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Fourth Circuit Holds That Bankruptcy Courts Are Not Limited by the 'Case and Controversy' Requirement of Article III

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Key Points

- A recent Fourth Circuit decision analyzed the differences in the source of authority for bankruptcy courts, whose power derives from Article I of the U.S. Constitution, and other federal courts, whose power derives from Article III.
- Most commonly, those differences are cited as limiting bankruptcy courts' power, but the Fourth Circuit held in *Kiviti v. Bhatt* that bankruptcy courts are not bound by the justiciability requirement of Article III absent a statutory limitation.
- The decision implicitly highlights the potentially exceptional reach of bankruptcy power, and that bankruptcy courts have some authority that Article III courts lack.

From time to time, the U.S. Supreme Court has distinguished the bankruptcy courts' power — deriving from Congress' authority under Article I of the U.S. Constitution to enact uniform bankruptcy laws — from the judicial power under Article III of the Constitution. Most often, the Court has recognized constitutional limitations on the power of bankruptcy courts.

A recent decision from the U.S. Court of Appeals for the Fourth Circuit, however, distinguished the source of the bankruptcy courts' powers and held that Congress, exercising its Article I authority, has granted bankruptcy courts some powers that Article III courts do not have.

In one limitation on bankruptcy courts, the Supreme Court held in the 2011 case *Stern v. Marshall* that they lack power to enter a final judgment on claims traditionally determined at law when the Constitution was enacted. The Court has also emphasized that the Bankruptcy Code limits bankruptcy courts' authority where the Code specifically conflicts with traditional equity powers exercised by courts.

For example, in 2017 the Court held in *Czyzewski v. Jevic Holding Corp.* that a bankruptcy court may not approve distributions under a structured dismissal of a Chapter 11 case that do not follow the Bankruptcy Code's priority rules unless the affected creditors consent.

On the other hand, the Court has also recognized that the bankruptcy power granted by the Constitution through Congress can exceed that exercised by Article III courts if congressional authority is clearly enough established. For instance, in *Allen v. Cooper* (2020), the Court held that a bankruptcy court may subject a nonconsenting state to bankruptcy proceedings, abrogating state sovereign immunity, and said that such power reflects "bankruptcy exceptionalism," which is "unique" to Article I's grants of authority.

The Fourth Circuit's September 14, 2023, decision in *Kiviti v. Bhatt* further explores the implications of the distinction between bankruptcy and Article III courts.[1]

Background

Adiel and Roee Kiviti hired Naveen Bhatt to renovate their home. He represented that he was a licensed contractor, but in fact he was not. When the renovations did not go well, the Kivitis sued him for the full amount they paid, $58,770. Bhatt filed for bankruptcy.

1 On November 15, 2023, the Bankruptcy Appellate Panel for the Tenth Circuit issued an opinion, *Pettine v. Direct Biologics, LLC (In re Pettine)*, disagreeing with the Fourth Circuit's decision and analysis in *Kiviti v. Bhatt*. It found that the jurisdiction of bankruptcy courts cannot extend beyond that of district courts, from which bankruptcy courts derive their jurisdiction, and that Article III's limitations on the district courts do in fact apply to bankruptcy courts.

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The case had an unusual procedural history. In Bhatt's bankruptcy case, the Kivitis brought an adversary proceeding against him with two counts:

- Count 1 sought a money judgment for the $58,770.
- Count 2 sought a declaratory judgment that the debt was nondischargeable under Section 523(a)(2)(A) of the Bankruptcy Code as having been obtained by "false pretenses, a false representation, or actual fraud."

On summary judgment, the bankruptcy court dismissed Count 2 with prejudice but allowed Count 1 to go forward, so the bankruptcy court's order dismissing Count 2 was not a final order that could be appealed as of right.

Because Bhatt's debt, if established, would be heavily discounted if it could be discharged in bankruptcy — indeed, probably to less than the cost of litigation — neither party wanted to continue litigating Count 1 before exhausting appeals on Count 2. They therefore agreed to voluntarily dismiss Count 1 without prejudice to allow the Kivitis to appeal their loss on Count 2 to the district court.

The Fourth Circuit Decision

On appeal, the district court affirmed the dismissal of Count 2. However, when the case reached the Fourth Circuit, it found that the district court lacked jurisdiction to consider the appeal because the bankruptcy court's order was not final.

Relying on well-established precedent, the circuit court held that the parties could not artificially make an order final — and thus appealable as of right — by colluding to dismiss Count 1. The parties would have to proceed with Count 2 or have it dismissed, too, for lack of prosecution.

The circuit court also addressed the Kivitis' argument that, with the dismissal of Count 2, Count 1 was constitutionally moot. This was because, even if the bankruptcy court granted judgment in their favor, they could not enforce the judgment outside of the bankruptcy claim and distribution process, which was proceeding on a different track, not in the adversary proceeding. Thus, they contended, Count 1, which was not a proof of claim, could not give them "any effectual relief."

> Relying on well-established precedent, the circuit court held that the parties could not artificially make an order final — and thus appealable as of right — by colluding to dismiss Count 1.

Interestingly, the Fourth Circuit rejected this argument by reasoning that "[m]ootness arises out of Article III's 'case-or-controversy' requirement. … But since bankruptcy courts are not Article III courts, they do not wield the United States's judicial Power. So they can constitutionally adjudicate cases that would be moot if heard in an Article III court."

Further, in response to the Kivitis' argument that bankruptcy courts derive their jurisdiction from the district courts' delegation of jurisdiction, the Fourth Circuit stated that Article III's "limit on the district court's authority does not constrain the bankruptcy court. Once a case is validly referred to the bankruptcy court, the Constitution does not require it be an Article III case or controversy for the bankruptcy court to act."

Noting that bankruptcy courts instead are "statutory creatures [that] have whatever power Congress lawfully gives them," the circuit court stated that:

> Congress said that bankruptcy courts may hear and determine *all* bankruptcy cases and *all* core proceedings referred to them by a district court. … By [28 U.S.C.] § 157's text, a bankruptcy court's jurisdiction requires only that the case or core proceeding arise under Title 11 and be referred to the bankruptcy court. Section 157 does not require every discrete dispute arising post-referral to satisfy Article III. Nor does any other [statutory] provision (internal citations and quotation marks omitted, emphasis in original).

Takeaways

How can one reconcile *Stern*, in which the Supreme Court found that a bankruptcy court could not issue a final order resolving a dispute within the traditional "at law" jurisdiction of Article III courts, and *Kiviti*'s holding that, although an Article III court could not determine Count 1 under the constitutional mootness doctrine, an Article I court could?

The basis can only be the Fourth Circuit's implicit recognition that, when Congress legislates within its power to enact uniform laws on bankruptcy — and determining the amount of a claim against the bankrupt debtor clearly falls within that power — the bankruptcy court's authority may exceed that of Article III courts.

The implications extend beyond the odd procedural history of *Kiviti* to any attack on a bankruptcy court's decision based on an allegation that it exceeded its constitutional power. The *Kiviti* decision suggests that the question in such cases should be: Was the bankruptcy court's decision permitted by the Bankruptcy Code, and was the applicable provision of the Code consistent with Congress' bankruptcy power?