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Retention of Jurisdiction in Bankruptcy Sale Orders: The First Circuit Says Not So Fast

By Peter C. Blain*

The U.S. Court of Appeals for the First Circuit recently rendered a decision which substantially impacts the scope of retention of jurisdiction provisions in sale orders and orders confirming Chapter 11 plans. The author of this article discusses the decision, which is an important reminder that the principle of a federal court's ability to interpret and enforce its own prior orders may be insufficient to permit the bankruptcy court, which is likely the most convenient and efficient forum, to address issues collateral to the sale or plan.

Today, most cases filed under Chapter 11 of the U.S. Bankruptcy Code[1] result in a sale of the debtor's assets under Code Section 363.[2] Occasionally, the sale is followed by confirmation of a plan of reorganization which distributes the sale proceeds in accordance with the Code's priorities. Universally, the order approving the sale includes a provision pursuant to which the bankruptcy court retains jurisdiction to adjudicate any and all issues related to the sale and the agreement pursuant to which the assets are sold. Where a plan is confirmed, the confirmation order provides that the bankruptcy court retains jurisdiction to interpret and enforce the provisions of the plan, sometimes referencing the asset sale specifically.

On June 2, 2017, the U.S. Court of Appeals for the First Circuit, in *Gupta v. Quincy Medical Center,*[3] rendered a decision which substantially impacts the scope of retention of jurisdiction provisions in sale orders and orders confirming Chapter 11 plans. The panel, which included retired U.S. Supreme Court Justice David Souter, held that such provisions cannot confer jurisdiction on a bankruptcy court, even to interpret its own orders, unless the court had subject matter jurisdiction in the first instance. The decision significantly limits the range of matters the bankruptcy court can resolve in connection with a Code

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1 11 U.S.C §§ 101–1532 (the "Code").

2 *See* Peter C. Blain, Michael D. Jankowski & L. Katie Mason, *Buying & Selling Businesses in Insolvency Proceedings*, J. of Tax'n and Reg. of Fin. Insts., May/June 2014, at 5.

3 *Gupta v. Quincy Med. Ctr,* 858 F.3d 657 (1st Cir. 2017).

Section 363 sale, making costly litigation in non-bankruptcy forums far more likely.

THE FACTS

On June 30, 2011, Quincy Medical Center, Inc. and certain affiliates (the "Debtors") entered into an Asset Purchase Agreement ("APA") pursuant to which the Debtors agreed to sell substantially all of their assets to Stewart Family Hospital ("Stewart"). The APA provided that Stewart would offer employment to each of the employees of the Debtors for not less than three months at such employees' pre-closing base salary levels. The Debtors filed voluntary Chapter 11 petitions on July 1, 2011, and on September 26, 2011, the bankruptcy court issued and order approving the sale. The sale closed on October 1, 2011, and on October 7, the Debtors proposed a plan of reorganization which was subsequently confirmed by the court. Both the sale order and the order confirming the plan included provisions pursuant to which the bankruptcy court retained jurisdiction to interpret and enforce the sale order and to resolve any disputes under the APA.

On October 7, 2011, Apurv Gupta and Victor Munger, senior executives at Quincy Medical Center ("Employees"), received letters from Stewart stating that their employment was terminated effective as of the October 1 closing. The Employees filed motions seeking allowance from the Debtors' estates of their claims for severance pay, which they asserted were entitled to administrative expense priority. The bankruptcy court denied the motions, but held that the motions should be treated as a request for an order directing Stewart to the pay the severance claims. Finding that the retention of jurisdiction provisions of the sale order and the court's authority to interpret and enforce its own prior orders was a sufficient basis for jurisdiction, after a non-evidentiary hearing, the bankruptcy court found Stewart liable for the Employees' severance pay.

Stewart appealed to the district court which reversed, concluding that the bankruptcy court lacked subject matter jurisdiction over the Employees' claims. The claims, said the district court, fell outside of the bankruptcy court's statutorily granted jurisdiction and the retention of jurisdiction language in the sale order did not change this analysis. The Employees appealed to the First Circuit.

BASIS OF JURISDICTION

The First Circuit began its decision by noting that the general grant of bankruptcy court jurisdiction arises under 28 U.S.C. § 1334, which in Section 1334(b) provides that the bankruptcy courts have jurisdiction over proceedings

"arising under title 11, or arising in or related to cases under title 11."[4] The court observed that the boundaries between proceedings which "arise under," "arise in," or which are "related to" title 11 are not always easy to distinguish from each another.[5] "Arising under" jurisdiction exists when the Code itself creates a cause of action.[6]

Citing *Collier on Bankruptcy*, the court said that "arising in" proceedings include administrative matters, orders to turn over property of the estate and determinations of the validity, extent and priority of liens, among other things.[7] "Related to" proceedings potentially have some effect on the bankruptcy estate, such as altering the debtor's rights or liabilities, or otherwise impact the handling of the bankruptcy estate.[8]

APPLICATION OF THE JURISDICTIONAL PRINCIPLES

The Circuit court noted that the bankruptcy court did not determine whether it had "arising under," "arising in" or "related to" jurisdiction. Instead the bankruptcy court relied solely upon the basis of the retention of jurisdiction provisions in the sale order and the plan of reorganization.[9] While bankruptcy courts, like all federal courts, retain jurisdiction to interpret their own orders, a bankruptcy court by order cannot retain jurisdiction over a matter if the jurisdiction is not underpinned by Section 1334. The bankruptcy court, said the court, cannot retain jurisdiction it never had. Retention of jurisdiction provisions in sale orders and plans, which the court noted are routinely included, may only be given effect if there is underlying jurisdiction under 28 U.S.C. § 1334.[10]

The court then noted that the Employees were silent about the application of "arising under" or "related to" jurisdiction. This silence indicated that they did not dispute that neither form of jurisdiction applied.[11] However, the Employees did insist that "arising in" jurisdiction did apply. The APA was

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[4] 28 U.S.C. § 1334 grants jurisdiction to the district courts. However, by rule each district court automatically refer such matters to the bankruptcy courts. *See Quincy, supra* note 3.

[5] *Id.*

[6] *Id.*

[7] *Id.* (citing Collier on Bankruptcy, § 3.01[3][e][iv] (Alan N. Resnick & Henry J. Sommer eds., 16th ed. 2016) (hereinafter "Collier").

[8] *Id.*

[9] *Id.*

[10] *Id.*

[11] *Id.*

approved in a sale order which could only be issued by a bankruptcy court. "But for" the bankruptcy case and the sale order approving the APA, asserted the Employees, the Employees' claims for severance would not exist.[12]

The court said that the Employees misapprehended the relevant law. There is no "but for" test for "arising in" jurisdiction. Quoting *Collier*, the court noted that "the fact that a matter would not have arisen had there not been a bankruptcy case does not ipso facto mean that the proceeding qualifies as an 'arising in' proceeding."[13] The court went on: "Instead, the fundamental question is whether the proceeding by its nature, not its particular factual circumstance, could arise *only* in the context of a bankruptcy case."[14] Stated differently, "arising in" jurisdiction only exists if the Employees' claims are the type of claims that can only exist in bankruptcy.[15]

The court dismissed the Employees' argument that although their claims are framed as state law claims, the claims depend upon an interpretation of the bankruptcy court's sale order. Instead, the court concluded that bankruptcy court approval of the asset sale did not automatically create jurisdiction over all future contract disputes related to the APA.[16] The Employees' claims were not merely framed as state law claims, but were actually employment dispute claims that could be decided solely under state law.[17] Affirming the district court, the First Circuit held that the claims did not fit the narrow category of claims that have no existence outside of the bankruptcy. Therefore the bankruptcy court did not possess the requisite "arising in" jurisdiction to adjudicate them.[18]

CONCLUSION

Lawyers have routinely drafted sale orders and plans which include retention of jurisdiction language assuming that any dispute which subsequently arises will be decided by the bankruptcy court issuing the sale order or the order confirming the plan. *Quincy* is an important reminder that the principle of a federal court's ability to interpret and enforce its own prior orders may be insufficient to permit the bankruptcy court, which is likely the most convenient

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[12] *Id.*

[13] *Id.* (quoting Collier § 3.01[3][e][iv]).

[14] *Id.* (citation omitted).

[15] *Id.*

[16] *Id.*

[17] *Id.* (wherein the court observed that the Employees filed identical claims against Stewart in Massachusetts state court).

[18] *Id.*

and efficient forum, to address issues collateral to the sale or plan. Instead, independent Section 1334 jurisdiction must exist before the bankruptcy court can act. Being mindful of this requirement should prevent bankruptcy practitioners from needlessly knocking on the wrong courthouse door.