

First Circuit Rules that Bankruptcy Court “Retention of Jurisdiction” Provisions Not Enough to Establish Jurisdiction

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It is very common for bankruptcy court orders to provide that the court retains jurisdiction to enforce such orders. Similarly, chapter 11 confirmation orders routinely provide that the bankruptcy court retains jurisdiction over all orders previously entered in the case. The enforceability of these “retention of jurisdiction” provisions, however, will not rest on the plain language in the order but on the bankruptcy court’s statutory jurisdiction. Because no court can simply create its own jurisdiction, whether these provisions are enforceable hinges on whether the dispute in question “arises under,” “arises in” or “relates to” the bankruptcy case as set forth by statute at 28 U.S.C. §§ 1334 and 157.

Recently, the First Circuit opined that a dispute involving a provision in a chapter 11 sale order did not “arise in” the bankruptcy case merely because the sale was approved by the bankruptcy court and the sale order included a “retention of jurisdiction” provision. *Gupta v. Quincy Medical Center*, 2017 WL 2389407, Case No. 15-1183 (1st Cir. June 2, 2017). The First Circuit recognized that “retention of jurisdiction” provisions are not sufficient to establish “arising in” jurisdiction—instead the bankruptcy court must consider the nature of the proceeding to independently determine if the matter could arise only in the context of a bankruptcy case.

The facts underlying *Gupta* are relatively straightforward. Quincy Medical Center (QMC) entered into an asset purchase agreement (APA) to sell substantially all of their assets to an entity created by Steward Health Care System (Steward). The APA required Steward to offer new employment to all QMC employees that were employed immediately prior to the sale closing. The APA also provided that if Steward terminated any employee after the sale closed, then Steward would be liable for severance pay. Immediately after executing the APA, QMC filed for chapter 11 to consummate the sale and liquidate. Both the sale order and the later order confirming the chapter 11 plan included provisions retaining the bankruptcy court’s jurisdiction to determine disputes arising under or relating to the APA.

Shortly after the sale closed, Steward terminated two senior executives. When Steward failed to pay severance, the former executives sought enforcement of the APA in the bankruptcy court. The bankruptcy court determined it had subject matter jurisdiction to hear the dispute pursuant to the retention of jurisdiction language in the sale order and found Steward liable for the severance pay. On appeal, the district court reversed, finding that the bankruptcy court lacked subject matter jurisdiction over the dispute. The district court reasoned that the breach of contract claim fell outside the bankruptcy court’s subject matter jurisdiction – a contract dispute between two non-debtor parties – which could not be established by mere provisions in orders. The First Circuit affirmed.

The First Circuit explained that the “jurisdiction of the bankruptcy courts, like that of all other federal courts, is grounded in, and limited by, statute.” The scope of bankruptcy court jurisdiction is found at 28 U.S.C. § 1334. Bankruptcy courts, by reference from the district courts, have jurisdiction over “cases under title 11”, and “proceedings arising under title 11, or arising in or related to cases under title 11.” The statute provides no clear definition of “arising under”, “arising in” or “related to” and the First Circuit “observed that the boundaries between these types of proceedings are not always easy to distinguish from each other.”

The former executives did not assert “arising under” or “related to” jurisdiction; rather, they only argued that their severance claims “arise in” the bankruptcy case “because the APA was approved by the bankruptcy court in the Sale Order pursuant to [the bankruptcy code], and . . . [the sale order] may ‘only be issued by a bankruptcy court.’” In essence, the former executives asserted a “but for” causation: “but for Debtors’ Chapter 11 case and the Sale Order approving the sale of Debtors’ assets to Steward in the APA, their claims for severance pay would not exist.”

The First Circuit rejected the “but for” test, instead holding that to establish “arising in” jurisdiction, the relevant proceeding must have “no existence outside of the bankruptcy[.]” “‘arising in’ jurisdiction exists only if Appellants’ claims are the type of claims that can only exist in a bankruptcy case.” Examples of “arising in” proceedings are typically administrative in nature – orders to turn over property, dischargeability of debts and assumption or rejection of contracts. Because the former executives’ claims were in the nature of a state law breach of contract claim, the First Circuit determined that the claims did not “arise in” the bankruptcy case and, therefore, the bankruptcy court did not have subject matter jurisdiction to determine the dispute.

Going forward, parties seeking to have their issues heard by a bankruptcy court should note that “retention of jurisdiction” provisions are not determinative. Bankruptcy courts must look beyond the “retention of jurisdiction” language and determine whether the proceeding meets the statutory test of “arising under”, “arising in” or “relating to” the bankruptcy case.

Authors