over states insults this preeminence by claiming "'superiority of power.'"[220] Professor Vazquez has observed that the current Supreme Court appears to believe that "the Eleventh Amendment affords the states fundamental and real protections not avoidable through simple pleading maneuvers."[221] Thus, in *Idaho v. Coeur d'Alene Tribe*, the Court narrowed the *Ex parte Young* doctrine's exception to sovereign immunity because the protections of the Eleventh Amendment are supposed to be "real limitations on a federal court's federal-question jurisdiction" that cannot be dodged by "'elementary mechanics of captions and pleadings.'"[222]

The narrower language of the Eleventh Amendment, itself, which limits the federal "judicial power" in any suit by a citizen of one state against another state, has been no impediment to the new federalism. "[S]overeign immunity derives not from the Eleventh Amendment but from the structure of the original Constitution itself," the Court has explained.[223] The limits of state sovereign immunity are determined not by the language of the Eleventh Amendment, therefore, but by "'history and experience, and the established order of things.'"[224] Historically, sovereign power has been justified on two grounds: (1) the indignity sovereigns would suffer if forced to defend suits against their consent and (2) the economic and political chaos that would flow from unrestricted private suits against states.[225] Either ground bolsters

(In *re* Southern Star Foods, Inc.), 190 B.R. 419, 426 (Bankr. E.D. Okla. 1995).

217. *See* Sacred Heart Hosp. v. Pennsylvania (*In re* Sacred Heart Hosp.), 133 F.3d 237, 244 (3d Cir. 1998); Dep't of Transp. & Dev. v. PNL Mgmt. Co. (*In re* Fernandez), 123 F.3d 241, 245 (5th Cir. 1997), *amended*, 130 F.3d 1138, 1139 (5th Cir. 1997); Schlossberg v. Maryland (*In re* Creative Goldsmiths), 119 F.3d 1140, 1146 (4th Cir. 1997).

218. Seminole Tribe of Fla. v. Florida, 517 U.S. 44, 144 (1994) (Souter, J., dissenting) (citing THE FEDERALIST NO. 81, at 548-49 (J. Cooke ed., 1961)).

219. *Alden*, 527 U.S. at 715 (quoting 1 W. BLACKSTONE, COMMENTARIES ON THE LAWS OF ENGLAND 234-35 (Oxford, 1765)).

220. *Id.*

221. *See* Carlos Manuel Vazquez, *Eleventh Amendment Schizophrenia*, 75 NOTRE DAME L. REV. 859, 868 (2000).

222. 521 U.S. 261, 270 (1997).

223. Alden v. Maine, 527 U.S. 706, 728 (1999) (citations omitted).

224. *Alden*, 527 U.S. at 727 (quoting Hans v. Louisiana, 134 U.S. 1, 14 (1890)).

225. *See* Carlos Manuel Vazquez, *What is Eleventh Amendment Immunity*?, 106 YALE L.J. 1683,

the claim of a state attorney general that his or her state's claims against a tobacco company debtor could not be discharged or subordinated in a Chapter 11 reorganization.[226]

The Eleventh Amendment was adopted in 1795 in the wake of *Chisholm v. Georgia*,[227] where a majority of Supreme Court Justices held that the State of Georgia could be sued in federal court for failing to pay debts incurred to finance the Revolutionary War. The *Chisholm* decision was a "'profound shock'" to the nation[228] because of the effect the *Chisholm* rule would have on state economic affairs; critics of the decision feared "prospective raids on state treasuries."[229]

An early articulation of the economic justification for immunity appeared in *Cohens v. Virginia*, where the Court noted that "[a] general interest might well be felt in leaving to a State the full power of consulting its convenience in the adjustment of debts, or of other claims upon it."[230] In *Cohens*, the Commonwealth of Virginia indicted P.J. and M.J. Cohen for selling federal lottery tickets in violation of Virginia law.[231] Following affirmance of their conviction by Virginia's highest court, the Cohens sought Supreme Court review by a procedural device known as a "writ of error."[232] The Commonwealth of Virginia claimed, in part, that the state court's conviction

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1720, 1732 (1997) (discussing fisc-protection basis for sovereign immunity).

226. A substantial scholarly history of federalism exists. *See, e.g.*, Akhil Amar, *Of Sovereignty and Federalism*, 96 YALE L.J. 1425 (1987); Fletcher, *supra* note 151; Herbert Hovenkamp, *Judicial Restraint and Constitutional Federalism: The Supreme Court's* Lopez *and* Seminole Tribe *Decisions*, 96 COLUM. L. REV. 2213 (1996); Louis L. Jaffe, *Suits Against Governments and Officers: Sovereign Immunity*, 77 HARV. L. REV. 1, 4 (1963); John E. Nowak, *The Gang of Five & the Second Coming of An Anti-Reconstruction Supreme Court*, 75 NOTRE DAME L. REV. 1091 (2000) [hereinafter, Nowak, *Gang of Five*]; John Nowak, *The Scope of Congressional Power to Create Causes of Action Against State Governments and the History of the Eleventh and Fourteenth Amendments*, 75 COLUM. L. REV. 1413 (1975); James E. Pfander, *History and State Suability: An "Explanatory" Account of the Eleventh Amendment*, 83 CORNELL L. REV. 1269 (1998).

227. 2 U.S. (Dall.) 419 (1793). Justice Marshall, in *Cohens v. Virginia*, 19 U.S. 264 (1821), explained, "[A]t the adoption of the constitution, all States were greatly indebted; and the apprehension that these debts might be prosecuted in the federal courts, formed a very serious objection to that instrument. Suits were instituted; and the Court maintained its jurisdiction. The alarm was general . . . ." *Id.* at 406.

228. Alden v. Maine, 527 U.S. 706, 720 (1999) (quoting 1 C. Warren, THE SUPREME COURT IN UNITED STATES HISTORY 96 (rev. ed. 1926)). Not all histories support this view of *Chisholm*. Professor Nowak observes that "reaction to *Chisholm* ran along party lines. Many Federalists and Federalist newspapers indicated agreement with the Court's position." Nowak, *Gang of* Five, supra note 226, at 1101.

229. *Alden*, 527 U.S. at 720 (quoting D. Currie, THE CONSTITUTION IN CONGRESS: THE FEDERALIST PERIOD 1789-1801, at 196 (1997)).

230. Cohens v. Virginia, 19 U.S. (6 Wheat.) 264, 407 (1821).

231. *Id*. at 265.

232. *Id*. at 375.

of the Cohens could not be reviewed by the Supreme Court.[233]

Chief Justice Marshall writing for the Court disagreed, reasoning that the writ of error, by which the Cohens sought review of their conviction, was not a "suit." "A writ of error is defined to be, a commission by which the judges of one Court are authorized to examine a record upon which a judgment was given in another Court, and, on such examination, to affirm or reverse the same according to law."[234] Justice Marshall stated that such a writ "can, with no propriety . . . be denominated a suit commenced against or prosecuted against the State whose judgment is so far demanded."[235] A writ of error was not a "suit" (and could therefore be pursued against a state) because "[n]othing is demanded from the State. No claim against it of any description is asserted or prosecuted. The party is not to be restored to the possession of any thing."[236]

Taking something from the state is not, of course, the only possible assault on the state treasury. Refusing to pay money lawfully owed to the state causes substantially similar economic harm.[237] All "private suits against non-consenting states . . . may threaten the financial integrity of the States," the *Alden* Court reasoned.[238] Whatever else one may say about immunity, "the framers clearly were motivated by a concern for the protection of state treasuries."[239] Indeed, "the vulnerability of the State's purse [is] the most salient factor in Eleventh Amendment determinations."[240] Protecting the public fisc is "[o]ne of the most important goals of the immunity of the Eleventh Amendment."[241] If this assertion is true, then one may ask whether this principle has as much force when the state is a creditor as when it is a

233. *See id*. at 376.

234. *Id.* at 409. This also echoes the "nonsuit" doctrine courts have developed to limit the effects of the new federalism. *See infra* Part IV.C.3.

235. *Cohens*, 19 U.S. at 410.

236. *Id.* at 410. *See also* Seminole Tribe v. Florida, 517 U.S. at 44, n.13 (1994) ("Significantly, Chief Justice Marshall understood the Eleventh Amendment's bar to have been designed primarily to protect States from being sued for their debts.").

237. The Fourth Circuit seems insensible to the distinction. *See infra* Part IV.C.3. That court came to diametrically opposite results regarding the dischargeability of the same transfer tax. In *Maryland v. Antonelli Creditors Liquidating Trust*, the court held that a debtor's plan of reorganization discharged certain transfer and recordation taxes owed by the debtor. 123 F.3d 777, 786-87 (4th Cir. 1997). In *NVR Homes, L.P. v. Clerks of the Circuit Court* (*In re* NVR, L.P.), by contrast, the court held that the new federalism prevented a debtor from recovering from the states those same taxes, once paid. 189 F.3d 442, 452 (4th Cir. 1999).

238. Alden v. Haine, 527 U.S. 706, 750 (1999).

239. William P. Marshall, *The Diversity Theory of the Eleventh Amendment: A Critical Evaluation*, 102 HARV. L. REV. 1372, 1383 (1989).

240. Hess v. Port Auth. Trans-Hudson Corp., 513 U.S. 30, 48 (1994).

241. *Id.* (quoting Jacintoport Corp. v. Greater Baton Rouge Port Comm'n, 726 F.2d 435, 440 (5th Cir. 1985)).

debtor.[242]

The economic basis for the Eleventh Amendment articulated in *Cohens* stands in contrast to the other justification for state sovereign immunity, namely that it is undignified for states to be haled into federal court against their will.[243] The indignity principle has roots in the maxim that the "King could do no wrong."[244] Although some have argued that immunity in this context means that, when the king erred, he could be sued,[245] we no longer have a king. Professor Althouse has thus observed that "once there is no king, and the courts are one of the three branches of government, and once the states' 'pre-eminence' is controverted by the existence of a national government, [this] logic collapses."[246]

Nevertheless, indignity forms an important component of the rationale articulated by certain courts in the Chapter 11 context. For example, in *NVR Homes, L.P. v. Clerks of the Circuit Courts*, a debtor sought to recover certain transfer taxes paid in connection with the disposition of property under its Chapter 11 plan of reorganization.[247] In denying the debtor the power to recover such funds, the Court of Appeals for the Fourth Circuit concluded that the chief evil would be to "exercise . . . federal judicial power to hale a state into federal court against its will and in violation of the Eleventh Amendment."[248] Immunity on this theory flows not from the economic consequences of judicial power over a state, but from defying the "will" of the state. Naming a state as a defendant, or serving it with process to demand that it appear in federal court, offends the Fourth Circuit.[249]

242. Protecting the public fisc has no obvious stopping point and could be used to justify all sorts of state intrusions. *See* James E. Pfander, *Once More Unto the Breach: Eleventh Amendment Scholarship and the Court*, 75 NOTRE DAME L. REV. 817, 825 (2000) (arguing "the fisc-protection policy has no obvious stopping point as one moves from rights grounded in congressional regulation of commerce to those grounded in the Fourteenth Amendment or other constitutional provisions").

243. *See, e.g.*, NVR Homes, L.P. v. Clerks of the Circuit Court (*In re* NVR, L.P.), 189 F.3d 442 (4th Cir. 1999).

244. The Siren, 74 U.S. (7 Wall.) 152, 153-54 (1868).

245. *See* Jaffe, *supra* note 226, at 4.

246. Ann Althouse, *The* Alden *Trilogy: Still Searching for a Way to Enforce Federalism*, 31 RUTGERS L.J. 631, 642 (2000).

247. 189 F.3d 442 (4th Cir. 1999).

248. *Id.* at 453 (quoting Maryland v. Antonelli Creditors' Liquidating Trust, 123 F.3d 777, 787 (4th Cir. 1997)). The *NVR* decision, similar to several others in the Fourth Circuit, attempts to dodge the force of the new federalism by holding states subject to those bankruptcy court actions not denominated "suits." *See, e.g.*, Virginia v. Collins (*In re* Collins), 173 F.3d 924 (4th Cir. 1999); Maryland v. Antonelli Creditors' Liquidating Trust, 123 F.3d 777 (4th Cir. 1997); Schlossberg v. Maryland (*In re* Creative Goldsmiths), 119 F.3d 1140 (4th Cir. 1997). This seems a rather flimsy fiction in the face of the power the Court now vests in states. *See infra* Part IV.C.3.

249. *Antonelli*, 123 F.3d at 786 (finding state not immune because "not named a defendant, nor . . . served with process mandating that it appear in a federal court").

The Fourth Circuit did not establish how far it will take the indignity principle. Indignity was not, for example, grounds for protecting the state from being forced to waive immunity if it wanted to protect its rights in bankruptcy. The *NVR* court observed that no basis exists for immunizing the state's claims from discharge simply because a state faces the "unenviable" choice of either potentially waiving immunity by voluntarily participating in the bankruptcy case or risking the discharge of its claim in toto.[250] Forcing the state to come into court is undignified; forcing the state to make this choice, according to the Fourth Circuit, is not.[251]

B. Other Strands of the New Federalism—Commerce Clause and Tenth Amendment Limits

Immunity from suit is not the only principle of the new federalism relevant to a Chapter 11 reorganization. The new federalism also teaches that Congress has limited power to regulate in traditional state spheres under the Commerce Clause or to compel states to comply with federal law under the Tenth Amendment. Both points are relevant to Chapter 11 reorganizations, because both strands of the new federalism would enhance a state attorney general's claim that a bankruptcy court lacks power to subordinate or discharge a state's claims under the MSA.

1. Commerce Clause

An important principle of the new federalism recognizes that Congress cannot legislate under its enumerated Article I powers where such legislation interferes with traditional state spheres of power. The Court therefore believes that Congress may not use its Commerce Clause power under Article I to regulate "local" matters within the police power.[252] In *United States v. Lopez*[253] and *United States v. Morrison*,[254] for example, the Court struck down antiviolence legislation as being, among other things, invasions

250. *NVR*, 189 F.3d at 453 ("As we have stated on other occasions, this position was not an enviable one for the states because they either had to enter federal court to defend their rights or allow the court to proceed without the benefit of their arguments.").

251. The question of waiver is now more interesting in the light of *College Savings Bank v. Florida Prepaid Postsecondary Education Expense Board*, 527 U.S. 666, 675-76 (1999), which overruled the constructive waiver doctrine of *Parden v. Terminal Railway of the Alabama State Docks Department*, 377 U.S. 184 (1964). *See supra* note 8.

252. The United States Constitution gives Congress the power "[t]o regulate Commerce with foreign nations, and among the several states, and with the Indian tribes." U.S. CONST. art. I, § 8, cl. 3.

253. 514 U.S. 549 (1995).

254. 120 S. Ct. 1740 (2000).

of the states' traditional police powers. In *Lopez*, the Court held that Congress lacked the power under the Commerce Clause to forbid possession of handguns near schools and struck down the Gun-Free Schools Act of 1990.[255] In *Morrison*, the Court relied on *Lopez* to strike down the Violence Against Women Act of 1994.[256] Because the Court believed that possessing guns near schools or violence against women had no effect on interstate commerce, Congress lacked the power to criminalize those activities, which are usually reserved to the states to control.[257]

As with sovereign immunity, a large part of the Court's concern with the Gun-Free Schools Act and the Violence Against Women Act was the balance of power between federal and state government. In both laws, Congress intruded on the traditional sphere of state power, the police power. Such laws could "completely obliterate the Constitution's distinction between national and local authority."[258] The majority believed that "[t]he Constitution requires a distinction between what is truly national and what is truly local."[259] Nothing could be more local, the *Lopez* and *Morrison* Courts

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255. *See Lopez*, 514 U.S. at 561, 567-68 (striking Gun-Free Schools Act of 1990, codified at 18 U.S.C. § 922(q) (1994)).

256. *See Morrison*, 120 S. Ct. at 1749-51 (striking Violence Against Women Act of 1994, codified at 42 U.S.C. § 13981 (1994)).

257. "[P]ossession of a gun in a local school zone," the *Lopez* Court reasoned, "was in no sense an economic activity that might . . . affect any sort of interstate commerce." *Lopez*, 514 U.S. at 567. The Court further reasoned that gun possession did not "substantially affect commerce" because it was "not an essential part of a larger regulation of economic activity." *Id.* at 561. Because this activity also did not affect the instrumentalities of interstate commerce, interstate markets, or things or people in interstate commerce, Congress had no power to criminalize it. *Id.* at 559. "Gender-motivated crimes of violence," the *Morrison* Court reasoned, "are not, in any sense of the phrase, economic activity." *Morrison*, 120 S. Ct. at 1751. The mere fact that violence of this sort could (probably would) affect interstate commerce was not enough. *Id*. at 1752.

Unlike *Lopez*, where the Brady Bill lacked a substantial congressional record, the Violence Against Women Act was supported by "a mountain of data," including four years of testimony by physicians, law professors, survivors of rape and domestic violence, representatives of state law enforcement and private businesses. *Morrison*, 120 S. Ct. at 1760 (Souter, J., dissenting). In enacting the Violence Against Women Act, Congress found that gender-based "violence affect[ed] interstate commerce 'by deterring potential victims from traveling interstate, from engaging in employment in interstate business . . . by diminishing national productivity, increasing medical and other costs, and decreasing the supply of and the demand for interstate products.'" *Morrison*, 120 S. Ct. at 1752 (quoting H.R. CONF. REP. NO. 103-711, at 385 (1994), *reprinted in* 1994 U.S.C.C.A.N. 1803, 1853). Nevertheless, "the existence of congressional findings is not sufficient, by itself, to sustain the constitutionality of Commerce Clause legislation." *Id.* at 1752. Rather, the *Morrison* Court reasoned that "Congress' findings [were] substantially weakened by the fact that they rely so heavily on a method of reasoning that [it had] already rejected as unworkable," by linking "the initial occurrence of violent crime (the suppression of which has always been the prime object of the States' police power) to every attenuated effect upon interstate commerce." *Id.* at 1752.

258. *Morrison*, 120 S. Ct. at 1752 (citing *Lopez*, 514 U.S. at 564).

259. *Id*. at 1754 (citing *Lopez*, 514 U.S. at 568).

reasoned, than the regulation of localized, noneconomic violence.[260] The Court stated that "we can think of no better example of the police power, which the Founders denied the National Government and reposed in the States, than the suppression of violent crime and vindication of its victims."[261]

The question for state attorneys general, tobacco companies, and other debtors with large state claims is whether the Court would view Chapter 11 as intruding into traditional state spheres of power. If the result of reorganization is the elimination, by subordination or discharge, of billions of dollars of state claims, the answer may well be "yes." By analogy, the *Lopez* and *Morrison* cases may stand for the proposition that Congress has little or no authority to regulate under the Bankruptcy Clause in Section 8 of Article I[262] when doing so would tread on traditional state spheres. From this perspective, Congress's power under the bankruptcy clause power may be limited, because bankruptcy law has long deferred to "traditional" state law on substantive contract, property, and related commercial rights.[263] One may find the Court applying this constricted analysis of the Commerce Clause by analogy to the Bankruptcy Clause.[264]

2. No Commandeering—The Tenth Amendment

State power is also central to the "no commandeering" interdiction of the Tenth Amendment.[265] The Tenth Amendment strand of the new federalism

260. *Id.* (citing *Lopez*, 514 U.S. at 566).

261. *Id.* (citing *Lopez*, 514 U.S. at 566 ("The Constitution . . . withhold[s] from Congress a plenary police power.")).

262. Article I, § 8, cl. 4 provides, in part, that Congress shall have the power "[t]o establish . . . uniform [l]aws on the subject of [b]ankruptcies throughout the United States." U.S. CONST. art. I, § 8, cl. 4.

263. *See, e.g.*, Barnhill v. Johnson, 503 U.S. 393 (1992); Butner v. United States, 440 U.S. 48 (1979).

264. As discussed *infra* Part V.B, the Bankruptcy Code should be distinguishable from the legislation in *Lopez* and *Morrison* on the grounds that Congress set forth in the Bankruptcy Code a complex remedial scheme that provides important protections for the states as creditors. Thus, the *Lopez* and *Morrison* majorities should read the Bankruptcy Code as being more carefully tailored to protect state interests than the Brady Bill or the Violence Against Women Act.

The relationship between the Commerce Clause, which was at issue in *Lopez* and *Morrison*, and the Bankruptcy Clause has so far received only modest attention. *See* Hoffman v. Conn. Dep't of Income Maint., 492 U.S. 96, 105 (1989) (Scalia, J., concurring in part and dissenting in part) ("*Union Gas* involved Congress's powers under the Commerce Clause, but there is no basis for treating its powers under the Bankruptcy Clause any differently."); *id.* at 111 (Marshall, J., dissenting) ("I see no reason to treat Congress's power under the Bankruptcy Clause any differently [than its powers under the Commerce Clause]."); *see also* The FEDERALIST NO. 42, at 271 (James Madison) (Clinton Rossiter ed., 1961) (describing Bankruptcy Clause and Commerce Clause as "intimately connected").

265. The Tenth Amendment provides that "[t]he powers not delegated to the United States by the

has been asserted most forcefully in *New York v. United States*[266] and *Printz v. United States.*[267] In *New York,* the Court held that Congress lacked the power to force states to take title to, or otherwise to provide for the disposition of, nuclear waste under the Low-Level Radioactive Waste Policy Amendments Act of 1985.[268] More recently in *Printz*, the Court struck the interim provisions of the Brady Handgun Violence Prevention Act, requiring certain local authorities to determine whether a proposed gun sale would violate federal law.[269]

In both cases, the Court was offended by legislation that "commandeered" the machinery of the states. The *Printz* Court noted that "[w]e held in *New York* that Congress cannot compel the States to enact or enforce a federal regulatory program."[270] Indeed, "[t]he Federal Government may neither issue directives requiring the States to address particular problems, nor command the States' officers, or those of their political subdivisions, to administer or enforce a federal regulatory program."[271]

Below the surface, at least two concerns related to state power compelled this conclusion. First, political accountability, or the lack thereof, was an important theme. "[W]here the Federal Government compels States to regulate," the *New York* majority reasoned, "the accountability of both state and federal officials is diminished."[272] Second, and related to the problem of accountability, was the question of cost. "By forcing state governments to absorb the financial burden of implementing a federal regulatory program, members of Congress can take credit for 'solving' problems without having to ask their constituents to pay for the solutions with higher federal taxes."[273]

An aggressive state attorney general could readily use the no-commandeering rule in the context of a Chapter 11 reorganization. First, a bankruptcy court order subordinating or discharging state claims would, in a

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Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people." U.S. CONST. amend. X. The reach and meaning of the Tenth Amendment are not clear. It has been characterized as a "truism," *United States v. Darby*, 312 U.S. 100, 124 (1941) and a "tautology," *New York v. United States*, 505 U.S. 144, 156-57 (1992).

266. 505 U.S. 144 (1992).

267. 521 U.S. 898 (1997).

268. *See New York*, 505 U.S. at 176 (finding the Low-Level Radioactive Waste Policy Amendments Act of 1985, 42 U.S.C. § 2021(b)-(j) (1994), an unconstitutional exercise of congressional power).

269. *See Printz*, 521 U.S. at 933 (finding the Brady Handgun Violence Prevention Act, 18 U.S.C. § 922(s)(2) (1992), an unconstitutional exercise of congressional power).

270. *Printz*, 521 U.S. at 935.

271. *Id.*

272. *New York*, 505 U.S. at 168. *See also* William P. Marshall & Jason S. Cowart, *State Immunity, Political Accountability, and* Alden v. Maine, 75 NOTRE DAME L. REV. 1069, 1073-75 (2000).

273. *Printz*, 521 U.S. at 930.

sense, be a command from a branch of the federal government that imposes a significant financial burden on the state and interferes with the political accountability principle underlying the Tenth Amendment. The MSA reflects a political decision to reap the financial rewards of suit against an unpopular and perhaps harmful industry. On this view, one may claim that a federal bankruptcy court—which is not accountable to citizens of any state—should not have the power to override the political judgments reflected in the MSA by subordinating or discharging the obligations contained in it.

Second, and more instrumentally, a state might use the Tenth Amendment to prevent a tobacco company debtor from complying with the many ministerial functions associated with corporate existence after emerging from bankruptcy. For example, assuming a tobacco company could reorganize under Chapter 11, it would undoubtedly need to file applications for certificates of existence or good standing and for authority to do business in a state other than the state of incorporation, and annual reports to maintain corporate existence.[274] While corporate statutes appear to give state officers little discretion to reject corporate filings of this type,[275] neither the statutes nor commentary on them contemplates the effect of the new federalism. Thus, it is entirely possible that an aggressive state attorney general and secretary of state could reject, on federalism grounds, corporate filings by a debtor whose confirmed plan of reorganization purportedly subordinated or discharged the state's claims under the MSA.[276] If, as in *Printz*, the federal government cannot force states to administer or enforce costly and unpopular regulatory programs, why can federal bankruptcy courts order secretaries of state to permit dead-beat tobacco companies to do business in their states?

A tobacco company would undoubtedly respond that a state's denial of authority to do business constitutes discrimination expressly forbidden by § 525 of the Bankruptcy Code.[277] That section provides in pertinent part that

274. *See, e.g.*, CAL. CORP. CODE § 1502(a) (Deering 1990) (requiring filing of bi-annual statement on a form prescribed by the secretary of state); DEL. CODE ANN. tit. 8, § 502(a) (1999) (providing that the annual franchise tax report to the secretary of state "shall be made on a form designated by the Secretary of State"); MODEL BUS. CORP. ACT § 1.21(b) (1999). *See also* M. Thomas Arnold, *Administrative Aspects of State Corporation Law*, 28 U. RICH. L. REV. 1, 6-7 (1994) (describing various forms and reports to be filed).

275. The Revised Model Business Corporation Act, for example, treats the filing of such papers as a ministerial function of the Secretary of State. MODEL BUS. CORP. ACT § 1.25(d) (1999). Whatever discretion there may be has been described as "very narrow." *See* Arnold, *supra* note 274, at 12.

276. *Compare* Smith v. Dir., Corp. & Sec. Bureau, 261 N.W.2d 228, 230-31 (Mich. Ct. App. 1977) (rejecting articles of incorporation where corporation's proposed purpose was to violate law by making usurious loans) *with* Gay Activists Alliance v. Lomenzo, 293 N.E.2d 255, 256 (N.Y. 1973) (finding secretary of state lacks discretion over filing of articles of incorporation that comply with prescribed form).

277. 11 U.S.C. § 525 (1994).

"a governmental unit may not deny, revoke, suspend, or refuse to renew a license, permit, charter, franchise, or other similar grant to . . . a person that is or has been a debtor under this title."[278] Nevertheless, § 525 would probably not trump the no-comandeering rule. First, § 525 by its terms forbids discriminatory treatment against a debtor "solely because such . . . debtor is or has been a debtor under this title."[279] "Solely" means that a state may well continue to discriminate against a tobacco company debtor for other reasons.[280] Second, and more fundamentally, it is no longer clear how § 525 would fare in light of the new federalism. If Congress does not have the power to abrogate state immunity under Article I, then Congress may not be able to empower federal bankruptcy courts to force states to issue licenses under Article I.[281] Indeed, bankruptcy courts appear to conclude that Congress no longer has the power to abrogate state immunity under § 525.[282]

At bottom, the new federalism is about power. Whether through the lens of the sovereign immunity doctrine, the Commerce Clause, or the Tenth Amendment, a majority of the current Court believes that the states should maintain far greater power than at any time since the New Deal.[283] Yet, the new federalism indulges in a kind of fiction. The Court presents a segmented view of state power in a complex, integrated economy, ignoring both the complexities of modern commercial life and the fact that the Constitution makes federal law the supreme law of the land.[284] As discussed below, bankruptcy courts struggle to limit the fictions of the new federalism in bankruptcy. While these courts may often come to the correct result, along the way they produce fictions every bit as untenable as those reflected in the new federalism.

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278. *See id*. § 525(a). This section codifies the result in *Perez v. Campbell*, 402 U.S. 637 (1971), where the Court concluded that a state would frustrate the fresh-start policy of bankruptcy if it could refuse to renew the driver's license of a debtor because a tort judgment had been discharged in the debtor's bankruptcy. *Id. See also* S. REP. NO. 95-989, at 81 (1978), *reprinted in* 1978 U.S.C.C.A.N. 2549, 2593.

279. 11 U.S.C. § 525(a) (1994).

280. *See, e.g., In re* Will Rogers Jockey & Polo Club, Inc., 111 B.R. 948 (Bankr. N.D. Okla. 1990) (finding state could reject application to run horse races where market for horse-racing was saturated). An "other" reason to discriminate against a tobacco company debtor may include the belief that the company threatens public health through the manufacture and sale of inherently dangerous products—cigarettes.

281. *See supra* Part IV.A.2.

282. *See, e.g., In re* Burkhardt, 220 B.R. 837, 842 (Bankr. D.N.J. 1998); *In re* Perez, 220 B.R. 216, 224-25 (Bankr. D.N.J. 1998), *aff'd*, No. 98-2043, 1998 U.S. Dist. LEXIS 21513 (D.N.J. Aug. 10, 1998) (unpublished opinion).

283. As discussed *supra* note 128, the recent decision in *Bush v. Gore*, 121 S. Ct. 525 (2000), suggests that the Court may believe it has great latitude in setting the scope of this power.

284. U.S. CONST. art. VI, cl.2.

C. Countervailing Doctrines—Fighting Fiction with Fiction

If one takes the new federalism seriously, one may think that bankruptcy courts should wield no power over nonconsenting states or their claims. Yet, in bankruptcy, courts dilute the new federalism with three countervailing doctrines, all as fictitious as the fiction of the new federalism's sovereign immunity. First, the doctrine of *Ex parte Young* permits courts—including bankruptcy courts—to enjoin state officials but not states *per se* from future violations of otherwise applicable federal law such as the Bankruptcy Code.[285] Second, the *in rem* doctrine permits courts to assume that bankruptcy courts have no jurisdiction over nonconsenting creditor states, but only over the assets of debtors and their estates.[286] Third, courts have used the "nonsuit" doctrine to conclude that certain aspects of Chapter 11 reorganizations are not "suits" against a state and, therefore, do not offend sovereign immunity.[287] A close look at these three doctrines, however, suggests that they may have limited value in the context of Chapter 11 reorganizations, both because they fail to account for the primacy of state power under the new federalism and because they exalt form over substance, turning on procedural distinctions that would make little sense in the context of a multibillion dollar tobacco company reorganization.

1. Ex parte Young

One way around sovereign immunity is the doctrine of *Ex parte Young*.[288] Under *Ex parte Young*, a federal court may exercise "federal jurisdiction over a suit against a state official when that suit seeks only prospective injunctive relief in order to 'end a continuing violation of federal law.'"[289] In *Ex parte Young*, shareholders of a railroad challenged certain states' rights to set rates.[290] The shareholders asked a United States District Court to enjoin a state attorney general from enforcing these rates.[291] The Court agreed that the

285. *See Ex parte* Young, 209 U.S. 123, 149-60 (1908); Franchise Tax Bd. v. Lapin (*In re* Lapin), 226 B.R. 637, 646 (B.A.P. 9th Cir. 1998).

286. *See, e.g.*, Gardner v. New Jersey, 329 U.S. 565, 572-74 (1947); Maryland v. Antonelli Creditors' Liquidating Trust, 123 F.3d 777, 786-87 (4th Cir. 1997). *See also* 28 U.S.C. § 1334(e) (1994).

287. *See infra* Part IV.C.3.

288. 209 U.S. 123 (1908). Although the principle that a United States court can enjoin future violations of otherwise valid federal laws has come to be associated with *Ex parte Young*, the doctrine appears to have roots in the older decision of *Osborn v. President of the Bank of the United States*, 22 U.S. (9 Wheat.) 738, 853-55 (1824).

289. Seminole Tribe of Fla. v. Florida, 517 U.S. 44, 73 (1994).

290. 209 U.S. 123, 129-30 (1908).

291. *See id.* at 131.

plaintiffs could sue the attorney general in federal court to assure that he complied with federal interstate railroad rates.[292] The fiction of *Young* is that somehow the state is an entity separate from the officers through which it acts. Thus, although a bankruptcy judge presumably cannot, after *Seminole Tribe*, issue a money judgment against a state without a waiver of immunity, the judge may be able, under *Ex parte Young*, to enjoin state officials, prospectively, from violating provisions of the Bankruptcy Code.[293]

A tobacco company debtor would seek in its Chapter 11 reorganization express injunctions under *Ex parte Young* prohibiting state attorneys general from taking future actions to collect on claims under the MSA. The tobacco company debtor would have to consider, however, how an aggressive state attorney general would respond to such an injunction. An attorney general could seek to capitalize on any or all of three weaknesses with the *Ex parte Young* doctrine.

First, the Court has narrowed *Ex parte Young*, and the current majority may overturn it. In *Seminole Tribe*, for example, the plaintiffs sought a prospective injunction against the Governor of the State of Florida for relief under *Ex parte Young*.[294] The Court held that an *Ex parte Young* injunction would be available only in the absence of "a detailed remedial scheme for the enforcement . . . of a statutorily created right."[295] The Indian Gaming Act in *Seminole* imposed upon states "liability that is significantly more limited than would be the liability imposed upon the State officer under *Ex parte Young*," and therefore, the *Seminole* Court held that Congress must not have intended to impose *Ex parte Young* liability on a state official.[296]

If, as *Seminole* held, *Ex parte Young* injunctions are not available where the law provides a "detailed remedial enforcement" scheme, one must ask whether the complex provisions of Chapter 11 of the Bankruptcy Code create such a scheme. Although courts have so far concluded that it does not,[297] no

292. *See id.*

293. *See, e.g.*, Franchise Tax Bd. v. Lapin (*In re* Lapin), 226 B.R. 637 (B.A.P. 9th Cir. 1998).

294. *Seminole Tribe*, 517 U.S. at 73.

295. *See id*. at 74.

296. *See id*. at 75-76.

297. *See Lapin*, 226 B.R. at 646. *See also* Guiding Light Corp. v. Louisiana (*In re* Guiding Light Corp.), 213 B.R. 489, 492 (Bankr. E.D. La. 1997); Schmitt v. Mo. W. State Coll. (*In re* Schmitt), 220 B.R. 68, 79 (Bankr. W.D. Mo. 1998). Thus, "the statutory scheme in *Seminole Tribe* is distinguishable from the bankruptcy enforcement mechanism because in *Seminole Tribe*, the IGRA permitted only substantially limited relief against a state in federal court. More importantly, Congress had established a 'system of mediation and possible intervention by the Secretary of the Interior.'" Klee, *supra* note 6, at 1570 n.212 (quoting Gibson, *supra* note 6, at 215). Professor Klee has also observed that "[t]he bankruptcy laws do not substantially limit relief in federal court; if anything, the opposite is true." *Id.*

Chapter 11 reorganizations are enormously complex undertakings, having little in common structurally with the kinds of litigations contemplated in *Seminole Tribe* and the Gaming Act. *See infra* court has considered this issue in connection with the subordination and discharge of claims that would occur in a DIP financing or plan of reorganization. The applicable provisions of the Bankruptcy Code, discussed in Part III.B, could be viewed as a highly detailed remedial scheme, akin to the Indian Gaming Act in question in *Seminole*.[298]

The Court narrowed *Young* even more dramatically in *Idaho v. Couer d'Alene Tribe*, holding that any judicial action analogous to a money damage claim may be outside the scope of *Ex parte Young*.[299] The Coeur d'Alene Tribe sued the State of Idaho and certain state officials asserting that it owned the bed of Lake Coeur d'Alene and certain nearby property. The tribe sought a declaratory judgment clearing title, an award of attorneys' fees, and a preliminary and permanent injunction prohibiting the State from interfering with the tribe's rights in the land.[300] In rejecting the tribe's claim that *Ex parte Young* empowered a federal district court to enjoin agents of the State of Idaho, the Court held that their suit was the "functional equivalent of a quiet title action which implicates special sovereignty interests."[301]

Coeur d'Alene's winnowing of *Ex parte Young* is even more potent for an aggressive attorney general than that of *Seminole*. The aggressive attorney general would argue that the subordination or discharge of state claims is the "functional equivalent" of *Coeur d'Alene*'s quiet title action. Since states are already depending on the funds promised under the Master Settlement Agreement,[302] these types of intrusive judicial orders eliminate important state economic rights.

Part V.A. Unlike the Gaming Act, which created and then narrowed a remedy as to one party (the states), the Bankruptcy Code creates remedies for and against multiple parties.

298. *Compare* Gibson, *supra* note 6, at 215 (viewing the statutory regime at issue in *Seminole* as "distinguishable from the bankruptcy provision in which Congress authorized relief against the states"); *see also* David P. Currie, Ex Parte Young *After* Seminole Tribe, 72 N.Y.U. L. REV. 547, 550 (1997) (stating that *Seminole Tribe*'s limitations on *Ex parte Young* will have very little effect on "most important cases" involving constitutional and not statutory claims against state officers).

299. 521 U.S. 261, 287-88 (1997).

300. *See id*. at 264-65.

301. *Id*. at 281.

302. While many states are using funds from the MSA for tobacco-related programs, *see, e.g.*, *State-By-State Status Report*, *available at* http://abcnews.go.com/sections/us/DailyNews/tobacco (last visited Feb. 1, 2001), some, such as New York, are using the funds to repair schools and roads. *See Tobacco Cash*, *available at* http://abcnews.go.com/onair/WorldNewsSaturday (last visited Feb. 1, 2001). A recent story in the *Wall Street Journal* notes that sagging sales-tax revenues and rising Medicaid expenses are leading states to "eye[] the tobacco windfall for decidedly less altruistic purposes." Will Pinkston, *Tobacco Money Tempts States in Slowdown*, WALL ST. J., Feb. 5, 2001, at A1. Virginia Governor Jim Gilmore, for example, has proposed a tax cut based on funds received under the MSA. *Id.*

Second, the Court's continual narrowing of *Ex parte Young* makes it an unstable doctrine.[303] Until *Seminole*, no reason existed to believe that *Ex parte Young* differentiated among injunctions; state actors violating federal law could be ordered to act affirmatively in conformity with federal law or to refrain from acting in violation of it.[304] Now, *Seminole* and *Couer d'Alene* suggest that the availability of an *Ex parte Young* injunction depends on the effect the injunction would have on state interests.[305] Where those interests have great economic significance—the loss of billions of dollars in projected revenue—the state's interest might be quite high. How, in this light, could a tobacco company debtor justify the *Ex parte* Young injunction it would seek in its plan of reorganization?

Third, the many legal fictions required to sustain *Ex parte Young* weaken its persuasive appeal. First, one must distinguish between the state, a legal fiction itself, and the actors through which it acts (for example, the state attorney general). Next, one must suspend belief in ordinary agency principles that apply to other incorporeal entities, including states, in other contexts.[306] Finally, one must somehow know whether the underlying law is sufficiently important to warrant intrusion into the state's sphere of governance.[307] Why, in the face of raw state power, should these fictions triumph?[308]

303. *See* William A. Fletcher, *The Eleventh Amendment: Unfinished Business*, 75 NOTRE DAME L. REV. 843, 852 (2000) ("The open question is whether the Court will make further inroads into *Ex parte Young*.").

304. *See* Swann v. Charlotte-Mecklenburg Bd. of Educ., 402 U.S. 1 (1971).

305. Fletcher, *supra* note 303, at 852 ("[I]t does not seem to me analytically wrong to conclude that remedies, even injunctive remedies, may be different depending on the underlying substantive legal obligation.").

306. *See, e.g.*, RESTATEMENT (SECOND) OF AGENCY § 33 (1958) ("An agent is authorized to do . . . what it is reasonable for him to infer that the principal desires him to do in the light of the principal's manifestations and the facts as he knows or should know them at the time he acts."). Moreover, principals are liable for the acts of agents acting within the scope of their authority. *Id.* § 219 ("A master is subject to liability for the torts of his servants committed while acting in the scope of their duties."). *Cf.* Erwin Chemerinsky, *State Sovereignty and Federal Court Power: The Eleventh Amendment After* Pennhurst v. Halderman, 12 HASTINGS CONST. L.Q. 643, 657, 656 n.70 (1985) (stating that "[i]nevitably, suits to stop officers from applying state law 'run against the state,'" and also citing common law agency cases in tort for principle that "an agent may not claim immunities of a principal"); Kenneth Culp Davis, *Suing the Government by Falsely Pretending to Sue an Officer*, 29 U. CHI. L. REV. 435, 437 (1962) (criticizing *Young* doctrine for creating fictional distinction between state and officers).

307. *See* Part IV.B.1.

308. *See also* Vazquez, *supra* note 221, at 868 ("*Ex parte Young* rested on a fiction insofar as it suggested that these suits '[do] not affect the State in its sovereign or governmental capacity.'") (quoting Pennhurst State Sch. & Hosp. v. Halderman, 465 U.S. 89, 144 (1984)).

2. In Rem *Doctrine*

Another doctrine that courts use to curtail the new federalism in bankruptcy focuses on the *in rem* nature of bankruptcy cases. On this theory, the Bankruptcy Code gives a court jurisdiction "of all of the property, wherever located, of the debtor as of the commencement of [the bankruptcy] case."[309] Because the jurisdiction is over "property" and not persons, bankruptcy courts theoretically do not exercise judicial power over states when they enter orders subordinating or discharging state claims.

The *in rem* doctrine is grounded in both the statutory grant of bankruptcy jurisdiction[310] and in *Gardner v. New Jersey*.[311] In *Gardner*, the State of New Jersey aggressively pursued the debtor, the Central Railroad of New Jersey, for unpaid taxes of more than $15 million for the years 1932 to 1939.[312] Shortly after receiving notice that the New Jersey attorney general would seek to levy on the debtor's property to satisfy this tax liability, the debtor filed a bankruptcy reorganization petition.[313]

The Comptroller of the State of New Jersey filed a claim on behalf of New Jersey for the more than $12 million in unpaid taxes plus more than $7 million in interest.[314] The State also asserted that its claims were secured by a senior lien on the debtor's property.[315] The debtor and its trustee objected to the State's claim, arguing that the claims "grossly overvalued" the debtor's property and that the claims had been compromised and settled by state legislation.[316] New Jersey's attorney general replied to the claim objections, asserting that the amounts reflected in the proofs of claims had been "finally adjudicated" and were "lawfully owing."[317] After the legislative settlement was declared unconstitutional under New Jersey's constitution,[318] the trustee asked the reorganization court to enforce the settlement or to adjudicate the underlying tax claims.[319] In response to this request, New Jersey's attorney general raised the defense that the reorganization court lacked jurisdiction to

309. 28 U.S.C. § 1334(e) (1994).

310. *Id*. § 1334(e) provides that courts in bankruptcy "shall have exclusive jurisdiction of all of the property, wherever located, of the debtor as of the commencement of [the] case, and of property of the estate." The grant of jurisdiction does not purport to reach creditors or their claims, although the effect of the discharge is obviously otherwise. *Id.*

311. 329 U.S. 565 (1947).

312. *See id*. at 568.

313. *Id*.

314. *Id.* at 570.

315. *Id*.

316. *Id.*

317. *Gardner*, 329 U.S. at 571.

318. *See* Wilentz v. Hendrickson, 38 A.2d 199 (N.J. Eq. 1944).

319. *Gardner,* 329 U.S. at 570.

determine the amount or priority of the tax claim.[320]

The Supreme Court, in an opinion by Justice Douglas, held that "the reorganization court had jurisdiction over the proof and allowance of the tax claims and that the exercise of that power was not a suit against the State."[321] The Court based this holding on the fact that the bankruptcy reorganization is an *in rem* process. "The whole process of proof, allowance, and distribution is, shortly speaking, an adjudication of interests claimed in a res."[322] Presumably, this meant that the court acted as custodian of the debtor's property, distributing it according to the rights of the parties as reflected in filed proofs of claims.[323] The process of proof and allowance of the state's claim was not "a suit against the state."[324] Rather, "[t]he State [was] seeking something from the debtor."[325]

The *in rem* doctrine contemplated by *Gardner* was consistent with the understanding of bankruptcy court power at that time: "[t]he date of filing the reorganization petition is the date of cleavage for Chapter X purposes. From that time on the debtor's property is *in custodia legis*, subject to the control and authority of the reorganization court."[326] The reorganization court, prior to the 1978 Bankruptcy Code, was undoubtedly a court of equity[327] with summary jurisdiction to protect and administer the *res* within its control.[328] Thus, the bankruptcy courts of that era had jurisdiction over all matters of administration beginning with the filing of the petition and ending with the entry of the final decree. This included matters such as the proof and allowance or disallowance of claims, classification of creditors and stockholders, approval of compromises, appointments of receivers and

320. *Id*. at 571.

321. *Id.* at 572.

322. *Id.* at 574.

323. Justice Douglas also reasoned that the expansive definition of "claim" and the supremacy of federal law defeated the state's claim of immunity. Justice Douglas reasoned that filing a proof of claim "waived" immunity, stating that "[w]hen the State becomes the actor and files a claim against the fund [the 'res'] it waives any immunity which it otherwise might have had respecting the adjudication of the claim." *Id*.

324. *Id*.

325. *Gardner*, 329 U.S. at 574.

326. James William Moore, 6 COLLIER ON BANKRUPTCY ¶ 3.04, at 415 (14th ed. 1978). *See also In re* N. Atl. & Gulf S.S. Co., Inc., 166 F. Supp. 29 (S.D.N.Y. 1958), *aff'd sub nom.* Wall Assoc. v. Schilling, 266 F.2d 548 (2d Cir. 1959); John Hancock Mut. Life Ins. Co. v. Casey, 134 F.2d 162 (1st Cir. 1943); *In re* Plankinton Bldg. Co., 138 F.2d 221 (7th Cir. 1943).

327. *See* Young v. Higbee Co. 324 U.S. 204 (1945) (finding that courts of bankruptcy are courts of equity and exercise all equitable powers unless prohibited by the Bankruptcy Act); Cont'l Ill. Bank & Trust Co. v. Chicago, Rock Island & Pac. Ry. Co., 294 U.S. 648 (1935).

328. *See In re* Baldwin, 291 U.S. 610 (1934); *In re* Cuyahoga Fin. Co., 136 F.2d 18 (6th Cir. 1943).

trustees, and confirmation of reorganization plans.[329]

Although current courts rely on *Gardner* to conclude that the *in rem* nature of bankruptcy defeats a claim of immunity as to discharge,[330] the doctrine may not make much sense in a modern, complex corporate reorganization. First, the doctrine is an anachronism in the light of the new federalism. As an historical matter, *Gardner* and its understanding of bankruptcy court power over debtors' assets may have reflected contemporaneous views of state-federal relations and judicial power. It may, for example, be no coincidence that the era of *Gardner*—with its confidence that federal courts could act as trustees—also produced the "old federalism," which believed that Congress had the power to authorize citizen suits against states.[331] The *in rem* doctrine may have reflected our understanding of state and federal government during the New Deal era; however, with *Seminole* and *Lopez* treating states as "real" sovereigns and protecting the "traditional" spheres of state power, the *in rem* doctrine no longer seems appropriate.

Second, in other contexts, the *in rem* doctrine has failed to defeat claims of sovereign immunity.[332] In *Missouri v. Fiske*, for example, the Supreme Court held that "[t]he fact that a suit in a federal court is in rem, or quasi in rem, furnishes no ground for the issue of process against a nonconsenting state."[333] There, the Court concluded that a state was immune from "suit" by remaindermen over rights in certain shares of stock, notwithstanding the fact that the stock was held *in custodia legis*.[334] Where, as would likely occur with an aggressive state attorney general in a tobacco company bankruptcy reorganization, "the state does not come in [to the estate resolution proceeding] and [instead] withholds its consent, the court has no authority to issue process against the state to compel it to subject itself to the court's

329. *See* Brown v. Gerdes, 321 U.S. 178 (1944); Sylvan Beach, Inc. v. Koch, 140 F.2d 852 (8th Cir. 1944) ("The court . . . had power to determine . . . matters . . . related to the administration of the estate. . . .").

330. *See, e.g.*, NVR Homes, L.P. v. Clerks of the Circuit Court (*In re* NVR, L.P.), 189 F.3d 442 (4th Cir. 1999); Virginia v. Collins (*In re* Collins), 173 F.3d 924 (4th Cir. 1999); Texas v. Walker, 142 F.3d 813 (5th Cir. 1998); Maryland v. Antonelli Creditors' Liquidating Trust, 123 F.3d 777 (4th Cir. 1997); Schlossberg v. Maryland (In re Creative Goldsmiths), 119 F.3d 1140 (4th Cir. 1997).

331. *See, e.g.*, Ford Motor Co. v. Dep't of Treasury of Ind., 323 U.S. 459, 464 (1945); Great N. Life Ins. Co. v. Read, 322 U.S. 47, 51 (1944). *See also* NLRB v. Jones & Laughlin Steel Corp., 301 U.S. 1 (1937) (upholding National Labor Relations Act as proper under Commerce Clause).

332. *See, e.g.*, French v. Ga. Dep't of Revenue (*In re* ABEPP Acquisition Corp.), 215 B.R. 513, 517 (B.A.P. 6th Cir. 1997). *See also* United States v. Nordic Vill., Inc., 503 U.S. 30, 38 (1992) (stating that "we have never applied an *in rem* exception to the sovereign immunity bar against monetary recovery, and have suggested that no such exception exists").

333. Missouri v. Fiske, 290 U.S. 18, 28 (1933) (denying issuance of process against nonconsenting state regardless of whether jurisdiction in case is *in rem* or quasi *in rem*).

334. *See id.* at 26-28.

judgment whatever the nature of the suit."[335]

Finally, and most practically, the *in rem* doctrine makes little sense in a corporate reorganization. Bankruptcy courts in large complex cases do not have custody of a debtor's assets. Indeed, the Bankruptcy Code provides that the debtor in Chapter 11 remains in "possession" of its assets.[336] The *in rem* fiction seems more tolerable where a debtor is liquidating, because a court (or trustee) is more accurately characterized as a custodian for the distribution of that which remains of the debtor.[337] Where the debtor is reorganizing, however, the court plays a smaller role; the *in rem* fiction is very weak in such cases because management of the debtor—not the court or a trustee appointed by the court—will make virtually all the important decisions about the debtor's reorganization, including how to treat classes of claims under a plan of reorganization.[338] It is, for example, an extraordinary fiction to say that the assets of a multinational corporation such as Philip Morris were *in custodia legis* with the bankruptcy court in, for example, Delaware.[339]

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335. *Fiske*, 290 U.S. at 28 (citing *In re* New York, 256 U.S. 490 (1920); Georgia v. Jesup, 106 U.S. 458, 462 (1882); The Davis, 77 U.S. (10 Wall.) 15, 19 (1869); The Siren, 74 U.S. (7 Wall.) 152, 154 (1868). United States v. Neb. Dep't of Revenue (*In re* Doiel), 228 B.R. 439, 441 & n.1 (D.S.D. 1998) (refusing to recognize *in rem* exception to Eleventh Amendment immunity).

336. 11 U.S.C. §§ 1107, 1108 (1994).

337. *See supra* note 326.

338. As discussed *supra* Part III.B.2, the DIP is controlled by management pursuant to 11 U.S.C. § 1102.

339. Indeed, a leading proponent of the *in rem* doctrine, Judge Jones of the Fifth Circuit, concedes in her well-articulated opinion in *Texas v. Walker* that the *in rem* doctrine is perhaps plausible only in the liquidation context. 142 F.3d 813 (5th Cir. 1998). "In a bankruptcy case," Judge Jones explained in *Walker*, "in its simplest terms, a debtor turns over his assets, which constitute the estate, for liquidation by a trustee for the benefit of creditors according to their statutory priorities." *Id.* at 822. Yet little about this sentence makes sense in a Chapter 11 reorganization of a large corporation. A tobacco company would not "turn over" any assets to any court. While an "estate" would be created upon commencement of a Chapter 11 reorganization, it would not be "liquidated" by anyone, much less a "trustee," unless the Chapter 11 case was converted to a liquidation under Chapter 7. *Compare* O'Brien v. Vt. Agency of Natural Res. (*In re* O'Brien), 216 B.R. 731, 737 (Bankr. D. Vt. 1998) ("Our *in rem* jurisdiction over property of the debtor and the estate empowers us 'to determine all claims that anyone, whether named in the action or not, has to the property or thing in question. The proceeding is one "against the world."'") (quoting 16 JAMES WILLIAM MOORE, ET AL., MOORE'S FED. PRACTICE ¶ 108-06 (3d ed. 1997)).

One author has suggested that the recent admiralty decision, *California & State Land Commission v. Deep Sea Research, Inc.*, 523 U.S. 491 (1998), would strengthen the *in rem* doctrine by analogy in a Chapter 11 reorganization. *See* Gershon, *supra* note 6, at 24-25. Admiralty doctrine, however, is motivated by very different concerns, including that a federal court sitting in admiralty is more realistically in constructive possession of the subject vessel. *See* 2 JOSEPH STORY, COMMENTARIES ON THE CONSTITUTION OF THE UNITED STATES § 1689, at 491-92 (5th ed. 1891) (stating that federal court "jurisdiction . . . is founded upon the possession of the thing"). It chiefly concerns "suits relating to the relationship of vessels, plying the high seas and our navigable waters, and to their crews." Askew v. Am. Waterways Operators, 411 U.S. 325, 344 (1973). It is difficult to imagine that the comparatively

3. "Nonsuit" Doctrine

The third way that courts contain the new federalism in bankruptcy is to conclude that the subordination or discharge of claims is not a "suit" for sovereign immunity purposes.[340] The Fourth Circuit recently took a lead role in developing this approach. In four recent cases, the Fourth Circuit correctly applied *Seminole Tribe* to conclude that Congress lacked power to abrogate state sovereign immunity from suits in bankruptcy court.[341] Nevertheless, the Fourth Circuit also held that not all bankruptcy matters were, in fact, "suits" governed by the Eleventh Amendment. Rather, where a court is merely "interpreting" the Bankruptcy Code—confirming a Chapter 11 plan, for example—the state is not subject to a "suit" and, thus, is not immune from the judicial action.[342]

The Fourth Circuit has built the "nonsuit" doctrine on a distinction between "adversary proceedings" or "contested matters" on the one hand—actions that appear more like "suits"—from matters that arise "naturally" from the confirmation of a plan of reorganization without commencement of a "suit," on the other hand.[343] Thus, the Fourth Circuit held that an adversary proceeding against a state to recover state tax payments as preferential transfers[344] and a "contested matter" to recover transfer taxes[345] were suits

ancient doctrines of admiralty really teach us much about the complexities of corporate reorganizations that result in the subordination or discharge of billions of dollars of state claims. *See* Am. Ins. Co. v. Canter, 26 U.S. (1 Pet.) 511, 545-46 (1828) ("[Admiralty] cases are as old as navigation itself; and the law admiralty and maritime, as it existed for ages, is applied by our courts to the cases as they arise.").

340. The *in rem* and nonsuit doctrines would appear both to overlap and to be in tension. In *Texas v. Walker*, the Court of Appeals for the Fifth Circuit blurred the distinction between the doctrines, reasoning that a state's claims were dischargeable because the "key assumption" behind holding such claims nondischargeable was "the equation of a bankruptcy case with a suit against the state." 142 F.3d 813, 822 (5th Cir. 1998). This assumption was "flawed" because "[i]n a bankruptcy case, in its simplest terms, a debtor turns over his assets, which constitute the estate, for liquidation by a trustee for the benefit of creditors according to their statutory priorities." *Id.* at 822. Yet, there is support for the view that *in rem* actions are suits in equity "against the world." *See infra* text accompanying note 404. *See also O'Brien*, 216 B.R. at 737.

341. *See* NVR Homes, L.P. v. Clerks of the Circuit Courts (*In re* NVR, L.P.), 189 F.3d 442, 452 (4th Cir. 1999); Virginia v. Collins (*In re* Collins), 173 F.3d 924 (4th Cir. 1999); Maryland v. Antonelli Creditors' Liquidating Trust, 123 F.3d 777 (4th Cir. 1997); Schlossberg v. Maryland (*In re* Creative Goldsmiths), 119 F.3d 1140 (4th Cir. 1997).

342. *See NVR*, 189 F.3d at 452.

343. *See id*. at 454.

344. *See Schlossberg*, 119 F.3d at 1142. An adversary proceeding has many of the features of a civil litigation commenced under the Federal Rules of Civil Procedure. FED. R. BANKR. P. 7003, 7004. Governed by Part VII of the Federal Rules of Bankruptcy Procedure, an adversary proceeding is commenced by the filing of a complaint with the court and the service of a summons on the defendant. *Id.* Voidable transfers (for example preferential payments under 11 U.S.C. § 547 (1994)) may be recovered only by successfully commencing and prosecuting an adversary proceeding.

345. *NVR*, 189 F.3d at 454. A "contested matter," like an adversary proceeding, has many of the

from which states were immune. In two other cases, however, the Fourth Circuit held that the mere discharge of claims arising from the confirmation of a plan was not a "suit" for purposes of state sovereign immunity, and therefore the state's claims were properly discharged.[346]

In *Maryland v. Antonelli Creditors Liquidating Trust*, the Fourth Circuit held that the confirmation of a debtor's plan of liquidation under Chapter 11 could deprive the State of Maryland of certain transfer and recordation taxes otherwise payable upon the transfer of properties liquidated under the plan.[347] Seeking to collect these amounts, the State of Maryland brought suit in state court to recover unpaid transfer and recordation taxes from the Antonelli Creditors' Liquidating Trust (the Trust), a creation of the debtor's Chapter 11 plan of liquidation.[348] The Trust removed the case to federal court and defended on the ground that Bankruptcy Code § 1146(c) and the debtor's plan of liquidation exempted the trust from paying state transfer and recordation taxes.[349] Maryland admitted that it was not immune from the immediate proceeding, having commenced the action, but rather claimed immunity from the confirmation of the debtor's plan of liquidation under Chapter 11.[350] The Fourth Circuit disagreed, stating:

> The state was not named a defendant, nor was it served with process mandating that it appear in a federal court. While it was served with notice of the proposed plan and its confirmation, it was free to enter federal court voluntarily or to refrain from doing so. This is to be distinguished from the case in which a debtor, a trustee or other private person files an adversary action against the state in the

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features of a civil litigation under the Federal Rules of Civil Procedure. FED. R. BANKR. P. 9014. However, they are different in that an adversary proceeding is commenced by the filing of a complaint and service of a summons on the defendant, while a contested matter is commenced by the filing of a motion, which is then served on the "party against whom relief is sought." FED. R. BANKR. P. 9014. Contested matters are governed by Federal Rule of Bankruptcy Procedure 9014, which in turn incorporates many, but not all, of the provisions of Part VII of the Federal Rules of Bankruptcy Procedure. *Id*. Part VII, in turn, incorporates many but not all of the Federal Rules of Civil Procedure. FED. R. BANKR. P. 7001-71. While contested matters are not civil litigations in a strictly formal sense, they can and often do deprive parties of significant rights. Most important for purposes of this Article, an objection to the confirmation of a Chapter 11 plan of reorganization is characterized as a "contested matter" rather than as an adversary proceeding. FED. R. BANKR. P. 3020(b)(1).

346. *See Collins*, 173 F.3d, at 925; *Antonelli*, 123 F.3d at 786-87.

347. *See Antonelli*, 123 F.3d at 786-87.

348. *Id.* at 779.

349. *Id.* Bankruptcy Code § 1146(c) provides that "[t]he issuance, transfer, or exchange of a security, or the making or delivery of an instrument of transfer under a plan confirmed under section 1129 of th[e Bankruptcy Code], may not be taxed under any law imposing a stamp tax or similar tax." 11 U.S.C. § 1146(c) (1994).

350. *See Antonelli*, 123 F.3d at 781.

> bankruptcy court, causing the bankruptcy court to issue process summonsing the state to appear. Such an adversary proceeding would be a suit "prosecuted against one of the United States" and adjudication of that suit would depend on the court's jurisdiction over the state, implicating the Eleventh Amendment's limitation on federal judicial power.[351]

In contrast, where a debtor seeks retroactively to recover the same kinds of taxes from the state by commencing a "contested matter," the state is immune.[352] Upon confirmation of the debtor's liquidation plan in the *NVR* case, the debtor transferred over 5,571 parcels of real property.[353] Along with these transfers, the debtor also paid $8,349,103 in transfer and recordation taxes to state and local taxing authorities.[354] Yet the debtor's plan sought to exempt the debtor from having to pay these taxes, under § 1146(c) of the Bankruptcy Code.[355] The debtor then immediately commenced contested matters under Bankruptcy Rule 9014 seeking declarations that its property transfers were exempt from these taxes and recoverable from the state and local authorities.[356] The authorities objected, arguing that they were immune from the debtor's "suits" to recover these amounts.[357] The Fourth Circuit agreed with the authorities, reasoning that the question of whether the contested matters were "suits" turned on two issues: (1) the degree of coercion exercised by the federal court in compelling the state to attend and (2) whether the resolution, or the remedy, would require federal court "jurisdiction" over the state.[358] Citing *Cohens*, the *NVR* court observed that "[t]he substantive consideration focuses upon whether the action was . . . 'the prosecution of some demand in a Court of justice,' as opposed to the orderly disposition of an estate, with the states' role limited to that of any other

351. *Id.* at 786-87 (quoting Schlossberg v. Maryland (*In re* Creative Goldsmiths), 119 F.3d at 1148 (4th Cir. 1997)). As discussed above, the *Antonelli* court also relied heavily on the *in rem* view of bankruptcy cases, which tends to blur with the "nonsuit" approach.

352. *See* NVR Homes, L.P. v. Clerks of the Circuit Courts (*In re* NVR, L.P.), 189 F.3d 442 (4th Cir. 1999).

353. *Id.* at 447-48.

354. *Id.* at 448.

355. Section 4.13 of NVR's plan of liquidation provided as follows:

> Pursuant to section 1146(c) of the Bankruptcy Code, the issuance, transfer, or exchange of securities pursuant to the Plan, and the transfer of, or creation of any lien on, any property of any Debtor under, in furtherance of, or in connection with the Plan shall not be subject to any stamp tax, real estate transfer tax, recordation tax, or similar tax.

189 F.3d at 448.

356. *Id.* at 447.

357. *Id*.

358. *Id.* at 452 (citing Maryland v. Antonelli Creditors' Liquidating Trust, 123 F.3d 777, 786-87 (4th Cir. 1997)).

creditor."[359]

The Fourth Circuit acknowledged that *NVR* appeared to "mirror *Antonelli* because both cases pose the issue of whether a debtor is entitled to an exemption from taxes under 11 U.S.C.A. § 1146(c)." This similarity was insufficient to produce the same result, however.[360] The *Antonelli* bankruptcy court merely "interpreted" a reorganization plan to determine "whether [it] complied with federal law."[361] Such conclusion only "collaterally" affected the rights of those with claims against or interests in the debtor—"even if one happens to be a state."[362]

In *NVR*, by contrast, the debtor sought to "take" funds from the States of Maryland and Pennsylvania. But this was not the controlling issue.[363] Rather, the debtor's strategy offended the Fourth Circuit because it asked the court to assert jurisdiction over the States.[364] In *NVR*, unlike *Antonelli*, the debtor sought to recover these taxes by a motion under Rule 9014 of the Federal Rules of Bankruptcy Procedure.[365] This rule governs contested matters, where a dispute exists between two discrete parties but involves weaker claims or interests than would require an adversary proceeding.[366] Although the *NVR* bankruptcy court did not, in connection with the contested matter, issue a summons to the states, it did serve the States with notice of the proceeding.[367] While this may have placed the States in the "unenviable" position[368] of having to "choose" to come into bankruptcy court to defend against the matter, it did "'not amount to the exercise of federal judicial power to hale a state into federal court against its will and in violation of the Eleventh Amendment."[369] The mere fact that the States faced a procedural Hobson's Choice was no basis for concluding that the contested matter was a

359. *NVR*, 189 F.3d at 452 (citing Cohens v. Virginia, 19 U.S. (6 Wheat.) 264, 407 (1821)). For a discussion of *Cohens*, see *supra* Part IV.A.2.

360. NVR, 189 F.3d at 452 (citing *Antonelli*, 123 F.3d at 779).

361. *Id.* at 452 (citing *Antonelli*, 123 F.3d at 787).

362. *Id.* at 452.

363. *Id.* (citing Schlossberg v. Maryland (*In re* Creative Goldsmiths), 119 F.3d 1140 (4th Cir. 1997)). In *Schlossberg*, the debtor sought to recover allegedly preferential payments made to the state pursuant to an adversary proceeding commenced against the state. *Schlossberg*, 119 F.3d at 1142-43.

364. *NVR*, 189 F.3d at 452.

365. *Id*. at 448.

366. *See* FED. R. BANKR. P. 9014.

367. *See NVR*, 189 F.3d at 447.

368. *Id*. at 453 ("As we have stated on other occasions, this position was not an enviable one for the states because they either had to enter federal court to defend their rights or to allow the court to proceed without the benefit of their arguments.") (citing Virginia v. Collins (*In re* Collins), 173 F.3d 924, 930 (4th Cir. 1999)).

369. *Id*. (quoting Maryland v. Antonelli Creditors' Liquidating Trust, 123 F.3d 777, 787 (4th Cir. 1997)).

suit against the States.[370]

Rather, the court held that the "ultimate resolution" of the dispute between NVR and the States would require federal courts to exercise jurisdiction over the States.[371] The States argued that "if the federal court action could not result in ordering the States to return the tax payments, then any opinion issued would be advisory and improper."[372] Without the power to compel the States to turn over the tax payments, however, no remedy effectively could be granted. Thus, the Fourth Circuit reasoned that jurisdiction over the States was necessary to resolve the contested matter, which "alone is enough to determine that the action, if it is to meet the requirements of Article III, is a suit against the states."[373]

This holding does not resolve the precise question of the effect of discharge for immunity purposes. In *Virginia v. Collins*, the Fourth Circuit—like other courts[374]—held that the discharge granted to a Chapter 7 debtor was not a "suit."[375] In *Collins*, the Fourth Circuit concluded that the Eleventh Amendment did not bar a debtor's motion to reopen a bankruptcy case to determine that a debt to the Commonwealth of Virginia had been discharged four years earlier.[376] The Chapter 7 bankruptcy case resulted in a liquidation of all of the *Collins* debtor's assets.[377] Although the Commonwealth of Virginia had been served with notice of the case, it did not participate by, for example, filing a proof of claim.[378] Four years after the discharge, Virginia

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370. *NVR*, 189 F.3d at 453.

371. *Id.*

372. *Id.* (citing Hewitt v. Helms, 482 U.S. 755, 761 (1987) ("The real value of the judicial pronouncement—what makes it a proper judicial resolution of a 'case or controversy' rather than an advisory opinion—is in the settling of some dispute *which affects the behavior of the defendant towards the plaintiff*.")).

The district court had "attempted to tip-toe" around the issue. *Id.* at 453. The district court had observed, "'Neither reached nor decided here is the question whether the bankruptcy court's [order declaring NVR exempt from the transfer and recordation taxes] is binding in any way on the [state] [t]axing [a]uthorities.'" *Id.* at 453 (quoting Clerk of the Circuit Court v. NVR Homes, Inc., 222 B.R. 514, 521 (Bankr. E.D. Va. 1998)).

373. *Id.* at 453. The Fourth Circuit also correctly recognized that recovering money from these states demanded "affirmative action" by the states. *Id.* This was impermissible. *See id.* (citing Cohens v. Virginia, 19 U.S. (6 Wheat) 264, 407-08 (1821)). Of course, the Fourth Circuit did not need to go further than recognizing that a demand for money from a nonconsenting state was almost certainly a "suit" against the state. *See id.* at 454 ("The demand for money from a state is a strong indication that a federal judicial proceeding is indeed a suit against the state under the Eleventh Amendment.").

374. *See, e.g.*, Texas v. Walker, 142 F.3d 813, 822 (5th Cir. 1998) (upholding discharge of state claims on both nonsuit and *in rem* jurisdiction grounds); *In re* Barrett Ref. Corp., 221 B.R. 795 (Bankr. W.D. Okla. 1998) (holding that bankruptcy court has power to grant discharge of state claims under Chapter 11 or Chapter 13 plan of reorganization).

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

376. *See Collins*, 173 F.3d at 926.

377. *Id.*

378. *See id.* at 926.

began to dun the debtor, leading the debtor to reopen the case to have the debt declared dischargeable.[379] In concluding that the debt had been discharged, the Fourth Circuit reasoned that its jurisdiction "over the dischargeability of debt, just like its jurisdiction to confirm a plan of reorganization, 'derives not from jurisdiction over the state or other creditors, but rather from jurisdiction over debtors and their estates.'"[380] Because the motion to reopen the bankruptcy case was "just a continuation of the original proceeding,"[381] it was held not to be a "suit" against a state in violation of Eleventh Amendment.[382]

The nonsuit doctrine has also been used to obtain DIP financing that subordinates state claims. In *In re Sun Healthcare Group, Inc.*,[383] the bankruptcy court for the district of Delaware cited *Antonelli* and *Collins* in holding that an order approving financing during a Chapter 11 reorganization that effectively subordinated state liens was not a "suit" and was therefore not subject to Eleventh Amendment immunity. In *Sun Healthcare*, the debtors (Sun Healthcare Group, Inc. and over 180 of its affiliates) filed to reorganize under Chapter 11 in late 1999.[384] As often happens in such cases, the debtors sought financing during the case under Bankruptcy Code § 364.[385] The *Sun Healthcare* lenders, having agreed to lend $200 million to the debtors, sought and obtained "priming" (senior) liens on the debtors' accounts receivable and the proceeds thereof.[386] Notably, the financing order stayed the Medicaid agencies for the States of Alabama, Connecticut, Idaho, Louisiana, Maryland, Missouri, New Hampshire, New Jersey, New Mexico, Oklahoma, and Virginia (the State Agencies), from offsetting their claims against amounts they owed to the debtors.[387]

The State Agencies, not surprisingly, sought to retain their common law offset rights. They therefore moved to have the bankruptcy court reconsider the order approving the financing, chiefly on the grounds that the bankruptcy court lacked jurisdiction over them by virtue of the Eleventh Amendment.[388]

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379. *Id.*

380. *Id.* at 929 (quoting Maryland v. Antonelli Creditors' Liquidating Trust, 123 F.3d 777, 787 (4th Cir. 1997)).

381. *NVR*, 189 F.3d at 451 (citing *Collins*, 173 F.3d at 930).

382. *See Collins*, 173 F.3d at 930.

383. 245 B.R. 779, 784-85 (Bankr. D. Del. 2000).

384. *See id.* at 781-83.

385. *See id.* at 782.

386. As discussed *supra* Part II.B.2., bankruptcy courts have the power under 11 U.S.C. § 364 to grant liens on a debtor's property in connection with such financing equal or senior to existing liens. 11 U.S.C. § 364(d)(1) (1994). *See id.*

387. *See id.* at 782-83 (citing Final Debtor-in-Possession Financing Order ¶ 16).

388. *See id.* at 783.

The bankruptcy court denied the State Agencies' motion because the motion seeking the financing was not a "suit." Because "no adversary proceeding or other suit has been filed against the [State Agencies] . . . [n]or was any process or summons issued requiring the [State Agencies] to appear [at] the [financing motion hearing]," the financing order was not a suit.[389]

The courts in cases such as *Collins*, *Antonelli*, and *Sun Healthcare* seem understandably anxious to preserve corporate debtors' power to subordinate or discharge claims held by states.[390] The *Collins* court observed that "[t]he power of bankruptcy courts to discharge debts is fundamental to our bankruptcy system."[391] A state could completely undermine the bankruptcy system by "assert[ing] Eleventh Amendment immunity to avoid the effect of a discharge order . . . . A person owing debts to a state could never have those debts discharged by a bankruptcy court unless the state agreed."[392] This reasoning would support a Chapter 11 debtor with significant state liabilities, who would argue, as in *Collins* and *Antonelli*, that it is not commencing a suit when it seeks to confirm a plan.[393] Instead, confirmation of the plan is simply part of the "interpretive" process of bankruptcy.[394]

An attorney general can offer several responses to such an argument. First, the debtor's argument ignores the fact that an objection to confirmation would automatically convert the confirmation process into a "contested matter" under Bankruptcy Rule 3020, thus presenting the very kind of action the Fourth Circuit characterized as an impermissible "suit" against a state.[395] It is no answer to say that a state must make the unenviable Hobson's Choice of waiving immunity by objecting to the confirmation or risk losing its rights, as the Fourth Circuit claimed.[396] Such argument may make sense when a debtor is liquidating because there will be no debtor (or assets) against which

389. 245 B.R. at 784-85 (citations omitted).

390. *See generally* Virginia v. Collins, 173 F.3d 924 (4th Cir. 1999); Maryland v. Antonelli Creditors' Liquidating Trust, 123 F.3d 777 (4th Cir. 1997); In re Sun Healthcare Group, Inc., 245 B.R. 779 (Bankr. D. Del. 2000).

391. 173 F.3d at 930-31.

392. *See id*. *See also In re* Robertson, 237 B.R. 124, 127 (Bankr. W.D. Va. 1999) ("[T]he decision in *Collins* carves out an exception to . . . [sovereign immunity] where discharge is involved. When discharge is at issue, the jurisdictional power of the bankruptcy court derives from control over the debtor and federal supremacy with respect to bankruptcy trumps any Eleventh Amendment claim of immunity by the state.")

393. *See supra* notes 350, 380-82 and accompanying text.

394. *See NVR*, 189 F.3d at 452.

395. *See id.* at 453.

396. *See id.* ("As we have stated on other occasions, this position was not an enviable one for the states because they had either to enter federal court to defend their rights or to allow the court to proceed without the benefit of their arguments.") (citing Virginia v. Collins (*In re* Collins), 173 F.3d 924, 930 (4th Cir. 1999)).

a state could assert a claim. However, where the debtor is reorganizing under Chapter 11, it will carry on its business more or less as it did before bankruptcy, perhaps in the states whose debts are being subordinated or discharged. If one takes the new federalism seriously, no principled basis exists for stripping the states of immunity in this context. The attorney general will argue that sovereign immunity and the state's right to receive billions of dollars in a tobacco company bankruptcy should not turn on these weak procedural distinctions.

Second, the Fourth Circuit's approach ignores that the "common law" source of sovereign immunity would not tolerate any of the Fourth Circuit's fine distinctions. The Eleventh Amendment may speak of "suits," but it also speaks of (and purportedly limits sovereign immunity to) certain kinds of suits.[397] The *Seminole* and *Alden* view takes us well beyond the language of the Eleventh Amendment, forbidding the exercise of judicial power against states under Article I.[398] The scope of state immunity is determined not by the language of the Eleventh Amendment, but by "'history and experience, and the established order of things.'"[399] "[S]overeign immunity," the *Alden* Court held, "derives not from the Eleventh Amendment but from the structure of the original Constitution itself."[400] The state attorney general will argue that courts must narrowly construe exceptions to immunity doctrine because immunity is supposed to be a "real limitation on a federal court's federal-question jurisdiction" which cannot be dodged by "'elementary mechanics of captions and pleadings.'"[401] "[S]imple pleading maneuvers"[402] should not be enough.

Third, even if the Eleventh Amendment limits state sovereign immunity in this context alone, it speaks of suits in both "law" and "equity."[403] History supports the view that the commencement of a bankruptcy case is the commencement of a "suit" in equity against the world, including states that are creditors.[404] According to this view, bankruptcy was a "judgment *in rem*:

397. *See* U.S. CONST. amend. 11 (stating that "[t]he Judicial power of the United States shall not be construed to extend to any suit in law or equity, commenced or prosecuted against one of the United States by Citizens of another State, or by Citizens or Subjects of any Foreign State").

398. *See supra* notes 190-95, 206 and accompanying text.

399. Alden v. Maine, 537 U.S. 706, 727 (1999) (quoting Hans v. Louisiana, 134 U.S. 1, 14 (1890)).

400. *Alden*, 537 U.S. at 728.

401. Idaho v. Couer d'Alene Tribe, 521 U.S. 261, 270 (1997).

402. Vazquez, *supra* note 221, at 868.

403. *See* U.S. CONST. amend. XI.

404. 2 LAWRENCE P. KING, COLLIER ON BANKRUPTCY ¶ 301.07, at 301-15 (15th ed., rev. 2000). *See also* Chicot County Drainage Dist. v. Baxter St. Bank, 308 U.S. 371 (1940); Myers v. Int'l Trust Co., 263 U.S. 64 (1923); Gratiot County St. Bank v. Johnson, 249 U.S. 246 (1919).

a determination of the debtor's status as bankrupt, binding upon all parties in interest, whether or not they appeared in the proceedings for adjudication."[405] While Congress abandoned the adjudicative feature in voluntary bankruptcy in the 1978 Act,[406] the filing of a bankruptcy petition now has "the same far reaching effect" as an adjudication under the Act[407] because the petition itself contains the "order for relief."[408] In other words, the commencement of the bankruptcy case is, in fact, a "suit."[409]

While the Fourth Circuit may wish it were not so, the new federalism represents an important shift of power away from Congress and federal courts to the states. Courts, like the Fourth Circuit, considering the bankruptcy implications of the new federalism have been understandably reluctant to carry this power to the logical conclusion that the claims of nonconsenting states should be immune from subordination or discharge in a Chapter 11 reorganization. Yet, the methods they have so far adopted are outmoded, formalistic, and unpersuasive. The real problem, as discussed in Part V, is that the competing fictions of the new federalism and the countervailing doctrines discussed above render the entire legal framework highly unstable. This instability will create real costs in a tobacco company bankruptcy.

V. REALISTIC PROBLEMS AND REALISTIC SOLUTIONS

When one scrutinizes the new federalism and the countervailing doctrines, it becomes apparent that the entire legal framework for bankruptcy reorganizations involving significant state claims is now highly unstable. If the analysis in Part IV of this Article is correct, a bankruptcy judge can find doctrinal support for virtually any result he or she would like to see in a Chapter 11 reorganization involving significant state claims. This instability

405. 2 LAWRENCE P. KING, COLLIER ON BANKRUPTCY ¶ 301.07, at 301-15.

406. *See* S. REP. NO. 95-989, at 31 (1978), *reprinted in* 1978 U.S.C.C.A.N. 2549, 2558 ("The term adjudication is replaced by a less pejorative phrase in light of the clear power of Congress to permit voluntary bankruptcy without the necessity for an adjudication, as under the 1898 [A]ct, which was adopted when voluntary bankruptcy was a concept not thoroughly tested.").

407. *See* KING, *supra* note 404, ¶ 301.07, at 301-15.

408. 11 U.S.C. § 301 (1994).

409. As discussed *supra* note 308, the nonsuit and *in rem* doctrines would appear to be in tension. Another argument is that Congress viewed the subordination and discharge of claims in a Chapter 11 plan as a kind of "suit" that required abrogation in § 106(b) of the Bankruptcy Code. Bankruptcy Code § 106(b) abrogates immunity as to both §§ 364 and 1141 of the Bankruptcy Code. *See* 11 U.S.C. § 106(b) (1994). *See also supra* Part IV.A.1. If the nonsuit doctrine is correct, Congress needlessly abrogated immunity from these provisions because they do not create "suits" in the first place. Abrogation would thus not only be ineffective under, for example, *Seminole Tribe*, but also surplusage.

may be an unfortunate effect of change in the law, but it will have concrete and costly consequences in Chapter 11 cases, where the most important matters are settled, not litigated. This Part suggests that courts, and the Supreme Court in particular, could correct this instability by confronting the fictions of the new federalism and its countervailing doctrines, and recognizing a constitutional basis for a bankruptcy exception to the new federalism superior to the power of states under the new federalism.

A. Realistic Problems—Distorted Settlements

Reorganization under Chapter 11 is essentially a negotiated process.[410] Chapter 11 negotiations are premised on the complex proposition that value can be maximized for all stakeholders in a debtor if the debtor is given a reasonable opportunity to restructure its affairs.[411] When it enacted Chapter 11 in 1978, Congress reasoned that "it is more economically efficient to reorganize than liquidate [a debtor], because [reorganization] preserves jobs and assets."[412] Moreover, valuing a large, complex business for reorganization purposes is difficult and expensive[413]—"'a guess compounded by an estimate.'"[414] Steven Schwarcz has observed that "[t]he genius of bankruptcy reorganization law is that it provides incentives for debtors and their creditors, notwithstanding their disparate interests, to reach a voluntary agreement on the terms of the restructuring."[415] The new federalism applied

410. *See, e.g.*, Bank of Am. Nat'l Trust & Sav. Ass'n v. 203 N. LaSalle St. P'ship, 526 U.S. 434, 458 n.28 (1999) (holding that "'the Chapter 11 process relies on creditors and equity holders to engage in negotiations toward resolution of their interests'") (quoting G. Eric Brunstad, Jr., Mike Sigal, & William H. Schorling, *Review of the Proposals of the National Bankruptcy Review Commission Pertaining to Business Bankruptcies: Part I*, 53 BUS. LAW 1381, 1405-06 n.136 (1998)); Richard Broude, *Cramdown and Chapter 11 of the Bankruptcy Code: The Settlement Imperative*, 39 BUS. LAW. 441 (1984); Kenneth Klee, *Cram Down II*, 64 AM. BANKR. L.J. 229 (1990); LoPucki & Whitford, *supra* note 93, at 126 ("Current law provides a complex legal environment in which representatives of thousands of creditors and shareholders bargain over the disposition of billions of dollars in assets. Adjudication of cases within that environment is thought to be virtually impossible.").

411. *See In re* Winshall Settlor's Trust, 758 F.2d 1136, 1137 (6th Cir. 1985) ("The purpose of Chapter 11 reorganization is to assist financially distressed business enterprises by providing them with breathing space in which to return to a viable state.").

412. *See* H.R. REP. NO. 595, at 220 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6179 ("The premise of a business reorganization is that assets that are used for production in the industry for which they were designed are more valuable than those same assets sold for scrap."); 123 CONG. REC. H35,444 (daily ed. Oct. 27, 1977) (statement of Rep. Rodino) ("For businesses, the bill facilitates reorganization, protecting investments and jobs."). *See also* MARTIN J. BIENENSTOCK, BANKRUPTCY REORGANIZATION 6-10 (1987).

413. *See* LoPucki & Whitford, *supra* note 93, at 130.

414. Peter Coogan, *Confirmation of a Plan Under the Bankruptcy Code*, 32 CASE W. RES. L. REV. 301, 313 n.72 (1982) (citing statement in H.R. REP. No. 595, at 225 (1978), *reprinted in* 1978 U.S.C.C.A.N. 6181, 6184).

415. Steven L. Schwarcz, *Sovereign Debt Restructuring: A Bankruptcy Reorganization Approach*,

to bankruptcy reorganization is offensive because even if a court rejects it, the new federalism remains a tempting source of leverage for states seeking a better negotiated deal than they would otherwise receive when they, like private tort creditors, simply hold unsecured personal injury claims.

The new federalism thus destabilizes the intense and highly strategized negotiations that occur in Chapter 11 reorganizations.[416] In this context, instability has several meanings.[417] First, to the extent that *Seminole* broke sharply with the past, the judgment created inconsistent decisions and values. Frank Easterbrook characterizes these inconsistent decisions as the "most powerful challenge to the Court as [an] institution."[418] Moreover, the viability of the new federalism may depend upon the identity of individual members of the Court. Five Justices—Kennedy, O'Connor, Rehnquist, Scalia, and Thomas—created the new federalism.[419] Replacing one of those five Justices with a Justice holding a different view of state power could eliminate the new federalism or remove what the dissenting four Justices—Breyer, Ginsburg, Souter, and Stevens—find so offensive.[420] Thus Professor Althouse has observed that "[a]nother one-vote shift could easily . . . consign this year's *Alden* symposia to the dustbin of legal scholarship."[421]

This instability also leaves unclear the contours of the new federalism and its countervailing doctrines. Since the Court's posture regarding state

85 CORNELL L. REV. 956, 959 (2000). As discussed *supra* Part III.B.2, different parties will have different incentives. In the case of management of the DIP, these incentives include the fear of losing control of the company if creditors seek the appointment of a trustee or the liquidation of the DIP. In the case of creditors, these incentives include the fear that a plan of reorganization will be "crammed down" such that the rights of dissenting junior creditors or interest holders will be eliminated.

416. *See* Klee, *supra* note 6, at 1535 ("*Seminole Tribe* and *Alden* have the effect of undermining a key purpose of the federal bankruptcy laws by altering the priorities legislated by Congress to elevate states to preferred positions relative to other creditors.").

417. Scholars of various stripes have analyzed the nature and implications of unstable doctrine. *See, e.g.*, Frank Easterbrook, *Ways of Criticizing the Court*, 95 HARV. L. REV. 802, 815-17 (1982); Roberto Unger, *The Critical Legal Studies Movement*, 96 HARV. L. REV. 561 (1983). *See also* Daniel A. Farber, *The Coase Theorem and the Eleventh Amendment*, 13 CONST. COMMENTARY 141, 142-43 (1996) (arguing that difficulties of legislative process may impede ability of Congress and states to "bargain" over waiver of sovereign immunity).

418. Easterbrook, *supra* note 417, at 803.

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

420. *See id.* While the recent decision in *Bush v. Gore* may offer no rule of law applicable to larger questions of federalism, it suggests that federalism is a value inconsistently invoked by the Court. 121 S. Ct. 525 (2000). Thus, while the Court has typically resisted second-guessing a state court's interpretation of its own law, on federalism and comity grounds, *id*. at 548 (Ginsburg, J., dissenting) (stating that "[r]arely has this Court rejected outright an interpretation of state law by a state high court"), the "extraordinary setting of this case," *id*. at 549, apparently justified the departure. It may be the case that *Bush v. Gore*'s absence of principle further destabilizes federalism jurisprudence, since it will be difficult to know when a case is sufficiently extraordinary to warrant abandoning the values of the new federalism.

421. Althouse, *supra* note 246, at 685.

sovereign immunity is no longer tied to any constitutional text,[422] the scope of state sovereign immunity and power is whatever five Justices say it is. Under the current Court's framework, state sovereign immunity and power have no obvious stopping point. Moreover, the countervailing doctrines are little help, because they trade on feeble and unconvincing procedural distinctions. As discussed above in Part IV.C, the Court may soon extinguish *Ex parte Young*.[423] The *in rem* doctrine may have made sense in the context of liquidations, but the doctrine cannot be supported in the context of complex reorganizations.[424] Similarly, the nonsuit doctrine turns on fine procedural distinctions and ignores the real economic impact of the subordination and discharge of state claims.[425]

Most likely, lower courts will not effectively resolve this instability in Chapter 11 reorganizations. Unlike the contexts in which the doctrine of sovereign immunity and its exceptions have so far been litigated,[426] disputes in Chapter 11 reorganizations are almost always resolved in the "shadow of the law."[427] Where the borders of that shadow are fuzzy, it becomes very difficult to come to fair and equitable settlements. The reorganization provisions of the Bankruptcy Code are designed to create predictable priorities that give interested parties a framework within which to negotiate. The doctrinal instability of the new federalism is thus especially painful in

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422. *See* Alden v. Maine, 527 U.S. 706, 728 (1999) ("[S]overeign immunity derives not from the Eleventh Amendment but from the structure of the original Constitution itself.").

423. *See, e.g.,* Fletcher, *supra* note 303, at 852.

424. *See supra* Part IV.C.2.

425. *See supra* Part IV.C.3.

426. *See* Pfander, *supra* note 226, at 1274 ("Eleventh Amendment scholarship has tended to regard the problem of enforcing state compliance with federal law as something that, though nettlesome, remained well within the capacity of the well-represented litigant.") (citing John C. Jeffries, Jr., *In Praise of the Eleventh Amendment and Section 1983*, 84 VA. L. REV. 47, 81 (1998)).

427. *See* Leandra Lederman, *Which Cases Go to Trial?: An Emprical Study of Predictors of Failure to Settle*, 49 CASE W. RES. L. REV. 315, 358 (1999) (citing Russell Korobkin & Chris Guthrie, *Psychological Barriers to Litigation Settlement: An Experimental Approach*, 93 MICH. L. REV. 107, 117 (1994)). One author has offered the following view of settlement negotiations in Chapter 11 reorganizations:

> Another possible explanation for the low settlement rates, however, might be advanced. Parties will go to court only if the outcome of litigation is uncertain: it must either be the case that their expectations about the results of trial conflict, or that one or both parties lack clear expectations about the result. One might, then, explain the low settlement rates by saying that Chapter 11 litigation is substantially more uncertain than other types of litigation. Higher levels of certainty in other areas of the law produce higher settlement rates. Settlement rates in the financial distress context may be low simply because the parties bargain in the shadow of bankruptcy law. Without firm expectations about their bankruptcy shares, the parties have may have insufficient information to negotiate.

Claire Finkelstein, *Financial Distress as a Noncooperative Game: A Proposal for Overcoming Obstacles to Private Workouts*, 102 YALE L.J. 2205, 2211 (1993).

the Chapter 11 context. The fictions of the new federalism and the three countervailing doctrines potentially take state claims under, for example, the MSA, out of this framework of predictable priorities. In cases where debtors have significant claims of this sort, parties will find it difficult, if not impossible, to strategize and negotiate intelligently in the reorganization. Parties interested in a tobacco company bankruptcy, for example, could still negotiate an agreement as to DIP financing or a plan of reorganization, but the new federalism injects a new order of speculation into the process. Unless one knows for certain whether state claims are even part of the framework, it is difficult to know whether or how a bankruptcy court would subordinate or discharge them in a bankruptcy reorganization. Given the unique pressures of reorganization under Chapter 11, a tobacco company debtor would find it difficult to resist settling with an aggressive attorney general, presumably on better terms than would be available to individual holders of personal injury tort claims.

B. Realistic Solutions—A Constitutional Bankruptcy Exception

States with substantial nontax claims may or may not inevitably receive preferential treatment. Some argue that the new federalism poses no real threat to reorganization under Chapter 11.[428] Others suggest that, if there is a problem, it is one Congress[429] or courts[430] can easily fix. These positions, however, ignore the essence of the new federalism—state power. Rather than "tip-toe"[431] around the issue of power, courts should recognize that the uniformity requirement of the Bankruptcy Clause creates a basis for limiting the new federalism in Chapter 11 reorganizations.[432] The merits of uniformity within and across bankruptcies should trump the force of the new federalism and render unnecessary the weak countervailing doctrines.

Prior to the new federalism, the Supreme Court had little trouble respecting Congress's constitutional power to vest bankruptcy jurisdiction in the federal courts, relying upon Congress's power under Article I "[t]o

428. *See* Leib, *supra* note 6, at 330 ("State sovereignty is not offended by a principle under which a bankruptcy court can determine all disputes involving the *res* and resolve the competing claims and interests of all creditors, including a state with respect to property of the estate.") (citations omitted).

429. *See* Klee, *supra* note 6, at 1578.

430. *See, e.g.*, Gershon, *supra* note 6, at 26-30 (arguing that the Supreme Court should recognize the bankruptcy exception through *in rem* or *Ex parte Young* doctrines).

431. NVR Homes, L.P., v. Clerks of the Circuit Courts (*In re* NVR, L.P.), 189 F.3d 442, 453 (4th Cir. 1999) (accusing district court of ducking sovereign immunity problems).

432. The question of whether more traditional debtor litigation against states—framed as adversary proceedings, contested matters, or otherwise—should also be effective against states on this theory has not been addressed in this Article.

establish . . . uniform Laws on the subject of Bankruptcies throughout the United States."[433] Professor Ralph Brubaker has observed that historically the role of "bankruptcy has been to provide a centralized mechanism for collection of a debtor's assets and distribution of those assets among all of the debtor's creditors."[434] In addition, with bankruptcy performing this centralizing function in courts rather than in administrative offices, "it is perfectly logical to conclude that congressional power to enact uniform national bankruptcy 'laws' necessarily, and even primarily, envisions the power to place adjudication of all disputes incident to administering bankruptcy estates in federal court."[435]

The new federalism's bow to state power should not displace this long-standing view. First, and most obviously, the Bankruptcy Clause is an enumerated power granted to Congress in Article I that is supposed to be supreme.[436] Second, the uniformity requirement should mean that states receive the same deal as other similarly situated creditors. In the Supreme Court's first interpretation of the Bankruptcy Clause, *Sturges v. Crowninshield*,[437] Chief Justice Marshall observed that "[t]he peculiar terms of the grant [of bankruptcy power] certainly deserve notice" because "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."[438] Uniformity in the bankruptcy context has generally meant uniformity of geographic application, such that bankruptcy law should apply in the same way across states, notwithstanding variations of state law.[439] The question then becomes whether the "special bankruptcy problem[] of uniformity"[440] means uniformity of result.

There is certainly support for the view that uniformity in the Bankruptcy

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433. U.S. CONST. art. I, § 8, cl. 4. *See, e.g.*, Textile Workers Union v. Lincoln Mills, 353 U.S. 448, 483-84 (1957) (Frankfurter, J., dissenting); Nat'l Mut. Ins. Co. v. Tidewater Transfer Co., 337 U.S. 582, 594-99 (1949) (Jackson, J., plurality opinion); Williams v. Austrian, 331 U.S. 642, 652 n.24 (1947); Kalb v. Feuerstein, 308 U.S. 433, 439 (1940); Schumacher v. Beeler, 293 U.S. 367, 374 (1934); Taubel-Scott-Kitzmiller Co. v. Fox (*In re* Cowen Hosiery Co.), 264 U.S. 426, 430 (1924).

434. *See* Brubaker, *supra* note 64, at 807. *See also* Hanover Nat'l Bank v. Moyses, 186 U.S. 181, 186 (1902) (stating that the Bankruptcy Power "extends to all cases where the law causes to be distributed, the property of the debtor among his creditors; this is its least limit") (quoting *In re* Klein, 14 F. Cas. 716, 718 (C.C.D. Mo. 1843) (No. 7865) (Catron, Circuit Justice)).

435. Brubaker, *supra* note 64, at 807 (citations omitted).

436. U.S. CONST. art. I, § 8, cl. 4; *id*. art. VI, cl.2.

437. 17 U.S. (4 Wheat.) 122 (1819).

438. *Id.* at 193-94.

439. *See, e.g.*, Vanston Bondholders Protective Comm. v. Green, 329 U.S. 156, 166 n.9 (1946) (Frankfurter, J., concurring); *Moyses*, 186 U.S. at 186. *See also* Judith Schenck Koffler, *The Bankruptcy Clause and Exemption Laws: A Reexamination of the Doctrine of Geographic Uniformity*, 58 N.Y.U. L. REV. 22, 59-62 (1983).

440. *Vanston*, 329 U.S. at 166 n. 9 (Frankfurter, J., concurring).

Clause requires uniformity of result. In *Railway Labor Executive v. Gibbons*, for example, the Court struck down last-minute congressional legislation intended to save the bankrupt Chicago, Rock Island, and Pacific Railroad Company from liquidation under the Bankruptcy Act of 1898 on uniformity grounds.[441] In *Gibbons*, the Court, in an opinion by Justice Rehnquist, held that the Rock Island Railroad Transition and Employee Assistance Act (RITA) violated the uniformity requirement as a law benefiting only a single debtor.[442] In striking the law as analogous to a "private bankruptcy bill,"[443] Justice Rehnquist observed:

> *Only* Rock Island's creditors are affected by RITA's employee protection provisions. . . . Unlike the situation in the [Regional Railroad Reorganization Act Cases],[444] there are other railroads that are currently in reorganization proceedings, but these railroads are not affected by the employee protection provisions of RITA. The . . . provisions of RITA cover neither a defined class of debtors nor a particular type of problem, but a particular problem of one bankrupt railroad. . . . RITA is nothing more than a private bill such as those Congress frequently enacts under its authority to spend money.[445]

If the new federalism reaches Chapter 11 reorganizations, states would be the only creditors entitled to exempt their claims from the process, simply by virtue of their status. If, as in *Gibbons*, uniformity means that all similarly situated debtors must be treated alike, the same should hold true for all

441. 455 U.S. 457, *reh'g denied*, 456 U.S. 924 (1982).

442. Pub. L. No. 254, 94 Stat. 399 (codified as amended at 45 U.S.C. §§ 1001-18 and scattered sections of Title 45 (Supp. IV 1980)).

443. Some view the uniformity language of the Bankruptcy Clause as intended to forbid state legislation discharging individual debts (known as "private bankruptcy bills"). Professor Koffler explains:

> The [*Gibbons*] Court found that the word 'uniform' was included in the bankruptcy clause to curb a particular abuse on the part of the states: the enacting of private bankruptcy bills. Several states had engaged in this practice prior to the drafting of the Constitution to the prejudice of commercial interests. Questions had arisen over whether the courts of one state were required to recognize the relief thus provided to the debtor by the private act of another state. The resulting confusion, together with the fact that some states had treated British creditors with disfavor, led Justice Rehnquist to conclude that the "uniformity requirement was drafted in order to prohibit Congress from enacting private bankruptcy laws."

Schenck Koffler, *supra* note 439, at 56-57 (quoting Railway Labor Executives' Ass'n v. Gibbons, 455 U.S. 457, 472 (1982)). *See also* Kurt H. Nadelmann, *On the Origin of the Bankruptcy Clause*, 1 AM. J. LEGAL HIST. 215 (1957) (discussing full faith and credit problems created by private state bankruptcy discharges).

444. *See* 419 U.S. 102 (1974).

445. 455 U.S. at 470-71 (emphasis in original).

creditors within the framework established by the Bankruptcy Code.[446] Taking state claims out of the bankruptcy process by providing states immunity portends either a better settlement than these claims would otherwise deserve—which at some point becomes a slap at uniformity—or likely results in the liquidation of otherwise viable businesses. The new federalism should not entitle states to become the ultimate "holdouts" if we care about uniformity of result.[447]

Private personal injury creditors of the tobacco company debtor will have claims that derive largely from the same conduct as those leading to the states' MSA claims—the manufacture and sale of cigarettes. Private tort plaintiffs should not be forced to accept inferior treatment for claims that are essentially identical to those of the states under the MSA (probably unsecured, nonpriority claims).[448] If uniformity means anything, it means the same treatment for the same kinds of claims, whether or not they are held by states.[449]

The logic of the new federalism should tolerate this approach. At least part of the Court's motivation for decisions, such as *Lopez* and *Morrison*, was to remedy what it viewed as Congress's failure to consider carefully the role and needs of states. Thus, the *Lopez* majority reasoned that "[t]o uphold the Government's contention[]" that the possession of handguns near schools affected interstate commerce, the Court "would have to pile inference upon inference."[450] One need not pile inference upon inference, however, to conclude that the Bankruptcy Code protects legitimate spheres of state

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446. *See also* Schenck Koffler, *supra* note 439, at 59 (suggesting that "the Framers intended the bankruptcy power to be exercised to enact only those laws . . . that would be uniformly applicable across the nation").

447. *See* Douglas G. Baird, THE ELEMENTS OF BANKRUPTCY 73 (1992); Finkelstein, *supra* note 427, at 2221-29 (discussing holdout problem in bankruptcy); Mark J. Roe, *The Voting Prohibition in Bond Workouts*, 97 YALE L.J. 232, 236-39 (1987).

448. That, at least, is how Professors Dagan and White would characterize the claims. *See* Dagan & White, *supra* note 21, at 380 ("It seems likely that the states' claims would be treated as mine-run unsecured claims, requiring the states to compete with individual smokers.").

449. *See also* Cent. Bank of Akron v. Ambrose (*In re* Ambrose), 4 B.R. 395, 398 (Bankr. N.D. Ohio 1980) ("The uniformity which is required by the Constitution relates to the law itself and not to its results upon the varying rights of debtor and creditor under the laws of the several states.") (citing Thomas v. Woode, 173 F. 585, 591-92 (8th Cir. 1909)). "Uniformity" is most frequently considered in the context of exemptions. Bankruptcy Code § 522 sets forth a complex regime under which states can elect to permit their citizens who file for bankruptcy to use state law exemptions or the exemptions set forth in the Bankruptcy Code. *See* 11 U.S.C. § 522(b) (1994). Because corporations are not entitled to the benefit of exemption statutes, which exempt certain property of the debtor from becoming estate property under Bankruptcy Code § 541, or from the property being attached by judgment creditors, analysis of uniformity in this context is useful only by analogy. Thus, while the *Moyses* Court enunciated a rule permitting state variation in exemption rules, it really said little about the need for uniformity of result across state lines. *See* Schenck Koffler, *supra* note 439, at 83-84.

450. United States v. Lopez, 514 U.S. 549, 567 (1995). *See also* discussion *supra* Part IV.B.1.

power. The Bankruptcy Code goes to great lengths to protect state tax claims from subordination or discharge.[451] Such claims are not only the economic lifeblood of the states but may also reflect a level of political legitimacy and accountability absent from contractual claims, such as those in the MSA.

At a higher level of generality, the Bankruptcy Code's protection of state tax claims could be said to parallel a distinction recognized by the Court in *National League of Cities v. Usery*.[452] In *Usery*, the Court struck down amendments to the Fair Labor Standards Act (FLSA) that had extended federal minimum wage and maximum hour provisions to state and municipal employees.[453] There, the Court acknowledged that the FLSA regulations were "undoubtedly within the scope" of the commerce power,[454] but congressional exercise of that power had unconstitutionally interfered with the integrity of the states and their "ability to function effectively in a federal system."[455] In other words, the fatal constitutional flaw was not that the wages and hours of state employees failed to affect interstate commerce, but rather that wage and hour determinations with respect to those employees were so "essential"[456] to state sovereignty that they were beyond the reach of federal regulatory authority.[457]

The Court rejected this approach as "unworkable" in *Garcia v. San Antonio Metropolitan Transit Authority*.[458] The *Garcia* Court stated that it was "difficult, if not impossible,"[459] to distinguish between "traditional" activities such as regulating ambulance services,[460] licensing automobile drivers,[461] operating a municipal airport,[462] performing solid waste disposal,[463] and operating a highway authority,[464] and "nontraditional" state activities, such as issuing industrial development bonds,[465] regulating

451. *See supra* Part III.

452. *See* 426 U.S. 833 (1976).

453. *Id*. at 852.

454. *Id*. at 841.

455. *Id*. at 843 (quoting Fry v. United States, 421 U.S. 542, 547 (1975)).

456. *Id*. at 845.

457. The *Usery* Court, therefore, overruled *Maryland v. Wirtz*, 392 U.S. 183 (1968), to the extent *Wirtz* upheld the extension of the FLSA to employees of state hospitals, schools, and institutions. *Usery*, 426 U.S. at 840.

458. 469 U.S. 528, 531 (1985).

459. *Id*. at 539.

460. *Id.* at 538 (citing Gold Cross Ambulance v. City of Kan. City, 538 F. Supp. 956, 967-69 (W.D. Mo. 1982), *aff'd on other grounds*, 705 F.2d 1005 (8th Cir. 1983)).

461. *Id*. at 538 (citing United States v. Best, 573 F.2d 1095, 1102-03 (9th Cir. 1978)).

462. *Id.* at 538 (citing Amersbach v. City of Cleveland, 598 F.2d 1033, 1037-38 (6th Cir. 1979)).

463. *Id.* at 538 (citing Hybud Equip. Corp. v. City of Akron, 654 F.2d 1187, 1196 (6th Cir. 1981)).

464. *Garcia*, 469 U.S. at 538 (citing Molina-Estrada v. P.R. Highway Auth., 680 F.2d 841, 845-46 (1st Cir. 1982)).

465. *Id*. at 538 (citing Woods v. Homes & Structures of Pittsburg, Kan., Inc., 489 F. Supp. 1270,

intrastate natural gas sales,[466] regulating traffic on public roads,[467] regulating air transportation,[468] operating a telephone system,[469] leasing and sale of natural gas,[470] operating a mental health facility,[471] and providing in-house domestic services for the aged and handicapped.[472] In the case of the particular activity and law in *Garcia*—applying FLSA to municipal transit employees—lower courts were split.[473]

As the Court now recognizes sovereign powers in the states in a way unprecedented since before the New Deal, it may be time to revive the *Usery* distinction, at least for purposes of determining whether state claims are subject to subordination or discharge in a Chapter 11 reorganization.[474] Justice Breyer recognized the need to make this distinction in *College Savings Bank v. Florida Prepaid*,[475] arguing in dissent that a state should be subject to suit when it "engages in ordinary commercial ventures . . . like a private person."[476] Congress would not be able to use its Article I powers to reach a state when it acts in "the area of its 'core' responsibilities, and in a way unlikely to prove essential to the fulfillment of a basic governmental obligation."[477] Fortunately, the Bankruptcy Code recognizes this distinction,

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1297 (D. Kan. 1980)).

466. *Id.*, 469 U.S. at 538 (citing Oklahoma *ex rel*. Derryberry v. FERC, 494 F. Supp. 636, 657 (W.D. Okla. 1980), *aff'd*, 661 F.2d 832 (10th Cir. 1981)).

467. *Id*. at 538 (citing Friends of the Earth v. Carey, 552 F.2d 25, 38 (2d Cir. 1977)).

468. *Id*. at 538 (citing Hughes Air Corp. v. Public Util. Comm'n of Cal., 644 F.2d 1334, 1340-41 (9th Cir. 1981)).

469. *Id*. at 538 (citing P.R. Tel. Co. v. FCC, 553 F.2d 694, 700-01 (1st Cir. 1977)).

470. *Garcia*, 469 U.S. at 538 (citing Public Serv. Co. of N.C. v. FERC, 587 F.2d 716, 721 (5th Cir. 1979)).

471. *Id.* 469 U.S. at 538-39 (citing Williams v. Eastside Mental Health Ctr., Inc., 669 F.2d 671, 680-81 (11th Cir. 1982)).

472. *Id*. at 539 (citing Bonnette v. Calif. Health & Welfare Agency, 704 F.2d 1465, 1472 (9th Cir. 1983)).

473. *Compare Garcia*, 469 U.S. at 530 & n.1, *with* Kramer v. New Castle Area Transit Auth., 677 F.2d 308 (3d Cir. 1982). *Compare* Francis v. City of Tallahassee, 424 So. 2d 61 (Fla. Dist. Ct. App. 1982), *with Garcia*, 469 U.S. at 535 (citing a lower court opinion at 557 F. Supp. 445 (W.D. Tex. 1983)). *See also* United Transp. Union v. Long Island R.R. Co., 455 U.S. 678, 685 (1982) (holding that commuter rail service provided by state-owned Long Island Railroad Company did not constitute a "traditional governmental function" and thus was not immune activity under *Usery*).

474. *See* Fletcher, *supra* note 303, at 855 ("The distinction between sovereign actions and commercial actions turns out to be critical to Eleventh Amendment jurisprudence . . . .").

475. 527 U.S. 666 (1999).

476. *Id.* at 694 (Breyer, J., dissenting).

477. *Id*. Ann Althouse has observed that in this context choice becomes important, asserting "that a state acts in its 'core' area of basic governmental functions because it *must* act, so no inference of waiver can arise; but when the state moves beyond this 'core,' it is making a choice, and it becomes acceptable for Congress to attach a condition." Althouse, *supra* note 246, at 662-63. This analysis is not necessarily helpful in the context of the MSA, however, because the MSA tells us nothing about when, if ever, the compulsion occurred.

permitting subordination or discharge based on whether a state claim is a "tax" claim—not whether it is a claim that happens to be held by a state.[478]

VI. CONCLUSION

To take the new federalism seriously is to recognize the limits of federal court power over states and their claims. While the new federalism may rest on anachronistic fictions, it is unlikely that even its proponents believe it should exempt states from the subordination and discharge of claims that ordinarily occurs in Chapter 11 reorganizations. Yet, without an equally powerful constitutional answer to the new federalism, the treatment of state claims, such as the state claims in the MSA, is highly uncertain and creates an instability that will likely give states better treatment than similarly situated creditors. We can do better than fight the fictions of the new federalism with the fictions of the *Ex parte Young*, *in rem*, and nonsuit doctrines. We should instead confront the new federalism head on, and recognize that Congress's scheme for bankruptcy reorganization is sufficiently sensitive to legitimate state needs to withstand even the most severe limits on judicial power over states. The language and purpose of the Bankruptcy Clause—in particular, its emphasis on uniformity—should form an exception to the expansive vision of state power that the Court seems generally to embrace. The bankruptcy process, and its many participants, deserve this much.

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478. *See* 11 U.S.C. §§ 507(a)(8), 523(a)(1) (1994). *See also supra* Part III.B.