No. 01-1545

In the Supreme Court of the United States

COMMONWEALTH OF PUERTO RICO, ET AL.,
PETITIONERS

v.

ARECIBO COMMUNITY HEALTH CARE, INC., ET AL.

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

BRIEF FOR THE FEDERAL RESPONDENTS IN OPPOSITION

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QUESTION PRESENTED

Section 106(b) of the Bankruptcy Code, 11 U.S.C. 106(b), provides that a governmental unit that files a proof of claim in a bankruptcy proceeding waives its immunity from counterclaims that arose out of the same transaction or occurrence. The question presented is whether Section 106(b) violates the Eleventh Amendment to the United States Constitution.

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OPINIONS BELOW

The opinion of the court of appeals on rehearing (Pet. App. 1-22) is reported at 270 F.3d 17. The previous opinion of the court of appeals (Pet. App. 23-31) is reported at 244 F.3d 241. The opinion of the district court (Pet. App. 36-50) is reported at 233 B.R. 625.

JURISDICTION

The judgment of the court of appeals was entered on October 29, 2001. A petition for rehearing was denied on January 14, 2002 (Pet. App. 77-78). The petition for a writ of certiorari was filed on April 15, 2002. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

Between 1984 and 1991, governmental units of the Commonwealth of Puerto Rico (petitioners) contracted with Arecibo Community Health Care, Inc. (respondent), to operate the Arecibo Regional Hospital. Pet. App. 3. In 1991, petitioners sued respondent in Puerto Rico court for breach of contract. *Ibid.*

Respondent then filed a voluntary petition for bankruptcy under Chapter 11 of the Bankruptcy Code, 11 U.S.C. 1101 *et seq*. Pet. App. 3. Petitioners filed a proof of claim in the bankruptcy proceeding, asserting that respondent owed them $1.65 million. *Ibid.* After the bankruptcy proceeding was converted to a Chapter 7 liquidation, the Chapter 7 trustee filed a claim against petitioners seeking more than $8.2 million in contract damages allegedly arising from the same contract and operative facts that gave rise to petitioners' claim. *Id.* at 3-4.

Petitioners moved to dismiss the trustee's claim on Eleventh Amendment grounds. Pet. App. 4. The bankruptcy court concluded that the trustee's claims were barred by the Eleventh Amendment. *Ibid.* The district court disagreed, ruling that petitioners had waived their immunity from suit pursuant to 11 U.S.C. 106(b). Pet. App. 5. Section 106(b) provides that "[a] governmental unit that has filed a proof of claim * * * 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." 11 U.S.C. 106(b).

The court of appeals initially reversed, holding that Section 106(b) of the Bankruptcy Code violates the Eleventh Amendment. Pet. App. 23-31. The United

States then intervened to defend the constitutionality of Section 106(b), and the United States and respondent sought rehearing of the panel's decision. *Id.* at 6. The court of appeals agreed to rehear the case. *Ibid.*

On rehearing, the court of appeals affirmed the district court's decision upholding the constitutionality of Section 106(b). Pet. App. 1-22. Relying on this Court's decisions, the court of appeals concluded that "a state may waive its immunity through its affirmative conduct in litigation." *Id.* at 12. The court of appeals specifically explained that this Court's decisions in *Gardner* v. *New Jersey*, 329 U.S. 565 (1947), and *College Savings Bank* v. *Florida Prepaid Postsecondary Education Expense Board*, 527 U.S. 666 (1999), make clear that a State waives its Eleventh Amendment immunity when it "voluntarily invokes" federal court jurisdiction. Pet. App. 15. Based on those decisions, the court of appeals concluded that, by filing a proof of claim, petitioners "validly effect[ed] a partial waiver of [their] sovereign immunity." *Ibid.*

The court of appeals then addressed the "scope" of that waiver. Pet. App. 17. The court noted that the "language of § 106(b) itself provides for a waiver of all claims arising out of the same transaction or occurrence as the state's claim." *Id.* at 18. The court further observed that "[w]here a state avails itself of the federal courts to protect a claim," it is "reasonable to consider that action to waive the state's immunity with respect to that claim *in toto*, and, therefore, to construe that waiver to encompass compulsory counterclaims." *Id.* at 18-19. Finally, the court noted that Section 106(b) avoids "the concrete unfairness that a contrary rule would impose on the other bankruptcy creditors." *Id.* at 22.

ARGUMENT

1. Petitioners contend that review is warranted to decide whether Congress may provide that Puerto Rico's filing of a proof of claim in a bankruptcy proceeding waives its immunity from a compulsory counterclaim without violating the Eleventh Amendment. There is a substantial question whether Puerto Rico may properly rely on the Eleventh Amendment in challenging an Act of Congress subjecting it to suit.

This Court has expressly reserved judgment on whether Puerto Rico should be treated as a State for Eleventh Amendment purposes. *Puerto Rico Aqueduct & Sewer Auth.* v. *Metcalf & Eddy, Inc.*, 506 U.S. 139, 141 n.1 (1993). Moreover, even if Puerto Rico may claim an immunity from suit that is equivalent to that of a State when there has been no action by Congress to dispense with Puerto Rico's immunity, it is not clear why Congress would lack authority to effect such a waiver. The Eleventh Amendment refers only to States, not territories, and Congress has broad power over the territories and their forms of government. See U.S. Const. Art. IV, § 3, Cl. 2 ("The Congress shall have Power to dispose of and make all needful Rules and Regulations respecting the Territory * * * belonging to the United States."). In addition, the territories have not entered the Union as States under the constitutional compact that has been understood to confirm the immunity of States, as sovereigns, from suit. Cf. *Blatchford* v. *Native Village of Noatak*, 501 U.S. 775, 780-782 (1991). Because the applicability of the Eleventh Amendment to Puerto Rico is unsettled and could provide an alternative basis for affirming the judgment below, this case is a particularly poor vehicle for resolving the question presented in the petition.

2. Even assuming, arguendo, that Puerto Rico may rely on the Eleventh Amendment, review of the decision below is not warranted. The court of appeals correctly upheld the constitutionality of Section 106(b), and that decision does not conflict with any decision of this Court or any other court of appeals.

Section 106(b) makes clear that filing a proof of claim constitutes a limited waiver of sovereign immunity: By filing a proof of claim, a governmental unit waives its 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." 11 U.S.C. 106(b). As the court of appeals explained (Pet. App. 18-19), the waiver described by Section 106(b) encompasses compulsory counterclaims.

In *Lapides* v. *Board of Regents*, 122 S. Ct. 1640, 1643 (2002), this Court recently reaffirmed that "[a] State remains free to waive its Eleventh Amendment immunity from suit in a federal court." As explained in *Lapides*, a State effects such a waiver by "voluntarily invok[ing] the federal court's jurisdiction." *Id.* at 1644.

Lapides relied on a line of cases beginning "more than a century ago." 122 S. Ct. at 1643. In *Clark* v. *Barnard*, 108 U.S. 436 (1883), the Court held that a State's "voluntary appearance in federal court amounted to a waiver of its Eleventh Amendment immunity." 122 S. Ct. at 1643 (citing *Clark*, 108 U.S. at 447). In *Gunter* v. *Atlantic Coast Line Railroad*, 200 U.S. 273 (1906), the Court held that, in general, "where a state *voluntarily* becomes a party to a cause and submits its rights for judicial determination it will be bound thereby and cannot escape the result of its own voluntary act by invoking the prohibitions of the Eleventh Amendment." *Lapides*, 122 S. Ct. at 1644

(quoting *Gunter*, 200 U.S. at 284) (emphasis added). And in *Gardner* v. *New Jersey*, 329 U.S. 565, 574 (1947), the Court held, "in the context of a bankruptcy claim, that a State 'waives any immunity . . . respecting the adjudication of' a 'claim' that it voluntarily files in federal court." *Lapides*, 122 S. Ct. at 1643-1644 (quoting *Gardner*, 329 U.S. at 574). Those cases establish a "general principle" that a State waives its immunity when it voluntarily invokes federal court jurisdiction. *Id.* at 1644.

By filing a proof of claim in federal bankruptcy court, a State voluntarily and affirmatively invokes the jurisdiction of the federal courts. In light of this Court's precedents, that step amounts to a waiver of Eleventh Amendment immunity. In the absence of a determination by Congress, a court would have to determine the scope of the waiver—whether it extends only to set-off claims, whether it extends to all counterclaims, or whether it extends only to compulsory counterclaims. In Section 106(b), however, Congress resolved any dispute about the scope of that waiver. Under Section 106(b), if the State chooses to file a proof of claim in a bankruptcy proceeding, it, like any other governmental unit, waives any immunity to claims that "arose out of the same transaction or occurrence." 11 U.S.C. 106(b).

Congress's specification of the scope of the State's waiver falls within Congress's broad authority to condition a State's access to a federal program or a federal benefit on a State's waiver of immunity from suit. See *Alden* v. *Maine*, 527 U.S. 706, 755 (1999); *College Savings Bank* v. *Florida Prepaid Postsecondary Education Expense Board*, 527 U.S. 666, 686-687 (1999); *South Dakota* v. *Dole*, 483 U.S. 203, 207 (1987); *Atascadero State Hosp.* v. *Scanlon*, 473 U.S. 234,

246-247 (1985); *Petty* v. *Tennessee-Missouri Bridge Comm'n*, 359 U.S. 275, 278-282 (1959). Just as Congress may condition approval of a federal compact between two States on the States' waiver of immunity from suit, *Petty*, *supra*, and condition a State's receipt of federal funding on such a waiver, *College Savings*, 527 U.S. at 686, Congress may condition access to the benefits of the federal bankruptcy system and the assets of the bankruptcy estate on a State's waiver of its immunity from compulsory counterclaims on behalf of the estate.

Congress's authority to condition access to a federal program or benefit on a waiver of immunity is not without limits: Congress must make the condition sufficiently clear, and the waiver must be related to the purposes of the underlying federal program. *South Dakota* v. *Dole*, 483 U.S. at 207. But those standards are readily satisfied here. Congress clearly specified that the scope of the State's waiver would extend to compulsory counterclaims, and that waiver is closely related to the purposes of a bankruptcy proceeding—to fairly allocate the property of the estate among competing creditors.[*]

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[*] In *College Savings*, the Court held that Congress lacks authority to prevent a State from engaging in commercial activity unless it consents to suit. The Court reasoned that "the point of coercion is automatically passed—and the voluntariness of waiver destroyed—when what is attached to the refusal to waive is the exclusion of the State from otherwise lawful activity." 527 U.S. at 687. In that context, waiver and abrogation "are the same side of the same coin." *Id.* at 683. Significantly, however, the Court distinguished conditions on otherwise lawful activity from conditions on participation in a federal program, and reaffirmed that Congress may condition a State's participation in a federal program on a waiver of immunity from suit. *Id.* at 686-687. The Court also reaffirmed that a State waives immunity from suit when it voluntarily invokes federal court jurisdiction. *Id.* at 675-676, 681

The constitutionality of Section 106(b) is also supported by the Court's holding in *Lapides* that waiver based on litigation conduct "rests upon the [Eleventh] Amendment's presumed recognition of the judicial need to avoid inconsistency, anomaly, and unfairness, and not upon a State's actual preference or desire." 122 S. Ct. at 1644. As the court of appeals explained, the waiver effected by Section 106(b) avoids "the concrete unfairness that a contrary rule would impose on the other bankruptcy creditors, whose pro rata share of the bankruptcy estate would be diminished because the estate cannot obtain the full amount of debt owed to it," even from those making claims against the estate. Pet. App. 22. That consideration is uniquely relevant in bankruptcy, which "is founded upon principles of equity." *Ibid.* (quoting *In re Straight*, 143 F.3d 1387, 1389 (10th Cir.), cert. denied, 525 U.S. 982 (1998)). A fundamental premise of bankruptcy is that all "creditors coming to the bankruptcy court for relief expect they will fare no better or no worse than others of their stature." *Ibid.*

The constitutionality of Section 106(b) is also supported by the Court's holding that when an individual files a proof of claim in bankruptcy court, he loses his Seventh Amendment right to a jury trial on a related preference action brought by the debtor. *Langenkamp* v. *Culp*, 498 U.S. 42, 44-45 (1990) (per curiam). Similarly here, Congress may condition a State's filing of a proof of claim on its waiver of immunity from suit on a compulsory counterclaim.

3. Petitioners contend (Pet. 8) that the principle that a State waives its immunity by invoking federal court

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n.3. Similarly, in *Lapides*, the Court distinguished the kind of waivers repudiated in *College Savings* from waivers through litigation conduct. 122 S. Ct. at 1643.

jurisdiction applies only to defenses to a State's claim and may not extend to an affirmative monetary recovery from the State. In *Lapides*, the Court squarely rejected that contention. 122 S. Ct. at 1644. The Court explained that the principle enunciated in *Gunter*, *Gardner*, and *Clark* "did not turn upon the nature of the relief sought," and "that principle remains sound as applied to suits for money damages." *Ibid.*

Petitioners similarly err in contending (Pet. 7, 9-10, 21) that this Court's decisions in *United States* v. *Shaw*, 309 U.S. 495, 504 (1940); *United States* v. *United States Fidelity & Guaranty Co.*, 309 U.S. 506, 513 (1940), and *Oklahoma Tax Commission* v. *Citizen Band Potawatomi Tribe*, 498 U.S. 505 (1991), establish that a State's waiver through invocation of federal court jurisdiction may not extend to compulsory counterclaims that seek an affirmative recovery from the State. As this Court explained in *Lapides*, "[t]hose cases * * * do not involve the Eleventh Amendment—a specific text with a history that focuses upon the State's sovereignty vis-a-vis the Federal Government." *Lapides*, 122 S. Ct. at 1646. Equally important, those cases all arose in a context in which Congress had not specified that the filing of a claim would waive immunity from compulsory counterclaims. They therefore do not address the authority of Congress to condition the participation of any governmental unit, including a State, in the bankruptcy process on a waiver of immunity from compulsory counterclaims.

4. The decision below is consistent with the Tenth Circuit's decision in *In re Straight*, *supra*. In that case, the Tenth Circuit upheld the constitutionality of Section 106(b), explaining that Congress has the power "to draw the equitable line * * * leav[ing] the choice to the governmental unit. It can eschew bankruptcy

relief and retain its immunity, or it can doff the protective cloak and join the ranks of creditors seeking the benefits from the debtor's estate. That choice is not constitutionally profound, and it is in accord with one of the fundamental principles of bankruptcy." 143 F.3d at 1392. The decisions below and *In re Straight* are the only two cases that have squarely resolved the question of Section 106(b)'s constitutionality. There is therefore no conflict in the circuits on that issue.

Petitioners contend (Pet. 13-14) that the decision below conflicts with the decisions in *In re Friendship Medical Center, Ltd.*, 710 F.2d 1297 (7th Cir. 1983), and *Ohio* v. *Madeline Marie Nursing Homes*, 694 F.2d 449 (6th Cir. 1982). Those cases, however, addressed the scope of waiver under the bankruptcy laws before the enactment of Section 106(b). They therefore have no bearing on the constitutionality of Section 106(b).

As petitioners recognize (Pet. 16 n.8), there is also no conflict between the decision below and the Fourth Circuit's decision in *In re Creative Goldsmiths of Washington, D.C.*, 119 F.3d 1140, 1147-1148 (1997), cert. denied, 523 U.S. 1075 (1998). Because the counterclaims at issue in that case fell outside the scope of Section 106(b), the Fourth Circuit had no occasion to issue a definitive ruling on the constitutionality of that provision. In any event, the dicta in that case do not conflict with the substance of the court of appeals' decision in this case. While the Fourth Circuit questioned Congress's authority to "deem" that certain state conduct constitutes a waiver, it indicated that Section 106(b) "may correctly describe those actions that, as a matter of constitutional law, constitute a state's waiver of the Eleventh Amendment." 119 F.3d at 1147.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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JUNE 2002