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Feature

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Does the Doctrine of Federalization Apply in Bankruptcy Court?

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Imagine the following situation: You represent a defendant in a multiple-party action in state court. The complaint was filed a year ago, and in the meantime, the state court has entered several orders regarding either discovery issues or dispositive motions. Suddenly, another defendant files for bankruptcy and removes the action to federal court. The following question arises: Is the federal court bound by the state court's orders? If the action was removed to a district court under the nonbankruptcy removal statute, the answer would be clear. Under the doctrine of "federalization," the state court's orders would become "federalized," meaning that the district court would treat the orders as if the district court had entered them.

If the action was removed to bankruptcy court under the bankruptcy removal statute, however, the answer would be surprisingly not so clear. Although several courts have invoked the doctrine in a bankruptcy case, most simply assumed without analysis that the doctrine applied. Thus, few courts have actually analyzed the issue. Also, it would appear that only one circuit court has addressed the issue in detail, and that court declined to rule on it.

The Doctrine of Federalization

Section 1450 of title 28 provides, in relevant part: "All injunctions, orders and other proceedings had in [a state court] action prior to its removal [to federal district court] shall remain in full force and effect until dissolved or modified by the district court." According to the U.S. Supreme Court, § 1450 was designed to resolve the unique problem of a shift in jurisdiction upon removal of an action from state to federal court. In this respect, § 1450 serves two basic purposes.

By providing that proceedings in state court shall have force and effect in federal court so that pleadings filed in state court, for example, need not be duplicated in federal court, the statute promotes judicial economy. In addition, the statute ensures that interlocutory orders entered by the state court to protect various rights of the parties will not lapse upon removal. For these reasons, the Supreme Court held that orders entered in state court should remain effective after the case is removed to federal court.[1] In effect, a district court "takes the case up where the State court left it off."[2] As a result, a state court order is essentially "federalized" when the action is removed to federal court.[3]

The *Farah* Case

It would appear that of the circuit courts, only the Third Circuit, in *Richards v. Farah (In re Farah)*, has analyzed the issue of whether the doctrine of federalization applies in bankruptcy, and it declined to rule on the issue.[4] The term "convoluted" might be an appropriate term to describe the tangled facts and procedural history in the *Farah* case.

To begin, Richards had invested millions of dollars with Farah in a joint bank account at PNC Bank. In August 1997, after the funds were withdrawn, Richards brought suit in a state court against Farah, who failed to defend himself, and the state

1 *Granny Goose Foods v. Bhd. of Teamsters & Auto Truck Drivers*, 415 U.S. 423, 435-36 (1974).
2 *Id.*
3 *Resolution Trust Corp. v. Northpark Joint Venture*, 958 F.2d 1313, 1316 (5th Cir. 1992), *cert. denied*, 506 U.S. 1048 (1993).
4 Although, as set forth below, the Ninth Circuit invoked the doctrine in a bankruptcy case, it simply assumed without analysis that the doctrine applied. *Mathews v. Traverse (In re Pappas)*, 1994 WL 134097 at **1-2 (9th Cir. April 13, 1994). Also, the Tenth Circuit, in likewise applying the doctrine in a bankruptcy case, relied on former 28 U.S.C. § 1479(c), which, similar to § 1450, provided that all injunctions, orders or other proceedings in a removed action shall remain enforceable until dissolved or modified by the bankruptcy court. *Gen. Elec. Credit Corp. v. Montgomery Mall Ltd. P'ship (In re Montgomery Mall Ltd. P'ship)*, 704 F.2d 1173, 1176 (10th Cir. 1983) (holding that chapter 11 debtor could not complain of short notice of creditors' motion for summary judgment in bankruptcy court where debtor had already been on notice that creditor sought summary judgment in state court action before it was removed to bankruptcy court), *cert. denied*, 464 U.S. 830 (1983). Section 1479 was repealed in 1984.

court entered default judgment. Richards then filed an amended complaint including a negligence count against PNC. In April 1998, the state court granted PNC's motion for summary judgment and dismissed the claim against PNC. Thereafter, Farah moved to vacate the default judgment against him. The state court opened the default judgment to allow Farah to prove a meritorious defense; Richards could still enforce the judgment, however.[5]

In November 1998, Farah filed for bankruptcy and removed the state court action to bankruptcy court pursuant to 28 U.S.C. § 1452, which authorizes removal in bankruptcy cases. In April 2000, Richards filed a motion under Federal Rule 54(b) for review of the state court order dismissing PNC based on alleged newly discovered evidence. In June 2001, the bankruptcy court denied the motion. On July 16, 2001, the court denied Farah's request for relief from the default judgment.[6]

On July 24, 2001, Richards filed a notice of appeal from the state court order dismissing PNC on the basis that the order was interlocutory and not appealable until July 16, 2001. The district court determined that it lacked jurisdiction to review that order, however. The court found that contrary to Richards's argument, the doctrine of federalization was not applicable, and the court reasoned that the bankruptcy court had properly treated the appeal from the order as a Rule 54(b) motion. Also, the district court found that the appeal, insofar as it related to the order denying the Rule 54(b) motion entered approximately a month before, was untimely. The court dismissed the appeal.[7]

Richards appealed again. In addressing his argument that the order dismissing PNC had been "federalized" upon removal, the Third Circuit noted that the concept has been well established in the nonbankruptcy removal context.[8] It further noted that it had not yet decided whether § 1450 has the same transformative effect when removal is effected under § 1452, the bankruptcy removal statute.[9] Nonetheless, the Third Circuit observed, the similarities between the general removal procedures of §§ 1441-46 of title 28 and the removal procedures in bankruptcy would indicate that the effect should be the same.[10] Moreover, the Third Circuit noted, the Supreme Court had previously concluded that other nonbankruptcy removal procedures can "comfortably coexist" with bankruptcy-removal procedures.[11] The Third Circuit declined to resolve the issue;[12] instead, although it found the appeal from the Rule 54(b) order untimely, it opted—in light of the confusion over removal procedures—to deem the appeal timely and remanded the matter back to the district court.[13] Incidentally, the Third Circuit noted in a footnote that if Richards was in fact appealing the "federalized" state court order dismissing PNC, such appeal would likewise have been untimely.[14]

5 2005 WL 647344 at *1 (3d Cir. March 22, 2005).
6 *Id.* at *1-2.
7 *Id.* at *2.
8 *Id.* at *3.
9 *Id.* at *4.
10 *Id.*
11 *Id.* (quoting *Things Remembered Inc. v. Petrarca*, 516 U.S. 124, 129 (1995)).
12 *Id.*
13 *Id.*
14 *Id.* at *4 n. 7.

Application of Federalization

Notwithstanding the Third Circuit's unwillingness to rule on the issue, one can argue that for several reasons, the doctrine of federalization should apply in bankruptcy court.

Bankruptcy Rule 9027(i)

First, Bankruptcy Rule 9027(i) essentially codifies the doctrine, and provides, in relevant part, that "[a]ll injunctions issued, orders entered and other proceedings had prior to removal shall remain in full force and effect until dissolved or modified by the court."[15] Rule 9072(i) is based on § 1450.[16]

Thus, some bankruptcy courts have treated state court orders in removed proceedings as "federalized" based on Rule 9027(i). In *Morris Black & Sons Inc. v. 23S23 Construction Inc. (In re Carriage House Condominiums LP)*, for instance, a bankruptcy court held that only counts I and III of a complaint remained pending after a state court had already dismissed count II before the action was removed to bankruptcy court.[17] Also, in *Ramirez v. Rodriguez (In re Ramirez)*, a bankruptcy court imposed sanctions under Rule 37(b)(2) against the debtor for failing to comply with a pre-removal state court order compelling the debtor to produce documents.[18] Next, in *In re Briarpatch Film Corp.*, a bankruptcy court remanded a removed state court action because the court concluded that it was required under Rule 9027(i) to respect the state court's pre-removal order and judgment.[19] Finally, in *Hunts Point Tomato Co. v. Roman Crest Fruit Inc. (In re Roman Crest Fruit Inc.)*, a bankruptcy court found that a state court temporary restraining order barring a company from transferring its interest in certain leaseholds continued after removal, pursuant to former Bankruptcy Rule 9027(k) and former 28 U.S.C. § 1479(c), which were predecessors of Rule 9027(i), pending the bankruptcy court's decision on a motion for preliminary injunction.[20]

Application of § 1450 in Bankruptcy Court

Second, as the Third Circuit noted in *Farah*, the effect of § 1450 should be the same in a bankruptcy court based on the Supreme Court's conclusion in *Things Remembered*.[21] In the wake of the *Things Remembered* decision, some courts have applied the procedural requirements for removal to district court, such as the deadline for removal, to removal to a bankruptcy court.[22]

Accordingly, one can argue that the principle embodied in § 1450—that state court orders remain in effect after removal—should apply also in a bankruptcy court. Indeed, several courts have cited § 1450 and/or its related case law as support for applying federalization in a bankruptcy case. For instance, courts have cited § 1450 as the basis for enforcing a pre-removal state court discovery order.[23]

15 Fed. R. Bankr. P. 9027(i).
16 *See* Fed. R. Bankr. P. 9011(i) Advisory Committee Note (1983) ("Subdivision...(k) [now (i)] [is] derived from 28 U.S.C...§ 1450.").
17 2011 WL 2489421 at *6 (Bankr. E.D. Pa. June 22, 2011).
18 2010 WL 1904270 at *6 (Bankr. S.D. Tex. May 11, 2010).
19 281 B.R. 820, 829-30 (Bankr. S.D.N.Y. 2002).
20 35 B.R. 939, 941 (Bankr. S.D.N.Y. 1983).
21 2005 WL 647344 at *4 (citing *Things Remembered*, 516 U.S. at 129).
22 *See, e.g., In re Asbestos Litig.*, 2002 WL 649400 at *3 (D. Ore. Feb. 1, 2002) ("Just as the procedural requirements of § 1447 [addressing procedure after removal to district court] apply to bankruptcy removals under § 1452, so also do the deadlines set in § 1446(b) [addressing deadline for removal to district court]. There is no conflict between § 1446 and § 1452.").

Further, courts have allowed parties to seek review of a state court order or judgment entered before removal to bankruptcy court, but only under the applicable federal—and not state—rules that allow for such relief, on the premise that based on § 1450 or case law applying it, such order or judgment should be treated as if it was entered in federal court. For example, in *Mata v. Schoch*, a district court applied Federal Rule 60(b) to reconsideration of a state court order granting summary judgment entered before removal to bankruptcy court.[24] Likewise, in *McCraney v. High Desert Neurology Inc. (In re McCraney)*, a bankruptcy court applied Federal Rule 55 to a motion for relief from default judgment entered before removal to bankruptcy court.[25]

Next, courts have, in the context of a motion to remand, rejected the argument that removal of a state court action to bankruptcy court would allow the removing party to escape the effects of pre-removal state court orders. These courts reasoned that they were required to enforce such orders under § 1450 and related case law, and thus, that comity did not require remand.[26] Bankruptcy courts have invoked § 1450 and its related case law in other removal situations as well.[27]

Law of the Case

Finally, although Rule 9027(i) allows a bankruptcy court to "dissolve" or "modify" a state court order in a removed action, the "law-of-the-case" doctrine nevertheless supports the application of federalization in bankruptcy court. Under the law-of-the-case doctrine, a court's decision on a rule of law should, subject to exceptions, continue to govern the same issues later in the same case.[28] By preserving the effect of state court orders, application of law of the case in an action removed to bankruptcy court would, like § 1450, foster judicial economy and protect parties' rights. For these reasons, some courts have held that an order in a state court action can constitute law of the case even after the action is removed to bankruptcy court. In *Bourdeau Bros. Inc. v. Montagne (In re Montagne)*, for example, a bankruptcy court found that a state court's pre-removal findings on a defendant's motion to dissolve a *writ* of attachment and a motion for reconsideration were law of the case in the determination of the defendant's post-removal motion for summary judgment in bankruptcy court.[29] Similarly, in *Success Data Systems Inc. v. NCR Corp. (In re Success Data Systems Inc.)*, a bankruptcy court remanded a removed action because the state court's previous determination regarding the enforceability of an arbitration agreement was law of the case and because denial of the remand motion would have essentially vested the bankruptcy court with appellate jurisdiction over the state court's decision.[30]

Conclusion

Bankruptcy courts should, under the doctrine of federalization, enforce state court orders in removed actions. abi

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23 *See, e.g., Pappas*, 1994 WL 134097 at **1-2 (affirming bankruptcy court judgment imposing sanctions under Federal Rule 37(b)(2) against party for failing to comply with state court discovery order entered prior to removal). *Ramirez v. Rodriguez (In re Ramirez)*, 2010 WL 1904270 at **5-6 (Bankr. S.D. Tex. May 11, 2010) (looking to "28 U.S.C. § 1450 and its case law to determine the effect bankruptcy removal has on state court orders under Bankruptcy Rule 9027(i)," and imposing sanctions under Rule 37(b)(2) against debtor for failing to comply with pre-removal state court discovery order).

24 337 B.R. 138, 144 (S.D. Tex. 2005).

25 439 B.R. 188, 200-1 (Bankr. D.N.M. 2010).

26 *New England Wood Pellet LLC v. New Eng. Pellet LLC*, 419 B.R. 133, 146 (D.N.H. 2009); *In re Global Outreach SA*, 2009 WL 1606769 at *10 (Bankr. D.N.J. June 8, 2009). *But see In re RBGSC Inv. Corp.*, 253 B.R. 369, 384 (Bankr. E.D. Pa. 2000) (citing § 1450, and its language allowing district court to dissolve or modify state court order following removal, as basis for rejecting argument that mere entry of pre-removal state court orders, by itself, automatically requires remand of removed action).

27 *See, e.g., In re Smith*, 437 B.R. 817, 824-25 (Bankr. N.D. Tex. 2010) (holding that court had authority under federalization doctrine to render final award of interest and costs on pre-removal state court judgment); *Alt. Debt Portfolios LP v. E-Z Pay Servs. (In re EZ Pay Servs. Inc.)*, 390 B.R. 445, 454 (Bankr. M.D. Fla. 2008) (observing that a federal court in removed action possesses jurisdiction to enforce temporary restraining order or injunction entered by state court prior to removal); *Massey v. Riebold (In re Massey)*, 3 B.R. at 110, 111-12 (Bankr. D. Col. 1980) (noting that bankruptcy court was required to enforce pre-removal state court judgment setting aside jury verdict but noting further that bankruptcy court had power to reinstate jury verdict if it found that state court had committed error of law).

28 *Christianson v. Colt Indus. Operating Corp.*, 486 U.S. 800, 815-16 (1988).

29 2009 WL 5195769 at **3-4, 7 (Bankr. D. Vt. Dec. 21, 2009).

30 58 B.R. 81, 84 (Bankr. E.D. Pa. 1986). *But see Redfield v. Cont'l Cas. Corp. (In re Cont'l Cas. Corp.)*, 818 F.2d 596, 604-5 (7th Cir. 1987) (recognizing that law-of-the-case doctrine applies to state court action removed to federal court, but noting that federal court is not bound as to procedural matters, and thus, holding that district court, in determining whether amended complaint sufficiently pled cause of action, was not bound by previous state court ruling dismissing complaint); *Bohm v. Titus (In re Titus)*, 2012 WL 695604 at *11 (Bankr. W.D. Pa. Feb. 29, 2012) (noting that rulings in removed state court action were law of case, but noting further that doctrine does not apply where it is necessary to correct glaring errors in law, and thus, finding doctrine inapplicable because rulings were clearly erroneous); *Oppegard v. Skeie (In re Oppegard Agency Inc.)*, 152 B.R. 581, 591 (Bankr. D. Minn. 1993) (holding that state court's pre-removal denial of motion for dismissal or summary judgment for lack of standing was not law of case where state court had not indicated that its decision was final determination on standing, and standing involved mere procedural determination that was not binding on bankruptcy court).