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Mandatory Abstention is Required when Foreign Law Claims are Brought in Conjunction with State Law Claims

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Introduction

When a case is wrongfully removed from state court, mandatory abstention provides moving parties with a way to remand their non-core claims.[1] 28 U.S.C. § 1334(c)(2) provides the framework for a motion that would require a federal district court to abstain. Congress enacted the statute to allow a party to litigate state claims in state court when the case was only removed to federal court because of its relation to a bankruptcy case.[2] The case law interpreting the statute has created a five-step test to determine when mandatory abstention is required.[3] The Third Circuit in *Stoe* articulated that:

> upon a timely motion under § 1334(c)(2), a district court must abstain if (1) the proceeding is based on a state law claim or cause of action; (2) the claim or cause of action is "related to" a case under title 11, but does not "arise under" title 11 and does not "arise in" a case under title 11; (3) federal courts would not have jurisdiction over the claim but for its relation to a bankruptcy case; (4) an action

[1] *See* Stoe v. Flaherty, 436 F.3d 209, 214 (3d Cir. 2006).
[2] *See id.* at 214.
[3] *See id.*; *see also In re* Mattson, 448 B.R. 540, 545 (Bankr. D. Kan. 2011) (listing the test as six factors by adding "upon a timely motion" as the first factor); *In re* WorldCom, Inc. Securities Litigation, 293 B.R. 308, 331 (citing *In re* Adelphia Commun. Corp., 285 B.R. 127, 143–44 (S.D.N.Y. 2002) (stating a motion to remand will fail if a party does not prove any one of the statutory requirements)).

"is commenced" in a state forum of appropriate jurisdiction; and (5) the action can be "timely adjudicated" in a state forum of appropriate jurisdiction.[4]

This test is typically applied to cases that only deal with state law claims, which leaves unanswered whether mandatory abstention is available when foreign law claims are brought in conjunction with state law claims.

This memorandum examines this question by analyzing the five-step test articulated in *Stoe* and outlining how the addition of foreign law claims implicates mandatory abstention in bankruptcy cases.

I. A Proceeding Does Not Need to Arise Solely Upon State Law Claims if the Pleaded Causes of Action are "Based in Part on" State Law Claims.

Typically, in motions for mandatory abstention, determining whether a proceeding is "based on a state law claim or cause of action" is hardly, if ever, litigated.[5] This factor's lack of litigation is due to the assumption drawn from the fourth factor's requirement that a party must bring the claims in the appropriate state forum.[6] However, a Delaware District Court, as a matter of first impression, broadly interpreted the statute's "based upon" language to encompass causes of action that are not based *solely* on state law claims.[7] Specifically, the Court interpreted

[4] *Stoe*, 436 F.3d at 213.
[5] *See* Thomas J. Salerno, Michael P. Pappas, and Logan R. Kugler, *Mandatory Abstention*, COMBANKLT § 3:36, n. 8 (2021) (explaining how "based on state law" is usually subsumed by requiring that the action could not have been brought in federal court without jurisdiction from the statute).
[6] *See id.*
[7] Principal Growth Strategies, LLC v. AGH Parent LLC, 615 B.R. 529, 535 (D. Del. 2020). The court handled its analysis as a matter of first impression because previous courts presented with this issue either reversed for an incorrect application of the law or chose not to answer the question directly. *See In re* Fairfield Sentry Ltd. Litigation, 458 B.R. 665, 689–90, n. 16 (S.D.N.Y 2011) (reversing lower court's finding that foreign law claims did not satisfy factor one of the test because they were added to the case after the motion for remand and should have never been considered); Von Richthofen v. Family M. Found., Ltd., 339 B.R. 315, 320 n. 6 (S.D.N.Y. 2005) (stating the salient point for "based upon a state law claim" is whether the

Congress' use of "based upon *a* state law claim," to be synonymous with "based at least in part on" state law.[8]

In *Principal Growth Strategies*, Defendants argued that because Plaintiffs brought five claims based on Delaware law and four claims based on Cayman Island law, mandatory abstention would not apply.[9] The Court pointed to Congress' silence on defining "based upon" in Title 28 and refused to interpret the text to limit mandatory abstention to cases where the action involved one claim for relief.[10] The Court further articulated its reasoning by comparing it to movies based upon true events and stated that nobody expects such movies to be based solely on true events.[11] Therefore, the addition of foreign law claims will not affect a District Court's ability to abstain from hearing a proceeding, so long as the claims are brought with state law claims and the remaining *Stoe* factors are satisfied.[12]

II. Foreign Law Claims do not Arise Under Title 11 Unless the Bankruptcy Code Creates the Cause of Action.

When determining if a "claim or cause of action is 'related to' a case under title 11 but does not 'arise under' title 11 and does not 'arise in' a case under title 11," a court will look to whether "the Bankruptcy Code creates the cause of action or provides the substantive rights invoked."[13] Put a different way, mandatory abstention is only available for claims that are non-

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"action is not based upon any federal cause of action," and does not directly address the conjunction of foreign and state law claims).

[8] *Principal Growth Strategies*, 615 B.R. at 535–36.

[9] *Id.* at 534–35.

[10] *See id.* at 535–36; *see also* Griffin v. Oceanic Contractors, Inc., 458 U.S. 564, 575 (1982) ("[I]interpretations of a statute which would produce absurd results are to be avoided if alternative interpretations consistent with the legislative purpose are available.").

[11] *See Principal Growth Strategies*, 615 B.R. at 535.

[12] *See id.* at 536.

[13] *Stoe*, 436 F.3d at 217 (citing Halper v. Halper, 164 F.3d 830, 836, 836–37 n. 7 (3d Cir. 1999)); *see In re* Fairfield Sentry Ltd. Litigation, 458 B.R. 665, 690 (S.D.N.Y 2011) (holding claims to be non-core because the bankruptcy code did not create them).

core to the bankruptcy case because they are non-essential to the administration of the estate.[14] When a case arises under title 11 it is commonly associated with a cause of action for fraudulent conveyances, preferential transfers, avoidance actions, dischargeability proceedings, and other actions that can only exist within a bankruptcy proceeding.[15]

Foreign law claims by their nature are not core based solely on their association to a Chapter 15 case unless they are essential to a bankruptcy proceeding like any other claim.[16] The addition of foreign law claims does not change the analysis. So long as the additional foreign claims are non-core, they can be properly adjudicated in state court along with the state law claims.

III. Without an Independent Basis for Federal Jurisdiction, Foreign Law Claims Alone do not Provide one.

If an independent basis for federal jurisdiction exists, a court will not be able to grant a motion for mandatory abstention.[17] Typically, a court will find an independent basis for jurisdiction through the existence of diversity or federal question jurisdiction.[18] However, mandatory abstention only applies to claims that arise under § 1334 and no other provision.[19] The Court in *Principal Growth Strategies* also held that an independent basis for federal

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[14] *See In re* Combustion Eng'g, Inc., 391 F.3d 190, 225 (3d Cir. 2005) ("Cases under title 11, proceedings arising under title 11, and proceedings arising in a case under title 11 are referred to as 'core' proceedings; whereas proceedings 'related to' a case under title 11 are referred to as 'non-core' proceedings."); *see also* Baker v. Simpson, 613 F.3d 346 (2d Cir. 2010) (holding mandatory abstention was not proper here because a malpractice claim was an essential part of administering the bankruptcy estate); *In re* TXNB Internal Case, 483 F.3d 292 (5th Cir. 2007) (stating mandatory abstention only applies in non-core proceedings).
[15] *See In re* Williams, 256 B.R. 885, 891 (B.A.P. 8th Cir. 2001) (citing Specialty Mills, Inc. v. Citizens State Bank, 51 F.3d 770, 773 (8th Cir. 1995)).
[16] *See Principal Growth Strategies*, 615 B.R. at 535.
[17] *See id.* at 538.
[18] *See id.* at 537–38; 28 U.S.C. §§ 1331, 1332 (2018).
[19] *See In re* TXNB Internal Case, 483 F.3d at 300.

jurisdiction must exist at the time a party makes its motion to compel mandatory arbitration.[20] Additionally, the possibility that an alternative basis for federal jurisdiction may arise at a later date is not sufficient to stop a motion for abstention.[21] Although diversity jurisdiction is likely to arise in cases with foreign law claims, given the parties' international ties, if an independent basis for jurisdiction does not exist a motion to abstain will be successful.

IV. Foreign and State Law Claims must be Commenced in the Appropriate State Forum.

Per the language of the statute, "the district court shall abstain from hearing such a proceeding if an action is commenced."[22] Although this language seems straightforward, there is a circuit split on how to interpret this issue.[23] The majority of circuits follow *Stoe*, *i.e.,* where a removed state case is considered "commenced" in state court.[24] The minority approach arose from the Ninth Circuit which held that removal of a state action is not always sufficient to satisfy the test.[25] In *Security Farms*, the action was commenced in state court, removed to a federal bankruptcy court, and then changed venues to a federal district court.[26] In this situation, the Ninth Circuit reasoned that since there was no pending state law proceeding for the court to defer

[20] *See* 615 B.R. at 538; *In re* Doctors Hosp. 1997, L.P., 351 B.R. 813 (Bankr. S.D. Tex. 2006) (denying motion for mandatory abstention because at the time the lawsuit was filed diversity jurisdiction existed); *see also In re* Butterfield, 339 B.R. 366, 373 (Bankr. E.D. Va. 2004) (denying a motion to abstain because the amount in dispute exceeded $75,000 and the parties were citizens of different states).
[21] *See Principal Growth Strategies*, 615 B.R. at 538.
[22] 28 U.S.C. § 1334(c)(2) (2018).
[23] *See Stoe*, 436 F.3d at 214; *but see In re* Lazar, 237 F.3d 967, 981 (9th Cir. 2001).
[24] *Stoe*, 436 F.3d at 214.
[25] *See* Security Farms v. Int'l Broth. of Teamsters, Chauffers, Warehousemen & Helpers, 124 F.3d 999, 1009 (9th Cir. 1997).
[26] *See id.* at 1005–1007.

to, abstention was unavailable.[27] The Ninth Circuit further stated that § 1334(c)(2) was "simply inapplicable" in cases that deal with a removed state case.[28]

The Ninth Circuit approach is the minority interpretation of the statute, and commencement in the appropriate state forum is typically sufficient to satisfy the test.[29] The inclusion of foreign law claims in this instance would not have much of a substantive effect on a court's abstention, as it would give foreign law claims the same treatment as state claims.

V. A Court has the Discretion to Determine if a State Forum can "Timely Adjudicate" the Proceeding.

In determining whether the state forum can timely adjudicate the claims in question, courts have applied a four-factor test that looks to the following: (1) compare the backlog between the federal and state courts' calendars; (2) the complexity of the issues presented and the respective expertise of each forum; (3) the status of the related title 11 bankruptcy claim; and (4) whether the state court proceeding would prolong the administration of the estate.[30] This inquiry is a mix of law and fact and thus a court can only make case-by-case decisions.[31]

First, the comparison between the courts' calendars is not a dispositive factor, but it can steer a court in its decision-making process.[32] The second factor is heavily dependent on the specific forum in question.[33] For example, the Delaware District Court in *Principal Growth Strategies* believed the Delaware Court of Chancery was more than capable to handle the case in

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[27] *See In re* Lazar, at 981.
[28] *Id.*
[29] *See Stoe*, 436 F.3d at 214.
[30] *See In re* Georgou, 157 B.R. 847, 851 (N.D. Ill. 1993).
[31] *See* Parmalat Capital Finance Ltd. v. Bank of America Corp., 639 F.3d 572, 580 (2d Cir. 2011); *In re* Fairfield Sentry Ltd. Litigation, 458 B.R. at 690 (stating that in the Second Circuit this issue is approached on a case-specific basis).
[32] *See* Parmalat Capital Finance Ltd. v. Bank of America Corp., 671 F.3d 261, 267 (2d Cir. 2012).
[33] *See id.*

question.[34] The District court pointed to the state court's long history of handling highly complex litigation involving multiple parties.[35] The Judge saw no reason to forgo remand in that case despite the complexity of the issues and the foreign nature of the proceedings.[36] Third, the analysis looks to the relation between the state case and the related title 11 bankruptcy proceeding to see if the resolution of one will affect the result in the other.[37] In *Parmalat Capital Finance*, the court stated that this factor favored remand because there was no indication that the final disposition of either the state or bankruptcy case would significantly impact the other.[38] Lastly, in determining if a state court proceeding will prolong the administration of an estate, a court will look to the nature of the bankruptcy proceeding in question, as different proceedings will have different levels of urgency.[39]

Conclusion

The language of 28 U.S.C. § 1334(c)(2), as applied through the *Stoe* test, provides courts with the basic framework to determine when it must abstain from hearing a case that could properly be held in a state forum.[40] The *Stoe* test does not speak to what courts should do when a party brings both state and foreign law claims. [41]However, under an expansive reading of the first step of the test, as articulated in *Principal Growth Strategies*, foreign claims can be brought in state court so long as the action is based in part on state law claims.[42] Therefore, if a moving

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[34] *See* 615 B.R. at 538.
[35] *See id.*
[36] *See id.*
[37] *See Parmalat Capital Finance*, 671 F.3d at 268.
[38] *Id.*
[39] *See id.* at 268–69; *see, e.g.*, *In re* Leco Enters., Inc., 144 B.R. 244, 251 (S.D.N.Y. 1992) (stating in Chapter 7 proceeding there is no administrative urgency and thus a court can weigh the timeliness of the adjudication lightly).
[40] *See Stoe*, 436 F.3d at 214.
[41] *See id.*
[42] *See Principal Growth Strategies*, 615 B.R. at 535–36.

party can satisfy the remaining four steps, the inclusion of foreign law causes of action will not preclude a party from bringing its claims and having them properly adjudicated in a state forum.