

Bankruptcy Removal: with Strings Attached

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As first-year law students, we learned about the general removal statutes—28 U.S.C. §§ 1441 and 1446—which allow a defendant to remove certain civil actions filed in state court to federal court on the basis of complete diversity or federal question.

Turn a page or two further in Title 28 and you will find another removal statute—28 U.S.C. § 1452—which provides for the removal of claims over which a bankruptcy court has jurisdiction. Whereas the general removal statutes allow for removal of an entire civil “action” provided there is diversity or a federal question, the bankruptcy removal statute allows the removal of “any claim or cause of action” over which a bankruptcy court has jurisdiction. For example, in a complex lawsuit involving multiple claims and parties, a party might only remove a counterclaim over which the bankruptcy court has jurisdiction, leaving the balance of the case in state court.

So, what is “bankruptcy jurisdiction”? As a general rule, bankruptcy courts have original, but not exclusive, jurisdiction over civil proceedings arising under title 11, and proceedings arising in or related to cases under title 11 (28 U.S.C. § 1334).

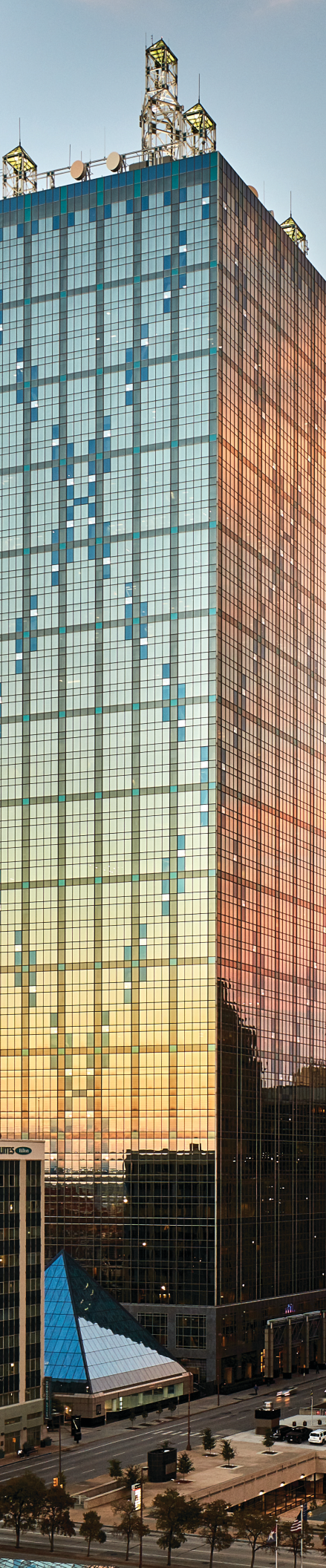
“Arising under” jurisdiction applies to claims created or determined by a statutory provision of the Bankruptcy Code. “Arising in” jurisdiction, on the other hand, is not based on a right expressly created by the Bankruptcy Code, but instead is based on claims that have no existence outside bankruptcy. “Related to” jurisdiction exists if the outcome of that proceeding could conceivably have any effect on the estate being administered in bankruptcy.

For cases filed in state court by a trustee, debtor, or debtor-in-possession, “related to” is the most likely basis for bankruptcy jurisdiction, since the claims will typically have an effect on the bankruptcy estate. For example, a dispute between the debtor and one of its customers based on a pre-petition contract might give rise to “related to” jurisdiction because the outcome could enlarge or deplete the bankruptcy estate.

Rule 9027 of the Federal Rules of Bankruptcy Procedure governs the procedure for bankruptcy removal. Like the general removal statutes, the removing party bears the burden of establishing the bankruptcy court’s jurisdiction. Whether the bankruptcy court will ultimately decide the removed claims does not, however, solely hinge on the existence of the bankruptcy court’s jurisdiction.

The doctrines of mandatory and discretionary abstention (28 U.S.C. § 1334(c)), and equitable remand (28 U.S.C. § 1452(b)) provide a means for the bankruptcy court to remand the case to state court, even when the bankruptcy court unquestionably has jurisdiction. Mandatory abstention applies when: (1) the plaintiff makes a timely motion for abstention; (2) the removed claim is based wholly upon state law; (3) the removed claim does not “arise under” the Bankruptcy Code and is not dependent upon the construction or application of bankruptcy law; (4) the claim could not have been commenced in federal court absent bankruptcy jurisdiction; and (5) the claim can be timely adjudicated in state court.

If mandatory abstention applies, the bankruptcy court must remand the claim to state court. If the requirements for mandatory abstention are not satisfied, the bankruptcy court may nevertheless exercise its discretion to abstain and remand the case under the doctrines of discretionary abstention or equitable remand.



In determining whether or not to exercise its discretion, the court will likely consider: (i) the existence of two closely related proceedings based upon state law or a state law cause of action; (ii) the absence of any basis for a jurisdiction other than bankruptcy jurisdiction; (iii) the likelihood of timely adjudication in state court; (iv) the predominance of state law issues; and (v) the degree of relatedness of the proceeding to the bankruptcy case. The court may also consider the burden on its docket, the likelihood that the commencement of the proceeding in bankruptcy court involves forum-shopping by one of the parties, the existence of the right to a jury trial, and the inclusion of non-debtor parties in the proceeding. The bankruptcy court is not required to address each factor, and permissive abstention and equitable remand may be warranted even where some of the factors are absent.

If your client finds itself adverse to a trustee, debtor, or debtor-in-possession in an unfavorable state court forum, consider whether it makes sense to remove all or some of the asserted claims to bankruptcy court under the bankruptcy removal statute. Don't get too comfortable though, because you may not be there for long.

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