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Bankruptcy

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BANKRUPTCY

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JURISDICTION

All developments in the bankruptcy field this year were overshadowed by the Supreme Court's opinion in *Northern Pipeline Construction Co. v. Marathon Pipeline Co.*,[1] declaring unconstitutional the broad grant of jurisdiction to bankruptcy judges in the Bankruptcy Reform Act of 1978.[2] The decision at least temporarily creates great uncertainty in the administration of the Bankruptcy Act and for the long run creates considerable doubt about the ability of Congress to establish a unitary system for the administration of bankrupt estates and the development of bankruptcy law.

The *Northern Pipeline* decision arose from the reorganization of Northern Pipeline under Chapter 11 of the Act.[3] After its petition for reorganization was filed, Northern Pipeline filed in the bankruptcy court a complaint against Marathon Pipeline alleging breaches of contract and warranty, misrepresentation, coercion, and duress.[4] The power of a bankruptcy court to hear a claim based on state law between a bankrupt and another party derives from section 241 of the Bankruptcy Act.[5] It provides:

> (b) . . . the district courts shall have original but not exclusive jurisdiction of all civil proceedings arising under Title 11 or arising in or related to cases under Title 11.
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> (c) The bankruptcy court for the district in which a case under Title 11 is commenced shall exercise all of the jurisdiction conferred by this section on the district courts.

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1. 102 S. Ct. 2858 (1982).
2. Pub. L. 95-598, 92 Stat. 2549 (codified in scattered sections of 11 & 28 U.S.C.).
3. 11 U.S.C. §§ 1101-1174 (Supp. II 1978). Unlike the old Bankruptcy Act, which contained several different forms of reorganization for different types of debtors, *see* D. EPSTEIN, DEBTOR-CREDITOR LAW IN A NUTSHELL 279 (West 1980), the new Act contains one unified chapter for all reorganizations, chapter 11. It is available to nearly all debtors except stockbrokers and commodity brokers.
4. 102 S. Ct. at 2858 & 2864. Under the Act, a debtor in a reorganization proceeding remains in possession of its business until ousted by the appointment of an independent trustee. 11 U.S.C. § 1104. This action was initiated by Northern Pipeline as plaintiff as though no bankruptcy had occurred.
5. Codified as amendments to title 28 of the U.S. Code, 28 U.S.C. § 1471 (Supp. II 1978).

Since the claim of Northern Pipeline was "related to" a case under Title 11, it was within this jurisdictional grant.[6]

This broad grant of power to bankruptcy judges was the basis of Marathon's motion to dismiss Northern's complaint on the ground that the statute conferred article III judicial power, that is, power to hear a case arising under a federal statute, on judges who were not given article III protection, *i.e.*, life tenure and protection from diminution of salary while in office.[7] Bankruptcy judges do not have these article III protections under the 1978 Act. They are appointed only for fourteen-year terms, they can be removed from office,[8] and their salary can be adjusted according to provisions of the Federal Salary Act of 1967.[9] In addition, during an interim transitional period the bankruptcy judges would serve only until March 31, 1984.[10]

Marathon's objection to the bankruptcy court's jurisdiction was based on the premise that if its rights were to be determined by a federal judge, it should be a judge with the protection envisioned by article III of the Constitution.[11] This was not an objection unanticipated by the drafters of the 1978 Bankruptcy Act. Indeed, the House of Representatives considered possible objections to limited-tenure bankruptcy judges and determined to obviate the objections by making all such judges "article III judges," *i.e.*, insulated by the article

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6. The leading treatise on the Bankruptcy Act interprets this language as requiring some "nexus" between the asserted claim and the bankruptcy case, such as "whether the outcome of the proceeding could conceivably have any effect upon the estate being administered." 1 COLLIER ON BANKRUPTCY § 3.01[1][e], at 3-46 (L. King 15th ed. 1982) [hereinafter cited as COLLIER]. It is difficult to imagine an action between a debtor and a third party which would not satisfy this standard, either by augmenting the estate or qualifying the third party to participate in the ultimate distribution of assets or in the reorganization plan.

7. Article III of the United States Constitution gives to the federal government judicial power over all cases "arising under this Constitution, [and] the Laws of the United States" and provides that this power shall be exercised by the Supreme Court "and in such inferior Courts as the Congress may from time to time ordain and establish." The judges of these inferior courts were to be insulated from political pressure by life tenure and a guarantee that their salaries could not be diminished while they served.

8. 28 U.S.C. § 153. Causes for removal include incompetence, misconduct, neglect of duty, and physical or mental inability. *Id.*

9. 28 U.S.C. § 154. The Federal Salary Act appears at 2 U.S.C. §§ 351-361 (1976). It creates a federal commission for the review of salaries of federal employees, including judges. Although probably intended to make recommendations for salary *increases*, there appears to be nothing in the Act which prohibits a recommended *decrease* in such salaries. In addition, the salary of bankruptcy judges are also adjustable under 28 U.S.C. § 461(b), which expressly contemplates a decrease in compensation.

10. 28 U.S.C. prec. § 151 (Supp. II 1978).

11. 102 S. Ct. at 2864.

III protections.[12] A simultaneously passed Senate bill[13] did not take this approach, and the Senate position prevailed in the conference report and was approved by both houses.[14] The Senate approach to this problem was to vest all bankruptcy jurisdiction in district courts and then through the district courts to the bankruptcy courts.[15] This cumbersome approach, rather than a direct delegation of jurisdiction to the bankruptcy courts, was designed expressly to allay Congress' perception of "substantial constitutional problems [which] surrounded the grant of expanded jurisdiction to the non-tenured bankruptcy court. . . ."[16] In addition, in creating bankruptcy courts, Congress declared them "an adjunct of the district court,"[17] again in an effort to avoid the constitutional problem.[18]

Against this background, the issue came before the Supreme Court in the *Northern Pipeline* case. There were two arguments advanced by Northern Pipeline[19] in support of the bankruptcy court jurisdiction. First, since Congress has the power to create substantive law relating to bankruptcy under article I of the Constitution,[20] it has the power under article I to determine how such rights and liabilities shall be determined, *i.e.*, to create what have become known as "article I" or "legislative courts."[21] Second, Northern Pipeline argued that the dispute was heard by an article III court, since the bankruptcy jurisdiction was vested in the district courts and the bankruptcy courts merely operated as adjuncts of these courts. Both of these arguments raised questions which the Court had addressed in earlier opinions, but for various reasons it had either been unable to assemble clear majorities to clarify doctrine or had not defined the limits of congressional power to make exceptions to article III.

The plurality opinion[22] first addressed the question of whether bankruptcy courts could survive as article I, or legislative, courts and attempted to limit this article III exception to three narrow areas.

12. H.R. 8200, 95th Cong., 2d Sess., 123, 124 Cong. Rec. 1804 (1978), discussed in 1 COLLIER, *supra* note 6, § 3.01[2][b], at 3-59 to 3-62.

13. S. 2266, 95th Cong., 2d Sess., 123, 124 Cong. Rec. 28284 (1978).

14. The conference report was approved as an amended version of H.R. 8200. 1 COLLIER, *supra* note 6, § 3.01[2][b], at 3-59 to 3-62.

15. 28 U.S.C. § 1471, discussed at *supra* notes 5-6 and accompanying text.

16. 1 COLLIER, *supra* note 6, § 3.01[1][d][i], at 3-36.

17. 28 U.S.C. § 151.

18. *See* 1 COLLIER, *supra* note 6, § 3.01[1][d][i], at 3-36 to 3-38.

19. Northern was joined in the Supreme Court by the United States, which had intervened to defend the statute. 102 S. Ct. at 2846.

20. U.S. CONST. art. I, § 8, gives to Congress the power "to establish . . . uniform Laws on the subject of Bankruptcies throughout the United States."

21. *See generally* C. WRIGHT, LAW OF FEDERAL COURTS § 11, at 29-38 (3d ed. 1976).

22. Justice Brennan was joined in his opinion by Justices Marshall, Blackmun, and Stevens.

First, the plurality held that the cases upholding limited tenure for territorial and District of Columbia courts[23] were based on the complete sovereign power of the federal government in those jurisdictions, unshared with any state authorities. Although this power derives to some extent from article I of the Constitution,[24] as does the bankruptcy power of Congress, the federal authority in these territories is of a special plenary nature, unlike other questions over which Congress has power to legislate by virtue of article I.[25]

In addition, Northern Pipeline relied on a series of cases[26] in which the Supreme Court had upheld congressional authority to create nontenured courts-martial. The plurality limited these cases to the exercise of the military authority of the federal government, which was conferred on the political branches of the government—the executive and the legislative—and was not limited by the separation of powers structure of the Constitution, as were other powers given to Congress where an independent judiciary was important.[27] Finally, the plurality addressed those cases most likely to sustain the jurisdiction of the bankruptcy courts, those sustaining jurisdiction of administrative agencies and nontenured judges of the Court of Customs. These cases were probably the most analogous to a case involving the bankruptcy courts because they involved courts based on the congressional power to legislate under article I. The plurality opinion in *Northern Pipeline* attempted to distinguish these cases as based on a "public rights" exception to the article III judicial power, which appears to recognize that some matters traditionally are entrusted by the Constitution to the political branches of government—the legislative and the executive—and are not within the protection of the separation of powers doctrine. In the plurality's language:

> The doctrine extends only to matters arising "between the Government and persons subject to its authority in connection with the performance of the constitutional functions of the executive or legislative departments," . . . and only to matters that historically could have been determined exclusively by those departments. . . . The understanding of these cases is that the Framers ex-

23. The principle cases are American Ins. Co. v. Canter, 26 U.S. (1 Pet.) 511 (1828) (territories) and Palmore v. United States, 411 U.S. 389 (1973) (District of Columbia).

24. The District of Columbia jurisdiction is an article I power, while the power over territories seems to derive exclusively from article IV, section 3 of the Constitution. The difference does not seem to be significant to the power of Congress to create "legislative courts" to exercise part of its sovereign power.

25. 102 S. Ct. at 2868.

26. Principally, Dynes v. Hoover, 61 U.S. (20 How.) 65 (1858) and Burns v. Wilson, 346 U.S. 137 (1953).

27. 102 S. Ct. at 2868-9.

> pected that Congress would be free to commit such matters completely to non-judicial executive determination, and that as a result there can be no constitutional objection to Congress employing the less drastic expedient of committing their determination to a legislative court or administrative agency.[28]

Although the plurality refused to draw the line of distinction between public and private rights, it said a public right requires at "a minimum" a contest between an individual and the government and would never extend to contests between two private parties.[29] In addition, suits in which the government is a party still would not be within the public rights category if the action otherwise was within the judicial cognizance at common law.[30] Thus, the presence of the United States as a party is "a necessary but not sufficient means of distinguishing 'private rights' from 'public rights.' "[31] Finally, while it would seem that an independent judiciary is most needed when the action is between the sovereign and one of its citizens, the Court rejected this argument and held that the "public rights" doctrine is not based on need (or in the plurality's language, "political theory"), but rather on what was reserved to the judicial branch "as a matter of historical fact."[32]

Having thus limited the previous exceptions to article III of the Constitution, the plurality easily concluded that the claim involved in *Northern Pipeline* did not qualify for special treatment. Although the plurality conceded that "the restructuring of debtor-creditor relations, which is at the core of the federal bankruptcy power, must be distinguished from the adjudication of state-created private rights, such as the right to recover contract damages that is at issue in this case," it concluded that "the former may well be a 'public right,' but the latter is obviously not."[33] Since Northern's claim was defined by the state law of contract and was unchanged by the mere filing of a bankruptcy petition by the plaintiff,[34] the plurality believed it was within the class of cases cognizable at common law.

The second attempt to sustain the bankruptcy jurisdiction was based on an argument that the courts were merely adjuncts of district courts, which are article III courts. This argument was based principally on two earlier decisions of the Court, *Crowell v. Benson*,[35] and

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28. *Id.* at 2869-70.
29. *Id.* at 2870-71.
30. *Id.* at 2870-71 n.23.
31. *Id.* at 2870-71 n.23.
32. *Id.* at 2870 n.20.
33. *Id.* at 2871.
34. See note 4, *supra*.
35. 285 U.S. 22 (1932) (sustaining the creation of an administrative tribunal to

United States v. Raddatz.[36] The plurality in *Northern Pipeline* read these cases as establishing two narrow exceptions to the article III scheme. First, where rights are created by Congress, that body should have "substantial discretion" to determine how such rights are adjudicated.[37] Second, where the rights involved are not of congressional creation, such as constitutional rights or claims cognizable at common law, certain fact-finding still could be delegated to an adjunct of the article III court, such as a federal magistrate, as long as he was "subject to sufficient controls by an article III district court."[38]

These two controls were satisfied, according to the plurality, in both *Crowell* and *Raddatz*. In *Crowell*, involving the adjudication of a congressionally created right, the agency was delegated only limited fact-finding authority and those facts were subject to a limited review in the district court, akin to the review of facts found by a jury; questions of law were determined solely by the court, and only the court could enforce awards.[39] In *Raddatz*, involving the delegation of some authority over constitutionally created rights, the magistrates were appointed and removable by district judges, they heard only particular issues referred by the district court, and findings of facts were subject to a *de novo* review, including the power to adduce additional evidence.[40]

In contrast, the delegation to bankruptcy judges was neither limited, as in *Crowell*, or capable of direct control by the district court, as in *Raddatz*. The 1978 Bankruptcy Reform Act created a *mandatory* delegation of *all* judicial functions to the bankruptcy courts;[41] they were given authority to hear all matters arising under, in, or related to bankruptcy cases, not merely some specialized species of issues, as was given to certain administrative agencies. In addition, although prior to the 1978 Act, bankruptcy referees, like magistrates, were appointed and removable by the district court, the 1978 Act made bankruptcy judges appointable (and removable) by the President. Furthermore, orders of a bankruptcy judge, in some situations, were

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make factual determinations concerning the eligibility for compensation under the Longshoremen's and Harbor Workers' Compensation Act).

36. 447 U.S. 667 (1980) (upholding the 1978 Federal Magistrates Act, which delegated certain authority to U.S. Magistrates not protected by article III).

37. 102 S. Ct. at 2876. This apparently would not include a right to completely delegate the adjudicatory function. The plurality emphasized the authority to delegate "some" functions and pointed to *Crowell*'s use of the term "specialized" functions. It refused to define the limits of Congress's power to delegate. *Id.* at 2876 n.32.

38. *Id.* at 2875.

39. 225 U.S. at 51-65.

40. 447 U.S. at 673-74.

41. 28 U.S.C. § 151 (Supp. II 1978).

reviewable by the district courts only by appeal.[42] This is a true appellate jurisdiction, not the kind of close supervision that exists with magistrates. Finally, the bankruptcy courts also received the power to enforce their own judgments. Thus, the "essential attributes of judicial power" were not reserved to article III courts as in both *Crowell* and *Raddatz*.[43]

If bankruptcy courts as constituted by the 1978 Act do not pass constitutional muster under these standards, how can they be reconstituted? Congress obviously could constitute them as full fledged article III courts, as contemplated originally by the House of Representatives,[44] and eliminate all problems. This is the approach taken in H.R. 6978, reported to the House by the Judiciary Committee, and supported by most of the witnesses to date before that committee.[45] Two other approaches are also possible. The first is to make the bankruptcy courts true adjuncts of the district courts, essentially functioning as federal magistrates. Thus they presumably would be referred most bankruptcy matters, but in order to have an article III court retain the "essential attributes of judicial power," all decisions on questions of fact would probably be reviewed *de novo* by the district court. Further, the district court would retain complete control over questions of law and directly issue whatever enforcement orders would result from bankruptcy proceedings.

There are two problems with this approach. First, it will place an extraordinary strain on the district courts and continue one of the problems the Bankruptcy Reform Act was designed to eliminate, the participation of already busy federal courts in much of the routine business of bankruptcy. Second, this approach assumes that many of the incidental actions, *i.e.*, those based on state law but "related to" bankruptcy cases,[46] are within the federal judicial power in the first place. Chief Justice Burger assumed as much when he suggested in his dissent that these are the only cases which the bankruptcy court cannot hear, and these can be routinely routed to the regular docket of the district court.[47] If the case is one sounding only in state law,

42. An appeal to the district court exists only in some cases, while other cases are appealable immediately to a bankruptcy appellate panel. Bankruptcy Reorganization Act of 1978, § 201(2), 28 U.S.C. § 160.

43. In addition, bankruptcy courts were given nationwide venue and jurisdiction, *see* 102 S. Ct. at 2863 n.4, which is much more expansive than even article III courts in most cases. *See* FED. R. CIV. P. 4(e).

44. *See supra* note 12 and accompanying text.

45. H.R. 6978, 9th Cong., 2d Sess., 128 Cong. Rec. H5884 (daily ed. Aug. 11, 1982); *see also* S. 2000, 97th Cong., 2d Sess., 128 Cong. Rec. S431 (daily ed. Feb. 4, 1982). *See generally News and Comments*, BANKR. CT. DEC. (CRR) A75 (July 23, 1982).

46. *See supra* note 5 and accompanying text.

47. 102 S. Ct. at 2882.

as in *Northern Pipeline,* it is questionable how the mere existence of a trustee or bankruptcy debtor as a party can otherwise bring the case within the federal judicial power. The pre-1978 bankruptcy law was not entirely clear on this question. The statute itself did not grant federal courts general subject matter jurisdiction over all such cases. Federal jurisdiction over such incidental actions was limited to cases in which the actions could have been brought in federal court between the debtor and the adverse party had no bankruptcy intervened, cases in which the adverse party consented to jurisdiction in the federal court, or cases in which the trustee's claim arose from the bankruptcy statute itself.[48]

Where the claim was not based on a federal right or on diversity of citizenship, the exercise of jurisdiction by federal courts would be very questionable. In the infrequent cases where the issue had arisen, the Supreme Court had sanctioned jurisdiction either on the theory that a bankruptcy trustee was a party or because the claim arose in the course of bankruptcy.[49] These reasons do not seem sufficient since neither rationale is supported by the literal language of the article III judicial power. The United States is not a party, and although the trustee is appointed by the court, he represents the debtor's estate and in no sense acts for the United States; nor does the claim in any sense arise under federal law, except in the sense that the trustee is given his status by the federal bankruptcy act.[50] Although this poses a particularly troublesome question for those who would constitute bankruptcy courts as adjuncts of article III courts, this issue may be beyond debate. Even the plurality concedes that these issues may be litigated in federal court because of "their relationship to the petition,"[51] despite the minor impediment of the language of article III.

The other possible approach is to constitute bankruptcy courts as article I courts, allowing them to adjudicate those claims which are within the "public rights" exception announced in *Northern Pipeline* and sending all other claims to district courts. This is the approach suggested by Chief Justice Burger, and he assumes the only claims not within the exception would be the kind involved in *Northern Pipeline, i.e.,* a claim based on state law.[52] The plurality even leaves room for this approach by suggesting that Congress might choose to

48. The trustee's avoidance power was under sections 60, 67, and 70 of the old statute. *See* Bankruptcy Act § 23(b), 30 Stat. 544, 552, *repealed by* Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549, 2682.

49. Williams v. Austrian, 331 U.S. 642 (1947); Schumacher v. Beeler, 293 U.S. 367 (1934).

50. Osborn v. Bank of the United States, 22 U.S. (9 Wheat.) 738 (1824).

51. 102 S. Ct. at 2872 n.26.

52. *Id.* at 2882.

reenact a broad bankruptcy court jurisdiction provision, taking the chance that on a case-by-case basis courts will deny the bankruptcy courts power since the particular issue is not within the "public rights" exception.[53]

If Congress took this approach, it is not clear what could be done by bankruptcy courts as independent article I courts. The plurality suggested that issues relating to "the restructuring of the debtor-creditor relationship" might be within the "public rights" exception, but it did not suggest how far such power might extend.[54] For example, does the power extend only to the question of whether the debtor is entitled to invoke bankruptcy, *i.e.*, may he be a "debtor" under section 109 of the Act? Since this right alone is meaningless, merely allowing a debtor to use the bankruptcy proceeding to distribute his assets, would the power extend also to granting the debtor a discharge? If so, doesn't this affect the common law claims of a creditor and fail to satisfy even the "minimum" test that the claim be between the government and one of its citizens.[55] Furthermore, this issue typically is one between two private parties, the debtor and the creditor.

Short of creating full-fledged article III courts or getting district courts very deeply into bankruptcy administration, the plurality opinion may leave little room for Congress to maneuver. Since two of the votes necessary to constitute a majority, those of Justices Rehnquist and O'Connor, would have invalidated only the power of bankruptcy courts to hear state law claims, Congress may choose to read their concurrences narrowly and attempt to preserve as much of the present bankruptcy jurisdiction as possible.

Before Congress acts, however, bankruptcy practioners are in limbo about how to proceed on even the simplest bankruptcy matter—where to file the petition. Even though the plurality contemplated that at least some routine matters could be performed by bankruptcy courts, it held that the grant of jurisdiction in section 1471(c)[56] was not severable, and the whole grant of power was stricken. When on

53. *Id.* at 2880 n.40.

54. *See supra* note 33 and accompanying text.

55. *See supra* note 29 and accompanying text.

56. The general grant of jurisdiction to district courts and through them to the bankruptcy courts is contained in section 241(a) of the Act, amending 28 U.S.C. § 1471. Although the Court speaks of all of 241(a) as being invalid, it obviously invalidated only that part of 241(a) which conferred jurisdictional authority on the bankruptcy courts, 28 U.S.C. § 1471(c). The rest of section 241(a), relating both to jurisdiction of the district courts and to other matters, such as venue, removal, and appeals, was not directly addressed by the Court and must be deemed to have not been affected by its decision.

December 24 the Court's self-imposed stay of its mandate is lifted[57] (and until Congress acts), how will bankruptcy matters proceed? Assuming *Williams v. Austrian*[58] and *Schumacher v. Beeler*[59] are still good law, district courts still have jurisdiction to hear all bankruptcy matters, both questions of pure bankruptcy administration, *i.e.*, right to relief and entitlement to discharge, and incidental plenary actions, even those based on state law.[60] Thus, all bankruptcy proceedings should be administrable by the district courts and all proceedings should be initiated there.[61]

Once a case is commenced in the district court there would appear to be no impediment to the Court referring large matters of administration to the existing bankruptcy judges as special masters under Rule 53 of the Federal Rules of Civil Procedure.[62] In such event, a reference would appear to be permissible under the standards of *United States v. Raddatz*, with the district court retaining supervision over the activities of the bankruptcy judge-master. At least until Congress acts, this may be the only way for the bankruptcy machinery to continue to operate.

UNIFORM BANKRUPTCY LEGISLATION

The Supreme Court this year also addressed a question which has arisen very infrequently in bankruptcy litigation, the meaning of the uniformity requirement under the congressional power to enact "Uniform Laws on the subject of bankruptcies."[63] The issue arose in *Railway Labor Executives Association v. Gibbons*,[64] which grew out of the bankruptcy of the Chicago, Rock Island and Pacific Railroad Company (Rock Island). Rock Island originally had filed a petition for reorganization under the 1898 bankruptcy statute, and it continued in operation until a labor strike in 1979. Soon after this, the district court in which the reorganization petition was pending determined that reorganization was not possible and ordered the railroad to

57. The Court originally stayed its mandate until October 4, 1982. 102 S. Ct. at 2880. The stay was extended upon motion of the Justice Department until December 24, 1982. Wall St. J., Oct. 5, 1982, at 1, col. 2.

58. 331 U.S. 642 (1947).

59. 293 U.S. 367 (1934).

60. 28 U.S.C. § 1471(a),(b).

61. Indeed, the bankruptcy case must be filed in the district court since this jurisdiction is exclusive. 28 U.S.C. § 1471(a). In contrast, the district court's jurisdiction over matters arising in, or related to, a bankruptcy proceeding is merely concurrent. 28 U.S.C. § 1471(b).

62. *But see* LaBuy v. Howes Leather Co., 352 U.S. 249 (1957) (criticizing a federal court for such a liberal, routine use of the reference power of rule 53).

63. U.S. CONST. art. 1, § 8.

64. 455 U.S. 457, 102 S. Ct. 1169 (1982).

liquidate. Because the outstanding liabilities to the employees of Rock Island would not be paid in full upon liquidation,[65] Congress enacted the Rock Island Railroad Transition and Employee Assistance Act (RITA),[66] which required payment from the Rock Island estate of up to $75 million in benefits to employees of the railroad not hired by other carriers. It required this money to be treated as an administrative expense for determining priority,[67] which meant that the employees would be paid before any other creditors.[68]

The statute was attacked by other creditors of Rock Island on several grounds, including that a statute directed at a specific debtor was not a "uniform" bankruptcy law and therefore was beyond Congress's bankruptcy power.[69] The Supreme Court agreed. It classified RITA as nothing more than a "private bill" not permitted under the congressional bankruptcy authority:

> The conclusion is thus inevitable that RITA is not a response either to the particular problems of major railroad bankruptcies or to any geographically isolated problem: it is a response to the problems caused by the bankruptcy of *one* railroad. The employee protection provisions of RITA cover neither a defined class of debtors nor a particular type of problem, but a particular problem of one bankrupt railroad.[70]

The Court was careful to distinguish RITA from other "nonuniform" bankruptcy legislation that might be permissible. For example, it suggested that Congress could enact legislation that would affect only one industry "as a distinctive and special problem"[71] and could "fashion legislation to resolve geographically isolated problems."[72] However, RITA did not purport to address a specific regional problem or to treat all members of a particular industry equally.[73]

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65. The 1898 Act did extend some protection to employees' claims for wages by giving them a second priority on the assets of the debtor (after administrative expenses) but only to the extent of $600 per claimant and even then only for wages earned within 90 days of bankruptcy. Bankruptcy Act § 64, 30 Stat. 544, 563, *repealed by* Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549, 2682.

66. 45 U.S.C. §§ 1001-1018 (Supp. IV 1980).

67. 102 S. Ct. at 1175.

68. Bankruptcy Act § 64 (repealed 1978).

69. Another argument advanced by the creditors was that the assets of Rock Island, the $75 million, were taken for a public purpose, *i.e.*, to partially alleviate unemployment among railroad workers, and that this taking was without compensation. 102 S. Ct. at 1174.

70. *Id.* at 1177.

71. *Id.* at 1176.

72. *Id. See* Regional Rail Reorganization Act Cases, 419 U.S. 102 (1974) (the 3R Act Cases).

73. None of the other railroads in bankruptcy at the time RITA was passed received

The Court's decision in *Gibbons* is probably not of great significance either to general bankruptcy administration or to the power of Congress to enact bankruptcy legislation. The opinion makes clear that some "nonuniform" legislation will be upheld if it is generally applicable either to a particular industry or geographical area; however, Congress cannot enact "private bills" for particular debtors under its bankruptcy authority.[74]

VALIDITY OF VENDOR'S PRIVILEGE

The Fifth Circuit this year again addressed a question which has remained troublesome both to sellers of movables and bankruptcy trustees alike, the validity of the Louisiana vendor's privilege against a trustee's claim as a bona fide purchaser. Section 545 of the Bankruptcy Act of 1978, like its predecessor, section 67(c) of the 1898 Act, invalidates "statutory liens" which are not "perfected or enforceable on the date of the filing of the petition against a bona fide purchaser that purchases such property on the date of the filing of the petition."[75] The Louisiana vendor's privilege is created by Civil Code article 3227: "He who has sold to another any movable property, which is not paid for, has a preference on the price of his property, over the other creditors of the purchaser, . . . if the property still remains in the possession of the purchaser."

The Fifth Circuit, in *In re Tape City, U.S.A., Inc.*,[76] sustained the seller's privilege against the trustee's claim that it was invalidated by section 545 of the Bankruptcy Act. In so doing the court did not write on a totally clean slate. The court's opinion in *Tape City* simply affirms without serious discussion the earlier decision of the court in *In re Trahan*,[77] which interpreted similar language in section 67(c) of the 1898 Bankruptcy Act. The district court in *Trahan* held that a vendor's privilege is perfected and enforceable against a bona fide purchaser, unless that purchaser also takes possession of the item. Thus, the language of old section 67, now section 545, does not invalidate the vendor's privilege.

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the benefit of the legislation. They were administered under the general bankruptcy statute. *See* 102 S. Ct. at 1177 n.11.

74. Justices Brennan and Marshall would allow a "private bill" upon proof that the legislation serves a "national interest apart from the economic interest of that debtor or class, and if the identified national interest justifies Congress' failure to apply the law to other debtors." *Id.* at 1179 (Marshall, J., concurring).

75. 11 U.S.C. § 545(2) (Supp. II 1978). A statutory lien is a lien arising "solely by force of a statute on specified circumstances or conditions." 11 U.S.C. § 101(38) (Supp. II 1978).

76. 677 F.2d 401 (5th Cir. 1982).

77. 283 F. Supp. 620 (W.D. La. 1968), *aff'd per curiam*, 402 F.2d 796 (5th Cir. 1968).

Since *Trahan* addressed the same question that was before the court in *Tape City*, it would have been predictable for the court to follow its prior decision except for the fact that *Trahan* was merely a *per curiam* affirmance and an intervening decision by the First Circuit, in *In re Nieves & Co.*,[78] squarely faced the same question under the Puerto Rico Civil Code's vendor's privilege and decided the question in favor of the bankruptcy trustee. As under Louisiana Civil Code article 3227, the Puerto Rico Civil Code gives a seller of movables a privilege for the purchase price while the purchaser remains in possession of the thing.[79] Rather than looking at the bare language of section 545, which does not expressly give the trustee the status of a purchaser *with possession*, the First Circuit interpreted the *policy* behind the lien invalidation provision of section 67(c) (now section 545). The First Circuit stated: "This provision strikes at a lien which is so tenuous that it can be defeated by transfer to a bona fide purchaser. The holders of such liens have reason to know that their security is extremely vulnerable."[80] This position was also consistent with the apparent reasons for the 1966 amendments to the statutory lien provision of the old statute:

> Notwithstanding the long established bankruptcy principle that valid liens should be enforceable in their entirety as against general, unsecured creditors and those entitled to priority, the realization developed that state-created statutory liens run counter to the *underlying objective of equitable distribution of the debtor's assets among all his creditors.*[81]

For the First Circuit, this policy was important since the language of the bankruptcy statute did not provide a clear answer to the question. For example, did the statute mean that a trustee may invalidate the privilege only if *all* bona fide purchasers may do so or that a trustee may invalidate the privilege if *any* bona fide purchaser may do so? The First Circuit held that when Congress spoke of giving the trustee the "rights of a hypothetical purchaser, it contemplated a full-blooded, not an anemic, purchaser."[82] That is, for the purpose of measuring the trustee's power under section 545, it must be assumed that the trustee both purchases and takes possession of the item.

78. 446 F.2d 188 (1st Cir. 1971). This position was followed by a Louisiana bankruptcy judge in *In re* Hughes, 9 Bankr. 251 (W.D. La. 1981). *See also*, Comment, *Statutory Liens Under Section 67c of the Bankruptcy Act: Some Problems of Definition*, 43 TUL. L. REV. 305 (1969).

79. P.R. LAWS ANN. tit. 31, § 5192 (2d ed. 1968).

80. 446 F.2d at 191 (citing S. Rep. No. 1159, 89th Cong., 2d Sess. 2, *reprinted in* 1966 U.S. CODE CONG. & AD. NEWS 2456, 2461).

81. 4 COLLIER, *supra* note 6, § 545.03(1) (emphasis added).

82. 446 F.2d at 192.

This is especially true in the case of a debtor who remains in possession of his estate following the filing of the petition in bankruptcy.[83] In these circumstances the debtor has the status of a bona fide purchaser under section 545 and in fact has possession of the item subject to the vendor's privilege.

Even the *Nieves* position, however, is not compelled, although it seems to address the real issue more correctly than those who support the vendor's privilege. Two commentators have supported the privilege largely on the distinction between the common law lien as a charge against property and the civilian privilege as growing out of the nature of the debt.[84] This seems to miss the point. As a matter of federal supremacy, Congress could invalidate the vendor's privilege by express language, whether the interest is like a lien or something else. That it has not done so expressly only begins the inquiry, which should be resolved by bankruptcy policy. That is, if Congress had thought about the possession requirement, how would it have treated the privilege? Congress, for example, has chosen to enforce state consensual liens in bankruptcy.[85] Since Louisiana could make its vendor's privilege enforceable in bankruptcy by requiring a voluntary grant of the privilege by the purchasers to the seller, as for a chattel mortgage, rather than arising automatically, perhaps the only reason the statutory lien should be treated differently is because it is not bargained for by the seller and not relied upon in extending credit to the debtor, as is a conventional chattel mortgage. Thus, the reason for recognizing the consensual lien—to facilitate commerce and encourage the extension of credit[86]—does not exist in the case of a vendor's privilege, because by definition the seller has not bargained for the privilege and presumably would have extended credit in any event.[87]

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83. Unlike Chapter 7 of the Bankruptcy Act (liquidations), in a petition for reorganization under Chapter 11 of the Act, a trustee is not automatically appointed. The debtor remains in possession of his business. 11 U.S.C. § 1104. In such case the debtor is given all of the powers and risks a trustee would have had, 11 U.S.C. § 1107, including the trustee's rights under section 545. 5 COLLIER, *supra* note 6, § 1107.03(2). *See Tape City*, 677 F.2d at 403 n.7.

84. *See* Rubin & Rubin, *The Louisiana Vendor's Privilege on Movables: A Secured Claim Valid Against A Bankruptcy Trustee*, 29 LA. B.J. 61 (1981).

85. Unlike the statutory lien, the consensual lien (*i.e.*, security interest), like a chattel mortgage, is created by agreement rather than by operation of law, even if the right to so agree is created by statute. 11 U.S.C. § 101(38). These liens are generally enforceable in bankruptcy, 11 U.S.C. § 725, although the trustee does succeed to whatever rights the debtor may have to invalidate such agreements, 11 U.S.C. § 541.

86. *See* R. SPEIDEL, R. SUMMERS, & J. WHITE, TEACHING NOTES FOR COMMERCIAL AND CONSUMER LAW 11 (3d ed. 1981).

87. Of course, the Louisiana vendor's privilege can be seen as the state's attempt to allocate the burden of bargaining in favor of the seller. That is, in the absence of an agreement to the contrary, the seller gets the privilege, a scheme at least as

In these circumstances, the bankruptcy policy of equitable distribution to all creditors should outweigh the state's interest in favoring a particular creditor.

In Louisiana, however, unlike states that have adopted article 9 of the Uniform Commercial Code (U.C.C.), the vendor's privilege may serve some additional purpose, and although given solely by statute, it in fact may have been part of the bargain between the original vendor and the bankrupt. Unlike article 9 of the U.C.C., a subsequent lender under the Louisiana Chattel Mortgage Act[88] must stand in line behind a previous lender who has taken a chattel mortgage in the debtor's after acquired property.[89] Thus, unlike jurisdictions having adopted article 9 of the U.C.C.,[90] in Louisiana it would be impossible for a subsequent lender to take first priority, even as to property as to which he furnishes the purchase price,[91] but for the vendor's privilege, which gives him first rank as to such property.[92] In the absence of such a device, the original lender who has taken a security interest in after acquired property has a lock on the debtor's business, since he is in a position to refuse future advances, and the debtor cannot turn elsewhere, since he cannot assure the subsequent lenders a good first priority in such security. In this instance, the vendor's privilege does in Louisiana what the purchase money security interest does in all other jurisdictions, and at least where a lender has relied on this device to defeat a senior chattel mortgage in after acquired property, it would appear the subsequent lender has a good claim to this form of security. It does promote the extension of credit in the same manner as the consensual chattel mortgage, where the credit would not be given but for the priority obtainable by the vendor's privilege.

However this question is ultimately decided, the two policies identified above, the policy of equitable distribution to all creditors and

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defensible as the contrary presumption, *i.e.*, no security if no agreement. Even if this were so, the federal bankruptcy act has *generally* prohibited such a presumption, by denying enforceability of a security interest unless affirmatively granted by the debtor. *See* 11 U.S.C. §§ 101(37) & 725.

88. LA. R.S. 9:5351-5366 (1950).

89. This is so by virtue of Civil Code article 3329 and LA. R.S. 9:5354 (Supp. 1978) (of the Chattel Mortgage Act), which rank mortgages in the order in which they are filed. A mortgage in after acquired property is possible by virtue of LA. R.S. 9:5352 (Supp. 1981).

90. The U.C.C. gives a subsequent security interest first priority where the lender advanced the purchase price for the item subject to the security interest. U.C.C. § 9-312(3) & (4) (1977).

91. Under the U.C.C. this would be a purchase money security interest. *See* U.S.C. § 9-107 (1977).

92. LA. CIV. CODE art. 3227.

the policy of enforcing bargained for security as a means of encouraging the extension of credit, seem to be more relevant to the inquiry than interpretational gymnastics about whether a purchaser should be presumed to have possession or whether there is some technical difference between a privilege and a common law lien. Where a creditor in Louisiana has relied on the position given him by the vendor's privilege in the manner that a purchase money security interest protects creditors in other states, it seems reasonable to protect that interest in bankruptcy. Where a seller gets such protection without asking for it, the bankruptcy trustee would appear to have a better claim. The problem with the Louisiana vendor's privilege is that it paints with too broad a brush, attempting to protect sellers in both categories. Whether bankruptcy courts can distinguish between these classes of creditors under the current wording of section 545 of the Bankruptcy Code and article 3227 of the Louisiana Civil Code, or do so without time-consuming factual inquiries, are additional questions. The clearest route would be for the vendor's privilege to be held unenforceable in its present form, requiring the legislature to provide a more narrow device for protecting the purchase money lender who does rely on such a right.

The results in *Trahan* and *Tape City*, therefore, may be correct but for the wrong reason. The panels in both cases failed to identify the correct competing policies and at least should have given more plenary consideration to the issues raised by those cases. Ultimately, this issue may have to be addressed by the Supreme Court or by Congress.