No. _____

In the Supreme Court of the United States

STATE OF MICH. WORKERS' COMP. AGENCY AND STATE OF MICH. FUNDS ADMIN., PETITIONERS

v.

ACE AM. INS. CO. AND PAC. EMPLOYERS INS. CO.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Whether the limited waiver of sovereign immunity established in *Central Virginia Community College* v. *Katz*, 546 U.S. 356 (2006), over a bankruptcy court's orders "ancillary to" the court's *in rem* jurisdiction extends to orders that obstruct a State in its enforcement of a comprehensive administrative scheme.

2. Alternatively, whether *Katz* should be overruled because it incorrectly concludes that the States when they ratified the Constitution agreed to waive their sovereign immunity with respect to "uniform laws of Bankruptcy."

PARTIES TO THE PROCEEDING

The Petitioners are the State of Michigan Workers' Compensation Agency and the State of Michigan Funds Administration (collectively, the "Michigan Defendants"). Petitioners were Defendants-Appellants in the United States Court of Appeals for the Second Circuit.

The Respondents, who were Plaintiffs-Appellees below, are Ace American Insurance Company and Pacific Employers Insurance Company (collectively, the "Insurers").

DPH Holdings Corporation also was a Defendant-Appellee below. DPH Holdings did not participate as Defendant-Appellee here because it settled the Insurers' claim.

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The United States Court of Appeals for the Second Circuit summary order, App. 1a–7a, is not reported but is available at 580 F. Appx 10 (2d Cir. 2014); that court's prior summary order, App. 43a–51a, is not reported but is available at 448 F. Appx 134 (2d. Cir. 2011). The United States District Court for the Southern District of New York's decision, App. 8a–35a, is available at 2013 WL 3948683; that court's prior order, 36a–42a, is unreported, and its prior decision, App. 52a–76a, is available at 437 B.R. 88 (S.D.N.Y. 2010). The United States Bankruptcy Court for the Southern District of New York order, App. 77a–81a, is not reported.

JURISDICTION

The court of appeals entered its summary order on September 19, 2014, App. 1a–7a, and an earlier summary order on November 29, 2011, App. 43a–51a. Petitioner invokes the jurisdiction of this Court under 28 U.S.C. § 1254(1).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The Bankruptcy Clause of the United States Constitution, U.S. Const. art. 1, § 8, cl. 4, provides that Congress shall have power "To establish . . . uniform Laws on the subject of Bankruptcies throughout the United States."

The Eleventh Amendment of the United States Constitution provides, "The Judicial power of the United States shall not be construed to extend to any suit in law or equity, commenced or prosecuted

against one of the United States by Citizens of another State, or by Citizens or Subjects of any Foreign State."

Section 106 of the Bankruptcy Code, 11 U.S.C. § 106, provides in relevant part:

> (a) Notwithstanding an assertion of sovereign immunity, sovereign immunity is abrogated as to a governmental unit to the extent set forth in this section with respect to the following:
>
> (1) Sections 105, 106, 107, 108, 303, 346, 362, 363, 364, 365, 366, 502, 503, 505, 506, 510, 522, 523, 524, 525, 542, 543, 544, 545, 546, 547, 548, 549, 550, 551, 552, 553, 722, 724, 726, 744, 749, 764, 901, 922, 926, 928, 929, 944, 1107, 1141, 1142, 1143, 1146, 1201, 1203, 1205, 1206, 1227, 1231, 1301, 1303, 1305, and 1327 of this title.
>
> (2) The court may hear and determine any issue arising with respect to the application of such sections to governmental units.
>
> (3) The court may issue against a governmental unit an order, process, or judgment under such sections or the Federal Rules of Bankruptcy Procedure . . . .
>
> * * *

> (5) Nothing in this section shall create any substantive claim for relief or cause of action not otherwise existing under this title, the Federal Rules of Bankruptcy Procedure, or non-bankruptcy law.

(b) A governmental unit that has filed a proof of claim in the case is deemed to have waived sovereign immunity with respect to a claim against such governmental unit that is property of the estate and that arose out of the same transaction or occurrence out of which the claim of such governmental unit arose.

INTRODUCTION

This case involves an important issue of state sovereignty, namely the limits on the States' waiver of sovereign immunity that this Court announced in *Central Virginia Community College* v. *Katz*, 546 U.S. 356 (2006), with respect to a bankruptcy court's orders pursuant to its *in rem* and "ancillary to" *in rem* jurisdiction. As this case illustrates, allowing a third-party insurer to piggy-back on the asserted waiver found in *Katz* as to litigation relating to the debtor's estate, in order to escape a State's comprehensive regulatory scheme for administering workers' compensation benefits for its citizens, exceeds the outer limits of any possible "bankruptcy exception" to sovereign immunity that the States could be found to have agreed to in ratifying the Constitution.

Alternatively, the case shows why this Court should overrule *Katz***.** That case incorrectly concluded that the States agreed to waive their sovereign immunity with respect to "uniform laws of Bankruptcy" when they ratified the Constitution. *Katz* incorrectly made bankruptcy a unique exception to this Court's recognition in *Seminole Tribe of Fla.* v. *Florida*, 517 U.S. 44 (1996), that the States did not waive their sovereign immunity with respect to any of Congress's Article I powers. Absent that conclusion, there would have been no basis for this litigation to have been removed from a state administrative forum with expertise in Michigan's workers' compensation law, or for the artificial bifurcation of two intertwined state-law issues that has obscured the true basis for the State's assertion of liability against the Insurers.

STATEMENT OF THE CASE

A. Nature of the dispute

An employer seeking to conduct business in Michigan must provide for workers' compensation coverage by seeking authorization to be a self-insurer and/or by purchasing insurance from an insurer authorized to transact workers-compensation insurance in Michigan. MICH. COMP. LAWS § 418.611(1)(a),(b). Michigan law does not prohibit an employer from being self-insured while also purchasing insurance coverage through an authorized insurer as a back-up for that self-insured status should the employer, as here, file bankruptcy.

Debtor Delphi Corporation was an automobile parts manufacturer with substantial operations in Michigan. Pursuant to those requirements, Delphi was party to numerous insurance policies issued by Respondents Ace American Insurance Company and Pacific Employers Insurance Company (collectively, the "Insurers"). Every policy issued by the Insurers identified Delphi as the insured. Under Michigan law, any policy issued to an employer within the State must cover *all* the employer's business and employees. MICH. COMP. LAWS § 418.621(4)(e). Policy provisions inconsistent with Michigan's Workers' Compensation Act are void. MICH. COMP. LAWS § 418.621(4)(h). In accordance with Michigan law, each policy contained a mandatory provision entitled "the Michigan Law Endorsement," MICH. COMP. LAWS § 418.621(4), an all-encompassing clause that dictated the scope of the contract.

The Michigan Law Endorsement in these policies demonstrates on its face that all Delphi Michigan employees and all Delphi Michigan locations are covered under the policy. Each of the 2003 to 2008 policies states, "You are insured if you are an employer named in item 1 of the Information Page," and item 1 of the Information Pages lists only Delphi Corporation. The policies also expressly provide that the "Named Insured" is "Delphi Corporation" and the address listed is that of Delphi's Michigan headquarters. Item 1 of the 2000 and 2001 policies similarly lists Delphi as "The Insured."

B. State sovereign immunity in bankruptcy

Sovereign immunity protects the States from the indignity of being haled into federal court by private parties. *Ex parte Ayers*, 123 U.S. 443, 505 (1887). In the bankruptcy setting no less than any other, abrogation of a State's sovereign immunity must be unequivocal. See *Hoffman* v. *Connecticut Dept. of Income Maint.*, 492 U.S. 96, 104 (1989) (holding that Eleventh Amendment immunity barred suit by a Chapter 7 trustee's preference avoidance action against a state agency because Congress had not enacted legislation sufficient to abrogate States' immunity); *United States* v. *Nordic Village, Inc.*, 503 U.S. 30, 38 (1992) (holding that Congress had not empowered a bankruptcy court to order recovery of money from the United States).

But in *Central Virginia Community College* v. *Katz*, 546 U.S. 356, 357 (2006), this Court held that insofar as orders ancillary to the bankruptcy courts' *in rem* jurisdiction implicate States' sovereign immunity from suit, the States agreed in the plan of

the Constitutional Convention not to assert that immunity. The States' agreement was limited to waiving any sovereign-immunity defense in proceedings brought pursuant to "Laws on the subject of Bankruptcies." *Katz*, 546 U.S. at 377.

C. Michigan's statutory scheme for workers' compensation coverage

In Michigan, insurers do not file the actual policies they have issued; instead, they must file with the State an "Insurer's Notice of Issuance of Policy," known as a "Form 400." MICH. COMP. LAWS § 418.625; Mich. Admin. Code r. 408.41 (1979). That notice remains in effect until the insurer files with the agency a "Notice of Termination of Liability," known as a "Form 401." MICH. COMP. LAWS § 418.625; Mich. Admin. Code r. 408.41a (1979).

The terms of the Form 400 are standard and are set by state law; for the insurer to truthfully sign the form, it must certify that it has provided the coverage required under state law. That certification is dispositive; since the State never sees the actual policies, it cannot possibly police them to investigate what the insurer and the beneficiary have contracted. And because state law voids any terms that are contrary to the statutory coverage requirements, those policy terms are immaterial. If the insurer files the Form 400, it has committed itself to providing the full statutorily required coverage.

Accordingly, once an insurance company files a Form 400 and includes the Michigan Law Endorsement in its policy, the intent of the insurer

and the employer are irrelevant under Michigan law. And it is irrelevant whether the underlying policy correctly describes the statutory obligation of the employer to obtain, and the insurer to sell, the required comprehensive coverage. The agency's records determine the insurer at risk on the date of injury—a process that "makes for orderly procedure in accordance with the law." *Zielke* v. *A.J. Marshall Co.*, 11 N.W.2d 209, 210 (Mich. 1943).

Together, Forms 400 and 401 and the Michigan Law Endorsement resolve eligibility and liability efficiently and quickly. This regime illustrates "the semi-public character" of Michigan's compensation insurance, for "if a compensation policy is written at all, an insurer will find that the scope of its liability to employees is taken completely out of the hands of the parties to the insurance policy and dictated by the law of the state." 9 Lex K. Larson, Larson's Workers' Compensation, § 151.01, p 151–1 (2011).

For eight of the nine years preceding Delphi's bankruptcy, the Insurers filed with the agency Form 400s for the Delphi workers. The Insurers argue that the policies they wrote for Delphi did not include workers' compensation coverage for all of Delphi's employees but only for a subset thereof. They further argue that their filing of eight separate Form 400s in eight separate years was merely accidental. But under Michigan law, intent is irrelevant to statutory workers' compensation contracts. "Instead, the *statute* requires such insurance and fixes the conditions of liability. To hold otherwise in ordinary workmen's compensation cases would greatly jeopardize the rights of employees for whose benefit

insurance is required by law." *New Amsterdam Cas.* v. *Moss*, 20 N.W.2d 272, 278 (Mich. 1945) (emphasis added).

D. The debtor's bankruptcy case and the emerging dispute

Delphi Corporation filed for Chapter 11 in the Bankruptcy Court on October 8, 2005. Prior to the bankruptcy, Delphi had paid all workers' compensation claims by Delphi employees as incurred. Shortly thereafter, the Bankruptcy Court approved Delphi's motion to assume the retention and deductible insurance policies with the Insurers. Pursuant to that authorization, the Insurers continued to provide policies to Delphi that listed Delphi Corporation as the insured and that contained the Michigan Law Endorsement stating that all employees of the listed entity were covered by those policies. The Insurers also continued to file Form 400s with the agency, which listed Delphi Corporation as a party for whom the statutorily mandated coverage was provided. There was no issue during the bankruptcy through the end of 2008 and beyond with respect to payment of claims filed by any Delphi employee.

The Bankruptcy Court confirmed Delphi's modified reorganization plan in July 2009 and Delphi emerged from bankruptcy (and the bankruptcy court discharged Delphi from any obligation to make payments on the workers' compensation claims) on October 6, 2009. App. 56a. As a result, Delphi no longer exists and is not available to pay Michigan workers' compensation benefits as a self-insured entity.

In July 2009, before the confirmation date, the agency notified the Insurers of their potential duty to pay the claims as certified by their Form 400 filings, and also notified the Bankruptcy Court of the Insurers' potential liability once Delphi was discharged from its Michigan workers' compensation obligations. Delphi Docket No. 18264, 7/14/09 Joint Objection ¶ 9. By August 30, 2009, the Insurers' attorneys began filing appearances and answers with the agency. On October 6, 2009, Delphi discontinued paying workers' compensation benefits not arising from injuries incurred post-petition.

As of October 24, 2009, 322 cases have been filed by former Delphi employees against the Insurers. In 300 of these cases, injured Delphi employees have not received any workers' compensation benefits; their cases are still pending before the Workers' Compensation Board of Magistrates. The other 22 cases have been settled by the Self-Insurers' Security Fund, one of the funds that make up Petitioner Michigan Funds Administration. Despite their obligations under the terms of their policies with Delphi or under the statutory contracts created by the Form 400 filings, the Insurers disputed their liability for all 322 claims filed by Delphi's former employees for injuries suffered during the periods covered by the Insurers' policies.

Ordinarily, such disputes would be resolved in a statutorily created Michigan administrative forum. Instead, after the Insurers started to defend these cases in Michigan, they sought to escape that established forum by filing an adversary proceeding against Delphi and the Michigan Defendants, asking

the Bankruptcy Court to determine the Insurers' liability under the policies.[1]

E. The proceedings below

The Insurers' complaint contended that "by the policies' express terms, as intended by the parties, the insurers are not liable for the claims now being asserted against the insurers in the Michigan proceedings under the Agency's legal theory as previously communicated to the insurers." App. 92a. In the alternative, the Insurers asked the Bankruptcy Court to "find the policies do so inadvertently through mutual mistake or scrivener's error" and therefore to reform the insurance policies to reflect the parties' actual intent. *Ibid*. Because Delphi needed workers' compensation coverage while in bankruptcy, Delphi agreed to reimburse the Insurers, dollar-for-dollar, on claims to the extent they arose under the policies. Delphi agreed with the Insurers in the course of that litigation that it did not intend for the insurance policies to provide coverage for Delphi's injured employees in Michigan.

The Michigan Defendants moved to dismiss on several grounds, including lack of subject-matter jurisdiction and sovereign immunity. The Bankruptcy Court denied the motion. App. 82a–124a. In doing so, the Court declared jurisdiction over not only the causes of action relating to

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[1] DPH, the holding company liquidating the trust, is a party to the Insurers' adversary proceeding, but only with respect to the policies' interpretation. Delphi and DPH could not be parties to the Form 400 litigation, which is between the State and the Insurers based on their filing of those forms.

interpretation of the insurance contracts but also the State's causes of action against the Insurers for their independent liability relating to the Form 400 claims. App. 97a, 98a, 105a, 106a, 111a–112a. The Michigan Defendants argued that the Insurers were independently liable based on the Form 400 filings, regardless of the language of the policies. They sought to have the Form 400 claims severed and returned to Michigan, and argued that their sovereign immunity barred the Bankruptcy Court from taking jurisdiction over the action.

But the Bankruptcy Court held that it had jurisdiction to decide the issue relating to the terms of the policies, that the Form 400 claims were sufficiently related to that policy issue to also fall within the Court's jurisdiction, and that the State's sovereign immunity had been waived by ratifying the Constitution, thus allowing the Court to hear the entire dispute.

The District Court affirmed the Bankruptcy Court's decision on both subject-matter jurisdiction and sovereign immunity, App. 52a–76a, as did the Second Circuit, App. 43a–51a. Both courts followed essentially the same analysis as the Bankruptcy Court. Citing *Katz* and *Tennessee Student Assistance Corporation* v. *Hood*, 541 U.S. 440 (2004), the Second Circuit summarily rejected the Michigan Defendants' sovereign immunity because the Insurers' adversary proceeding "is an *in rem* proceeding (or, at least is otherwise necessary to effectuate the *in rem* jurisdiction of the Bankruptcy Court)." App. 49a. The Second Circuit held this despite the fact that the Insurers' adversary proceeding did not involve a

state claim against the estate *res* or a proceeding relating to the debtor's status and that the Form 400 dispute did not involve the debtor, Delphi. The Second Circuit also denied the Michigan Defendants' petition for rehearing, App. 127a–28a. This Court subsequently denied interlocutory certiorari.

On remand, the Michigan Defendants again sought to return to Michigan. The Insurers then filed a motion for injunction. By order dated August 10, 2012, the Bankruptcy Court determined that legal actions could move forward in Michigan on the issue of the Insurers' liability pursuant to the Form 400s, but only under certain conditions—that (1) the inquiry be limited to the Insurers' liability based on the filing of the Form 400s that identify insurance policies naming Delphi, and (2) there be an "express presumption that, for purposes of such actions or proceedings only, such policies do not provide any coverage for such claims." Bankruptcy Court's August 10, 2012 Order Granting in Part and Denying in part Plaintiffs' Emergency Motion for Injunction, p 3.

This litigation in Michigan is currently pending before the Michigan Court of Appeals. Although the Bankruptcy Court's conditions do not precisely preclude the State from arguing that state law mandates the scope of the coverage of such policies regardless of the intent of the drafters, they make the State's arguments much more difficult. They create a practical problem inherent in trying to reduce this dispute to a matter of pure contract interpretation, divorced from the statutory regulations overlaying those contract issues.

The Michigan Defendants separately sought summary judgment before the Bankruptcy Court on the issue of the scope of coverage of the policies themselves. They argued that the express language of the insurance policies, the requirements of Michigan workers' compensation law, and public policy all established that the Insurers were liable to all Delphi employees at all Delphi workplaces under the policies the Insurers admittedly issued.

But the Bankruptcy Court ruled that Delphi was not the "Insured Employer" under the policies based on certain exclusionary language in the policies, and held that the policies limited coverage to certain Delphi subsidiaries. App. 36a–42a. The Court ruled that with respect to the scope of the policies the intent of the employer and the insurers controlled and authorized them to limit coverage to only employees of certain Delphi subsidiaries. *Ibid.*

On appeal, the Michigan Defendants argued that the Insurers were liable and that the Bankruptcy Court's order violated Michigan's sovereign immunity. The District Court concluded that the plain language of the policies at issue insured only discrete subsidiaries of Delphi and not Delphi itself, and rejected the sovereign immunity argument. App. 8a–35a.

Again by summary order, the Second Circuit affirmed the lower courts' determination that "by their plain meaning, the Insurers' contracts do not cover Delphi or its self-insured subsidiaries in Michigan." App. 4a. The Court focused on the parties' intent instead of on Michigan's statutory endorsement provision. App. 4a–5a. The Court

recognized that each policy identified Delphi as "the insured" or the "named insured" but, citing a Michigan-specific section and an exclusion-endorsement section of the policies, determined that the policies covered only certain non-self-insured Delphi workplaces. App. 5a. The Court also held that the Michigan Law Endorsement, which under Michigan law must be included in every policy providing workers' compensation coverage, applied only to the "named insured." App. 6a. The Court then relied on its own evaluation of the contract terms to conclude that the "named insured" was not Delphi Corporation (the only entity named on the Michigan Law Endorsement page), but rather, only the non-self-insured entities that are nowhere explicitly listed as the "named insureds." Finally, the Court reaffirmed its earlier holding that this case did not offend Michigan's sovereign immunity because the adversary proceeding was an *in rem* proceeding. App. 7a.

REASONS FOR GRANTING THE PETITION

I. Review is warranted because a bankruptcy court's exercise of its "ancillary to" *in rem* jurisdiction does not extend to orders that obstruct a State from enforcing a comprehensive regulatory scheme.

A defining feature of our constitutional system is dual sovereignty. See *Gregory* v. *Ashcroft*, 501 U.S. 452, 457 (1991). Upon ratifying the Constitution, States did not consent to become mere appendages of the federal government; they entered "with their sovereignty intact." *Federal Maritime Comm'n* v. *South Carolina State Ports Auth.*, 535 U.S. 743, 751

(2002) (citation omitted). And an integral component of that sovereignty is immunity from private suits. *Ibid*.

The holding in *Katz* was a controversial limitation on state sovereignty. See *Katz*, 546 U.S. at 379–393 (Thomas, J., joined by Roberts, C.J., and Scalia and Kennedy, J.J., dissenting). The decision rejected the view taken by all members of the Court in *Seminole Tribe*, 517 U.S. at 54, that the decision would apply to bankruptcy, and it singled out bankruptcy as the sole area of Congress's Article I powers that was not protected under *Seminole*'s holding. This Court said that in giving the federal government the power to enact uniform bankruptcy legislation, the States understood they were giving Congress power to subordinate state sovereignty "within a limited sphere." *Ibid.*

This case asks this Court to articulate the scope of that "limited sphere." Whatever the outer limits of the concept of ancillary jurisdiction discussed in *Katz,* the States did not intend any limited subordination of their sovereign immunity to extend to a bankruptcy order that obstructs a State from applying and enforcing its comprehensive regulatory state law to a non-debtor party. A third party insurer's attempts to escape liability under a State's comprehensive regulatory scheme for administering workers' compensation benefits for its citizens exceeds the outer limits of any possible "bankruptcy exception" to sovereign immunity that the States could be found to have agreed to in ratifying the Constitution.

A. The bankruptcy court's "ancillary to" jurisdiction immediately effected application of Michigan law.

No one would contest that a bankruptcy court has *in rem* jurisdiction to resolve such a proceeding as between the Insurers and the debtor. App. 8a–9a. Further, if this litigation had pertained solely to proofs of claim filed by either the Insurers or the Michigan Defendants against the debtor, a federal bankruptcy court would clearly have had *in rem* jurisdiction to resolve those requests for payment from the *res* of the bankruptcy estate. But here, this litigation was a precursor—in the Bankruptcy Court's words, something that "sets the table," App. 63a, 121a—that would have to be decided before any proofs of claim would be addressed. This "tablesetter" motion had to be determined entirely by state law.

While the Bankruptcy Court purported to apply state law, it actually failed to do so because it (1) allowed the intent of the parties to control over the requirements of the Michigan Law Endorsements, contrary to state law, and (2) essentially left Michigan with a Hobson's choice: either to keep all the issues in the federal system before courts that had no expertise or experience in interpreting Michigan workers' compensation law, or to accept the Bankruptcy Court's conditions in order to allow even the Form 400 issue to be returned to Michigan to be litigated in the forum that specializes in the intricacies of Michigan workers' compensation law.

Had the litigation on the Insurers' liability proceeded unhindered by actions before the

Bankruptcy Court, the preliminary interpretation would have been made by a workers' compensation magistrate with expertise and experience in Michigan's system. The first level of appeal would then have been to the Michigan Compensation Appellate Commission, a panel with similar expertise and experience. Further review would have been within the Michigan court system, experienced in interpreting and applying the many parts of Michigan's deeply integrated system. A proper decision based on Michigan law is crucial to upholding the Michigan Legislature's policy in drafting Michigan's Workers' Disability Compensation Act.

Instead, on remand, a federal bankruptcy court located in New York, having no familiarity with Michigan workers' compensation law, undertook to analyze the interplay between the contracts in question and the Michigan Law Endorsement. The result was a determination that the intent of the parties in writing a contract would control.

The Court could only render such an erroneous interpretation by determining that the intent of the Insurers and covered employer in agreeing to workers' compensation insurance contracts overrode the Michigan Endorsement, contrary to Michigan law. The Court essentially modified Michigan law. And although the Bankruptcy Court offered to allow the State to pursue liability against the Insurers based on their signing of the serial Form 400s, that offer was conditioned on the State agreeing to significant limitations.

Michigan now has 300 cases that must be resolved in a state administrative forum. If the Michigan Defendants do not prevail on their argument that the Form 400 filings control, these cases will have to be resolved under the Bankruptcy Court's policy interpretation that is diametrically opposed to state law.

But even on the Form 400 issue, Michigan will be unfairly disadvantaged. The state court is not free to look at the totality of the circumstances, including the filing of notices of policies, the payment of claims, and the certifications within the Form 400s. Instead, the state court must presume that the policies did not provide coverage—essentially a repeat of the Bankruptcy Court's incorrect interpretation of Michigan law.

B. The "ancillary to" jurisdiction will have lasting effects in Michigan.

The District Court opined that "[t]he [Bankruptcy] Court's construction of [the policies] ought have little effect outside this proceeding." App. 34a. To the contrary, the decision potentially impacts every workers' compensation insurance policy issued in Michigan. Insurers, recognizing that any of their clients could go bankrupt, will be emboldened to avoid liability by challenging coverage for facilities, locations, businesses, classifications of employees, and any other term. Michigan must be allowed to preserve the power to set minimum standards for workers' compensation insurance policies, including the scope of coverage.

If the decision below is upheld, Michigan will be forced to revisit its 80-year-old statutory and regulatory scheme for workers' compensation. Michigan will be uncertain whether it can rely on its current system, since future litigants in bankruptcy courts anywhere in the country are likely to use the Second Circuit's decision as persuasive precedent for considering the intent of the contracting parties, contrary to Michigan law. Whereas, now, Michigan does not require insurers to file their workers' compensation policies with the State, it may have to begin to examine the policies themselves. There are some 150,000 policies issued in a typical year in Michigan, comprising untold millions of pages of terms and conditions—an unwieldy task that the current statutory scheme avoids for good practical reason.

Thus, Michigan will be forced to discard a system that is easily administrable and makes sense—one that allows the agency and the employees to know the terms of coverage simply by virtue of the filing of the Form 400 and the presence of the Michigan Endorsement in every contract. It is not the proper role of a bankruptcy court to tell the Michigan Legislature or regulators how Michigan law should operate or be administered, or to impose substantial additional burdens of time and money on that system.

This litigation goes to the very heart of state sovereign interests. Michigan's workers' compensation system establishes broad regulatory policy for the benefit of its citizens' safety, health, and welfare. Michigan's Act represents a regulatory

regime that balances Michigan employers' and employees' rights. The Michigan Defendants' discretion to argue the impact of its statutory scheme on the Insurers' policies should not be cabined by a federal bankruptcy court's interpretation of Michigan law. Due respect for state sovereignty requires that the Michigan Defendants be allowed to proceed with Michigan administrative proceedings free of interference from the Bankruptcy Court. The fact that the results of those proceedings *may* eventually have some related impact on the bankruptcy does not mean that the initial litigation can or should proceed in the bankruptcy court.

C. The Second Circuit overextended the concept in *Katz* of "ancillary to" *in rem* jurisdiction.

In affirming the Bankruptcy Court's decision, the Second Circuit erred in assuming that every action that either falls within the Bankruptcy Court's *in rem* jurisdiction or "is otherwise necessary to effectuate [its] *in rem* jurisdiction" with respect to the debtor necessarily abrogates state sovereign immunity as to any other litigation that relates to that *in rem* proceeding, App. 7a, 29a–31a, even when the rights being determined all arise under state law and the outcome would obstruct state law.

Congress "never intended" that bankruptcy proceedings "be used to disrupt the orderly administration of the workers' compensation laws by the state." *Ohio v. Mansfield Tire & Rubber Co.* (*In re Mansfield Tire & Rubber Co.*), 660 F.2d 1108, 113–14 (6th Cir. 1981). Congress has made clear that

even the bankruptcy automatic stay, one of bankruptcy law's most fundamental tenets, does not operate to stay the commencement or continuation of a governmental unit's policy and regulatory power. 11 U.S.C. § 362(b)(4). Yet such disruption is precisely what the Insurers are seeking, the Bankruptcy Court allowed, and the Second Circuit affirmed.

Congress has not clearly evinced that governmental units would be subject to the proceedings presented here. This Court has defined "bankruptcy" as the "subject of relations between an insolvent or nonpaying or fraudulent debtor and his creditors, extending to his and their relief." *Katz*, 546 U.S. at 371 (quotation omitted). Accordingly, the thrust of the limits on state sovereign immunity that Congress established in Section 106(a) (and that *Katz* holds may lawfully apply to the States) are to deal with bankruptcy proceedings between a debtor and governmental agency acting as a creditor. They do not extend to allowing debtors to bring affirmative actions against States that would not have been allowed outside of bankruptcy.[2] Even less so can it be plausibly asserted that the States would have

[2] Section 106(a)(1) lists the specific provisions for which sovereign immunity has been abrogated, and that list does not include Section 541 within its scope; that omission was made consciously to preclude the argument that the bankruptcy filing gave the debtor the right to bring state-law-based causes of action that were not otherwise created by the Code. See *PT-1 Long Distance, Inc.* v. *PT-1 Techs., Ind.* (*In re PT-1 Commc'ns*), 403 B.R. 250,262 (Bankr. E.D. N.Y. 2000). That limitation is similar to the distinction between the extent of the bankruptcy court's jurisdiction with respect to Code-created public rights and state-law created private rights drawn in *Stern* v. *Marshall*, 131 S. Ct. 2594, 2612-14 (2011).

understood that they were ceding their immunity from state law causes of action initiated not even by the debtor but by a third-party non-debtor to determine its own rights and interests.

The Bankruptcy Court's incursion into Michigan's regulatory authority over its workers' compensation scheme represents an overextension of *Katz's* concept of jurisdiction "ancillary to the Bankruptcy Court's exercise of its *in rem* jurisdiction," see *Katz*, 546 U.S. at 373, and offends the dignity of state sovereignty. Whatever sovereign immunity defenses the States agreed not to assert in the plan of the Convention, there is nothing to suggest they agreed to such wholesale intrusion.

This Court should grant the Petition and hold that a bankruptcy court's jurisdiction "ancillary to" its *in rem* jurisdiction does not extend to a bankruptcy court's obstruction of a State's enforcement of one of its comprehensive regulatory schemes.

II. The Second Circuit's sovereign-immunity ruling has serious consequences for the States.

It is a reality of the modern world that state agencies and institutions face the possibility of litigation not only in their own State but everywhere in the United States. This case is illustrative. Although the Michigan Defendants did little more than regulate Delphi and the Insurers to ensure that Delphi's employees were adequately protected in the case of a workplace injury, they found themselves embroiled in litigation in bankruptcy court in New York, obstructed from enforcing Michigan's statutory

workers' compensation system in an appropriate Michigan administrative proceeding.

This situation presents precisely the "indignity" that sovereign immunity is supposed to prevent. *Ayers*, 123 U.S. at 505. And the seriousness of that indignity is magnified by the fact that it has been imposed by a federal circuit that oversees bankruptcy courts processing some 40,000 claims per year.[3] The Southern District of New York itself is third among the district courts in Chapter 11 filings[4] and typically handles among the most massive cases by dollar volume. Because of the broad venue provisions in 28 U.S.C. § 1408, the debtor has great leeway to file in districts far from the core of its business activities.

The decision in this case potentially impacts workers' compensation policies not just in Michigan but in other States as well. It sets precedent for allowing insurance companies to disregard the dictates and policies of state law, forcing States to change their statutory and regulatory schemes. Without clarification of *Katz*'s scope, any State might, in any jurisdiction, be subjected to the kind of interference imposed on Michigan by a bankruptcy court in New York. And in future cases this expansion of *Katz* could affect more than just a state workers' compensation scheme. It could affect any regulatory process of any State involved in bankruptcy proceedings. *Katz* opens the door for

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[3]http://www.uscourts.gov/uscourts/Statistics/BankruptcyStatistics/BankruptcyFilings/2014/0914_f2.pdf.

[4] *Ibid.*

insurers to flee state regulatory schemes for the safety of federal bankruptcy courts.

Consider, for example, the possible negative impact of a bankruptcy court's ability to misinterpret—even dismantle—a State's employment laws, worker safety rules, licensing regimes, environmental laws, and police powers—based on the desire of a party to litigate those issues with the State based on the fortuity of a bankruptcy filing by a third party. These are all areas where the health and welfare of state citizens depend on the State's ability to provide—and rely on—comprehensive regulatory schemes.

The Eleventh Amendment protects two ideals that are fundamental to the American system: "first, that each State is a sovereign entity in our federal system; and second, that 'it is inherent in the nature of sovereignty not to be amenable to the suit of an individual without its consent.'" *Seminole Tribe*, 517 U.S. at 54 (citation omitted). Whatever exception *Katz* made to the Eleventh Amendment pertaining specifically to the *in rem* jurisdiction of the bankruptcy courts, it is important to enforce the "limited" scope of the States' purported "consent" to suit in bankruptcy proceedings and to carefully construe the limits Congress chose to place on the States' immunity.

The scope of state sovereign immunity after *Katz* is sufficiently important to all States to warrant the granting of this petition. This Court's resolution of the issue is necessary for uniform settlement of bankruptcy disputes and the preservation of state

sovereign immunity. Accordingly, the Michigan Defendants respectfully request that the Court grant their petition and reverse.

III. Alternatively, the Court should grant the petition and overrule *Katz*.

This Court in *Seminole Tribe,* 517 U.S. at 66, 72–73, made clear that "Article I of the U.S. Constitution cannot be used to circumvent the constitutional limitations placed upon federal jurisdiction." Both the majority and the dissents in *Seminole Tribe* clearly understood that its reasoning would apply to federal bankruptcy proceedings. *Ibid.* at 72 n16. Based on that holding, over the next ten years every Court of Appeals that reached the issue applied *Seminole* in bankruptcy cases and concluded that the purported abrogation of state sovereign immunity in Section 106(a) of the Bankruptcy Code was not constitutional. See *In re Hood*, 319 F.3d 755, 761 (6th Cir. 2003) (listing cases from the Third, Fourth, Fifth, Seventh and Ninth circuits).

That principle appeared to be well settled until the Sixth Circuit adopted a contrary approach, asserting that Congress's powers with respect to bankruptcy cases were uniquely different from those applicable to all of its other Article I powers in cases filed in law and equity. *In re Hood*, 319 F.3d at 763-67. This Court adopted that view in *Katz* in a 5-4 decision, treating as dicta the Court's application of *Seminole Tribe* to bankruptcy. The Michigan Defendants respectfully submit that the holding in *Katz* is based on flawed factual and legal analysis and should be overruled.

A. The development of sovereign immunity jurisprudence shows strong adherence to preserving state sovereignty.

The effect of *Katz* and the flaws in its reasoning can be seen by a brief review of the case law applicable to state sovereign immunity prior to that decision. The most fundamental principle of interpretation regarding state sovereign immunity is that it existed prior to and independent of any rights dealt with in the Constitution. The Constitution did not seek to alter that existing right, nor did the Eleventh Amendment create or define its scope. See *In re State of New York No. 1*, 256 U.S. 490, 498 (1921). Instead, the Eleventh Amendment was an "exemplification" of that retained immunity. *Id.*; see also *Hans* v. *Louisiana*, 134 US 1, 16 (1980) (acknowledging that a State cannot be sued without its consent).

Beginning in the 1930s, this Court began to give greater recognition to congressional powers to regulate economic and social affairs. Numerous cases examined whether those powers could be applied to the States as well as to private entities. The earlier cases turned on how a congressional intent to impose such controls had to be demonstrated and whether there had been a voluntary waiver of immunity by the States with respect to a particular law. See, e.g., *Parden* v. *Terminal R. of Ala. State Docks Dept.*, 377 U.S. 184 (1964) (permitting employees of a railroad owned and operated by Alabama to bring an action against their employer under the Federal Employers' Liability Act). But see *College Sav. Bank* v. *Florida Prepaid Postsecondary Educ. Expense Bd.*, 527 U.S. 666, 681 (1999) (overruling *Parden*, explaining that

it could not be squared with the Court's cases requiring unequivocal waiver of sovereign immunity).

With respect to abrogation, this Court has always imposed a high standard of proof that Congress actually intended such a result, and has generally found that this standard has not been met. This Court applied that principle to bankruptcy in both *Hoffman*, 492 U.S. at 104 (1989) (barring preference avoidance action against a state agency), and *Nordic Village,* 503 U.S. at 38.(1992) (barring transfer avoidance action against the United States).

In *Atascadero State Hospital* v. *Scanlon*, 473 U.S. 234 (1988), the majority again held that the statute at issue did not contain a sufficiently clear showing of congressional intent to overrule the States' immunity. The four dissenters argued that no extraordinary showing of congressional intent needed to be shown as to specific laws because the States, in ratifying the Constitution, had made a global concession of authority to Congress to abrogate their immunity with respect to any power granted to Congress under Article I of the Constitution.

The issue arose again in *Pennsylvania* v. *Union Gas*, 491 U.S. 1, 15–23 (1989), where the majority held, for the first time, that Congress had stated its intent to abrogate the States' immunity with the requisite clarity. The dissenters in *Atascadero* relied on their prior views to conclude that Congress's action in doing so was constitutional. *Ibid*.

Just seven years later, however, in *Seminole Tribe*, 517 U.S. at 72, this Court overruled *Union Gas* and held that, in ratifying the Constitution, the States had not agreed to surrender that immunity regardless of the extent of the powers granted to Congress under Article I. Both the majority and the dissent assumed that the decision would apply with equal force in the bankruptcy context. *Seminole Tribe*, 517 U.S. 72 n16.

But in *Katz*, the majority of this Court adopted the view that while *Seminole Tribe* precluded reliance on Congress's powers under the Article I Bankruptcy Clause, bankruptcy stood alone among Congress's powers in that the States had already given up their immunity when they ratified the Constitution. 546 U.S. at 357. Thus, there was no retained immunity with respect to bankruptcy that Congress would need to abrogate pursuant to *Seminole*. Based on that conclusion, *Katz* held that Congress has the power to legislate without regard to state sovereign immunity—not only for actual *in rem* actions but also with respect to issuing orders "ancillary to" its *in rem* bankruptcy jurisdiction. *Ibid.* at 363, 372–73.

The majority needed to take that approach in order to avoid the effect of its prior rulings holding that Congress did not have the power to *abrogate* existing state immunity. See *Hood*, 541 U.S. at 456 (Thomas, J., dissenting) ("Congress lacks authority to abrogate state sovereign immunity under the Bankruptcy Clause."); *Hoffman*, 492 U.S. at 105 (O'Connor, J., concurring) ("I agree with Justice Scalia that Congress may not abrogate the States'

Eleventh Amendment immunity by enacting a statute under the Bankruptcy Clause."); *Seminole*, 517 U.S. at 72 n16. And to avoid overruling *Seminole* as a whole, the majority needed to demonstrate why bankruptcy was a unique exception to *Seminole's* rejection of the assertion that the States had waived their immunity in ratifying the Constitution.

B. *Katz* cannot be reconciled with the decision in *Seminole Tribe*, this Court's jurisprudence generally, or sovereign immunity principles.

The *Katz* majority decision does not credibly reconcile its holding with *Seminole Tribe* or settled cases such as *Hoffman*. As explained in the *Katz* dissent, see 546 U.S. at 379–393 (Thomas, J., joined by Roberts, C.J., and Scalia and Kennedy, J.J., dissenting), the *Katz* majority's decision to abrogate state sovereign immunity based on the bankruptcy clause is textually and historically problematic.

To begin, *Katz* does not present the necessary "compelling evidence" that the States intended to surrender their immunity in ratifying the Constitution. In an unbroken line of cases stemming from *Hans*, this Court has placed the burden on the party seeking to show a waiver of state immunity from suit to prove that such an action would have been an accepted practice at the time the Constitution was ratified. See, e.g., *Principality of Monaco* v. *Mississippi*, 292 U.S. 313, 322–23 (1934) ("no compelling evidence that the Founders thought such a surrender inherent in the constitutional compact"); *FMC* v. *S.C. State Ports Authority*, 535 U.S. 743, 755 (2002) (noting the "dearth of specific

evidence indicating whether the Framers believed that the States' sovereign immunity would apply"). If no evidence existed one way or the other, that was deemed sufficient to show that States could not be said to have agreed to a waiver of immunity from suits that no one had ever tried to bring against them at the time of the Constitution.

The *Katz* majority did not argue that there was affirmative evidence that States had been and could have been sued in bankruptcy—generally or for avoidance actions in particular—at the time the Constitution was adopted, or that they had agreed to waive their immunity from such suits. Instead, the majority asserted that the statement in *Seminole Tribe* about the application of that holding to bankruptcy was dicta, that the grant of a power to Congress to enact "uniform" bankruptcy laws implicitly included a waiver of sovereign immunity with respect to such laws, that there was no evidence that the States had affirmatively objected to being covered by the bankruptcy laws, and that avoidance actions were a well-known aspect of bankruptcy laws at the time of the Constitution such that it could be assumed the States would have thought such suits could also be brought against them under laws enacted pursuant to the Bankruptcy Clause. Each of those assertions, however, is either a *non sequitur,* lacks factual or legal support, or fails to measure up to the standard used in applying the *Hans* presumption.

First, the discussion of bankruptcy in *Seminole Tribe* was not dicta. Not only did this Court discuss the application of its principles to bankruptcy in

Seminole Tribe but its very first application of that case's principles was to a bankruptcy case. See *Ohio Agric. Commodity Depositors Fund* v. *Mahern*, 517 U.S. 1130 (1996) (granting petition for writ of certiorari in *Matter of Merchants Grain, Inc.*, 59 F.3d 630 (7th Cir. 1995) and vacating judgment and remanding in light of *Seminole Tribe*). Even the Sixth Circuit in the *Katz* case did not attempt to justify its holding in *Hood* under *Seminole Tribe*, attempting instead to avoid that case's impact by placing the waiver at an earlier point in time when the Constitution was adopted.

Second, the grant of power to Congress to enact "uniform" laws of bankruptcy does not support any inference with respect to state sovereign immunity, much less provide "compelling evidence" of waiver. See *Federal Aviation Administration* v. *Cooper*, 566 U.S. ___; 132 S. Ct. 1441, 1448 (2012) ("[A] waiver of sovereign immunity must be 'unequivocally expressed' in statutory text."). *Katz* suggests that one reason for inclusion of the power to pass "uniform" bankruptcy laws in Article I was to avoid the unfortunate situation where a party might receive a discharge from prison and/or from his debts in one state and still be subject to collection actions in another state. But there is nothing in the desire to provide a geographically uniform discharge that logically supports a finding that the States agreed to waive their immunity in bankruptcy cases.

A geographically uniform discharge can apply across state boundaries whether or not state debts are covered or States can be sued in connection with them. Even now, the States are treated differently

from private creditors in numerous ways under the Code, including having many of their debts excluded from discharge. No one has ever suggested that such a result is somehow inconsistent with a uniform law of bankruptcy. Nor does *Katz* present any evidence that either before or after the ratification of the Constitution any party used bankruptcy or insolvency law to obtain the release of any person held to answer for a debt owed *to the State*. Neither is there any reason to assume that the States would have been incensed if their prison officials were occasionally directed, pursuant to federal law, to allow for the release of a debtor held on a private party's writ. This is not "compelling evidence" of the States' agreement to waive their immunity with respect to a broad subjugation to federal bankruptcy laws with respect to their *own* interests and debts.

Third, there is no persuasive way to distinguish the Bankruptcy Clause from the other Article I clauses. Although the Framers included the word "uniform" in the Bankruptcy Clause, the States relinquished some sovereign immunity with *each* Article I power in order to achieve a uniform system of federal laws. It is not clear that the Framers intended "uniform" to mean something other than geographic unity or the preclusion of grants of private bankruptcy relief to individual debtors by state legislatures—neither of which would require any limitation of state sovereign immunity.

Further, while *Katz* reasoned that the power of federal courts to issue writs of habeas corpus to States means that the States ceded their sovereign immunity, 546 U.S. at 373, 375, the connection

between habeas and private suits against the States is not strong enough to support abrogation of sovereign immunity. And to the extent the Eleventh Amendment could be read as barring only suits brought against a State by citizens from another State (the diversity clause), such a reading would not, for example, distinguish the Bankruptcy Clause from the Commerce Clause over which States still retain sovereign immunity under *Seminole Tribe*.

Fourth, there is no evidence that suits against States were an established part of bankruptcy law at the time of the Constitution. The *Hans* presumption requires either a conscious, affirmative agreement to a waiver of immunity or a showing that similar actions against the State were not "anomalous and unheard-of" at the time of the Constitution. 134 U.S. at 18. The *Katz* majority did not cite any evidence from which it could be conclusively inferred that the States would have expected that such suits could be brought against them. To the contrary, there was no evidence ever cited that they had been subjected to *any* suits under bankruptcy or insolvency laws at the time of the Constitution.

The majority raises the point that avoidance actions, *per se*, were a well-established form of action in bankruptcy cases. But it has not been shown that any such action had been brought *against a State*. It is the latter point that is significant: suits to collect on bonds would have been a routine occurrence at the time of the Constitution, but *Hans* held that such suits were barred by the Eleventh Amendment because a suit *brought against a State* to collect on such a bond would have been unheard of. Here as

well, the relevant question is whether avoidance actions could have been asserted against a State. There is simply no proof that such ever occurred.

Fifth, the fact that bankruptcy jurisdiction is principally *in rem* does not establish a basis for States' waiver of their sovereign immunity. The *Katz* majority relied in part on the fact that the bankruptcy power is principally exercised through *in rem* jurisdiction. 546 U.S. at 378. The majority explained that "the jurisdiction exercised in bankruptcy proceedings was chiefly *in rem*—a narrow jurisdiction that does not implicate state sovereignty to the same degree as other kinds of jurisdiction." *Ibid*. That assertion derives solely from *Hood*, 541 U.S. at 450, and contradicts a long line of prior case that held that *in rem* and *in personam* jurisdiction did not operate differently with respect to sovereign immunity, at least in the spheres of law and equity jurisdiction. See, e.g., *Nordic Village*, 503 U.S. at 38. This, along with the fact that this Court has not since applied this concept outside of bankruptcy, counsels that, at a minimum, *Hood* should be narrowly interpreted.

Hood suggested an exception for *in rem* jurisdiction. *Katz* then extended that concept to the rather amorphous concept of "orders ancillary to *in rem* jurisdiction." 546 U.S. at 371. Such orders could, in any event, only be issued based on the Court's *in personam* jurisdiction over the State. As at least one commentator has noted, "federal bankruptcy jurisdiction has *never* been exclusively *in rem* in nature, and is even less so today, given the 'modern shift away from in rem as the jurisdictional

paradigm.'" Brubaker, Ralph, Katz and the New Bankruptcy Exception to States' Constitutional Sovereign Immunity: Abandoning *Hood*'s In Rem Theory (and *Seminole Tribe*), 26 No. 3 BLL 1, March 2006, p. 8 (citing *Menk* v. *Lapaglia* (*In re Menk*), 241 B.R. 896, 914 n. 8 (B.A.P. 9th Cir. 1999) (internal citation omitted)).

Thus, the convergence of *Hood* and *Katz* creates decidedly circular reasoning: Under *Hood*, invasion of state sovereign immunity is allowed precisely because *in re*m jurisdiction is different from *in personam* jurisdiction, yet this difference justifies entry of the very *in personam* orders that *Hood* sought to distinguish from its holding. And as the dissent in *Katz* points out, "The fact that certain aspects of the bankruptcy power may be characterized as '*in rem*'" "does not determine whether or not the States enjoy sovereign immunity against such *in rem* suits" or answer the question "'whether the Bankruptcy Clause subjects the States to transfer recovery proceedings – proceedings the majority describes as 'ancillary to and in furtherance of the Court's *in rem* jurisdiction,' though not necessarily themselves *in rem*." *Katz*, 546 U.S. at 391 (Thomas, J., joined by Roberts, C.J., and Scalia and Kennedy, J.J., dissenting).

Finally, the scope of the Eleventh Amendment is contrary to a conclusion that the Bankruptcy Clause is unique. The *Katz* majority does not reconcile its holding with the Eleventh Amendment. Again, the Eleventh Amendment did not create or limit the States' retained immunity; thus, it surely covers at least those actions that directly fall within its terms.

Even assuming that the States had somehow *sub silencio* agreed to waive their immunity with respect to bankruptcy laws when they ratified the Constitution, the enactment of the Eleventh Amendment was a separate, free-standing assertion of state immunity. On its face it contains no exemption for bankruptcy powers and in connection with its passage there was no discussion about limiting the broad sweep of its plain words that the State may not be sued by a party of a different citizenship in a case brought in law or equity.

In short, ancillary suits against States, as authorized here, are contrary to this Court's settled sovereign-immunity jurisprudence and an affront to States' sovereign dignity. This Court should grant the petition and (1) clarify that a bankruptcy court's exercise of jurisdiction "ancillary to" its *in rem* jurisdiction does not extend to orders that obstruct a State in its enforcement of a comprehensive regulatory scheme, or alternatively, (2) overrule *Central Virginia Community College* v. *Katz*, 546 U.S. 356 (2006).

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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