

**UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF _____**

In re : **Chapter 11**
:
BIG BOX, INC. :
: **Case Number 04-11111 (ABC)**
Debtor :
: **Hearing Date: __/__/04 at 10:30 a.m.**
: **Objection Deadline: __/__/04 at 5:00 p.m.**

**LIMITED RESPONSE OF STATES OF ----- TO DEBTOR'S
EXPEDITED MOTION FOR STORE CLOSING ORDER**

The Debtor has filed two motions seeking authority to conduct store closing sales at certain of its stores. Both motions were filed with on an expedited basis and, as noted by the U.S. Trustee in its Limited Objections, with service only being made on a generic Attorney General address. Not surprisingly, such notice would be unlikely to reach the proper persons within the Consumer Protection Division with the time necessary to appear and respond to these Motions in a timely fashion. Absent the voluntary actions of the United States Trustee to bring this to the attention of one of those offices, and its communication with other states through the National Association of Attorneys General, it is unlikely any states would have been aware of the proposed Orders. In addition, had the states not already been faced with numerous of these motions, generally filed in the identical language and with the identical case cites, they would not have been in a position to formulate any response to the Motions.

In those responses, which have been filed in a number of cases, including several within this district, the States have raised the following issue. First, this form of motion is procedurally defective because its **requests declaratory relief determining that State laws are preempted by the Code and injunctive relief to enforce that preemption., Rule 7001, however, requires that either a proceeding “to obtain an injunction” or to “obtain a declaratory judgment relating to any of**

the foregoing” (i.e., injunctive relief) *must* be brought by way of an adversary complaint.

Failure to bring the proper form of action exacerbates the notice problem and violates due process.¹

Second, the Motion are barred by the States’ sovereign immunity and the Eleventh Amendment.

An action seeking injunctive and/or declaratory relief against the States to bar them from enforcing their laws is precisely the sort of action barred by the Eleventh Amendment. “A judicial proceeding is considered brought against the sovereign if the result could serve ‘to restrain the Government from acting, or to compel it to act.’” *U.S. E.P.A. v. General Elec. Co.*, 197 F.3d 592, 597 (2nd Cir. 1999) *amended on other grounds*, 212 F.3d 689 (2nd Cir. 2000) quoting *Dugan v. Rank*, 372 U.S. 609, 620 (1963) (citations and internal quotation marks omitted). It is immaterial that the Debtor failed to file the motion as an adversary proceeding against the state (as it was obligated to do) since, as noted in *Idaho v. Coeur d’Alene Tribe of Idaho*, 521 U.S. 261, 270 (1997), “The real interests served by the Eleventh Amendment are not to be sacrificed to elementary mechanics of captions and pleading.” The Eleventh Amendment applies whether the private party seeks declaratory or injunctive relief. *Green v. Mansour*, 474 U.S. 64, 72-73 (1985); *Pennhurst State School & Hosp. v. Halderman*, 465 U.S. 89, 100-101 (1984) and cases cited therein; *Cory v. White*, 457 U.S. 85, 90 (1982); *In*

¹ On the other hand because the request for authorization to conduct a store closing sale merely allows the *debtor* to do something that only the Code precludes it from doing (i.e. carrying out an action not in the ordinary course of business), that aspect of the motion would not be barred under Rule 7001 and the States do not object to the granting of a general power to conduct a store closing sale, so long as the sale is not exempted from compliance with state law.

re Sacred Heart Hosp. of Norristown, 204 B.R. 132, 139 (E.D. Pa. 1997), *affirmed* 133 F.3d 237 (3rd Cir. 1998) and cases cited therein. The States have not waived their immunity in this case and Section 106(a) cannot provide a constitutional basis to issue such an order against the States.

Third, the Code does not preempt state consumer protection statutes in regard to these sales, nor does Section 105 authorize the relief sought. The Motions ask the Court to authorize the sales, without regard to state GOB laws, based solely on the language in Section 105. That section provides no independent grant of authority and cannot create new rights. *Southern Ry. Co. v. Johnson Bronze Co.*, 758 F.2d 137, 141 (3rd Cir. 1985). Thus, the Debtor must point to some existing provision of the Code to provide the authorization it seeks; it cannot just rely on the generic authority of Section 106. The Debtor also argues generally **that “bankruptcy law preempts state and local laws that conflict with the underlying policies of the Bankruptcy Code.”** (Motion, p. __).² However, the cases cited in the Motion do not support that proposition and the Debtor cannot point to anything in the Code that provides such a sweeping authorization to ignore nonbankruptcy law. *Belcufine v. Aloe*, 186 B.R. 623 (Bankr. W.D. Pa. 1995), *affirmed* 112 F.3d 633 (3rd Cir. 1997) dealt with the interpretation of a state law and merely chose to interpret an ambiguous law in a way that did not conflict with bankruptcy policies. *Baker & Drake v. Public Service Commission of*

² This overstates even the language of Section 105, itself – it does not provide that the court may issue any order that assists in the “policies” of the Code. It is limited to orders needed to “carry out the provisions of this Title.” (Emphasis added.) *Johnson Bronze* and numerous other cases have found it necessary to caution against the overexpansion of the actual words in Section 105 to allow the court to issue whatever order it thinks would be equitable and helpful.

Nevada, 35 F.3d 1348 (9th Cir. 1994) did not hold that it was generally appropriate to preempt state law whenever it involved economic regulation; it merely stated that implied preemption based on a conflict between the Code and state law *might* more likely be found appropriate in such circumstances. Its primary holding, though, as in this case, was that a state law that made reorganization more difficult for a particular debtor was *not* preempted by the Code, and was not the sort of “obstacle” to the achievement of Congressional will that would warrant preemption. Finally, *In re Scott Housing Systems, Inc.*, 91 B.R. 190 (Bankr. S.D. Ga. 1988) merely provides that state laws that violate the automatic stay are preempted. The stay, though, excepts police and regulatory actions, such as state actions under their GOB laws would surely be. Moreover, the cases cited (*Missouri v. U.S. Bankruptcy Court*, 647 F.2d 768 (8th Cir. 1981) and *In re Cash Currency Exchange, Inc.*, 762 F.2d 542 (7th Cir. 1985)) are no longer even valid law, in light of the revisions to the Code that now except police and regulatory actions from Section 362(a)(3). The continued citation of such superseded authority merely reflects the Motions’ general failure to provide *any* authority that actually supports the propositions asserted.

More interestingly, the Motions do not even argue that Section 363 actually has the requisite preemption language. At most, it asserts that the state laws would “undermine” the “policy” of Section 363(b). However, as the Third Circuit noted, Section 363 does not attempt to establish any general preemption of nonbankruptcy law (apart from language in Section 363(l) that is not relevant to this Motion). It is a power given to the court to authorize the debtor to take actions forbidden to *the debtor* by bankruptcy law, not a power to authorize the debtor to ignore other generally applicable law.

In *Integrated Solutions, Inc. v. Service Support Specialties, Inc.*, 124 F.3d 487 (3rd Cir. 1997), the court noted that preemption of state law is *not* favored, and that, absent express preemption, the trustee or debtor-in-possession has no greater rights in the property than the debtor had prepetition. The trustee in that case argued that he should be allowed to sell a tort claim held by the estate in the face of state law forbidding such transfers because Section 363 and 704 “demonstrate that the ‘overriding purpose of the Bankruptcy Code is the expeditious and equitable distribution of the assets of the debtor's estate’” and allowing state law to preclude such sales would conflict with that purpose. The court flatly rejected those arguments, noting that neither the sections’ actual language or the legislative history suggested such a broad reading. “Sections 363(b)(1) and 704 do not expressly authorize the trustee to sell property contrary to the restrictions imposed by state and contract law. *These sections are simply enabling statutes that give the trustee the authority to sell or dispose of property if the debtors would have had the same right under state law.*” (emphasis added). *Integrated Solutions* makes clear that state laws that actually bar the sale or transfer of an asset are not preempted unless explicitly covered by Section 363(l). The Attorneys General here assert a far less intrusive position – they merely wish the Debtor in closing these stores to operate under the same laws applicable to any other entity.

The argument in the Motions essentially boils down to the claim that it is too much trouble for the Debtor to learn and obey the laws, not that it cannot do so and carry out its sales. The factual lack of merit of such an argument is underscored by the fact that the Debtor began both sales prior to even filing bankruptcy or obtaining authorization from this court. The agency agreements provide that the sales agents *will* comply with all state and local laws

regarding such sales. Presumably, the Agent did so and, at least with respect to initial permits and other pre-sale activities, it has complied, notwithstanding the arguments made to this court about its inability to do so. If it has not complied, then no order this court could enter would retroactively solve that problem.

Most of what the Debtor seeks to be relieved from is the completion of a number of minor forms. And, while the Debtor might not be familiar with the applicable provisions, surely the liquidation consultants that it has hired are – and they routinely comply with them on a daily basis. There is no irreconcilable conflict between the state law and the Code, merely a matter of convenience for the Debtor. It is possible that some applications of the laws to later events may or may not raise more significant problems for the Debtor, such as with respect to the allowed length of the sale. However, the state laws do differ in that regard, and many have exceptions for sales authorized by court order. Nothing in the Motion indicates what laws may be applicable to the sales, what time periods they set, whether those limits will actually impact on the sale, or whether the Debtor could adjust its sales plans to accommodate those laws in the limited instances where they do apply. In short, the issue of whether there is any *actual* effect upon the Debtor's planned operations by way of the applicable state and local laws is one that needs to be reviewed with a nuanced approach, not a shotgun order.

The obvious difficulties with attempting to imagine in advance all of the potential ways that a violation by the Debtor of state law might arise and then to determine what the proper outcome should be, and whether the Code should preempt such exercise of state authority, is a process neither the Attorneys General nor this Court should be forced to undertake. Instead,

the States have taken the position that a debtor should be required to wait until there is some concrete, actual example where it contends that enforcement of state law would seriously hamper or bar its ability to carry out its liquidation program. If so, it can then argue that enforcement of *that* state law should be enjoined and that the responsible state official (who then can be identified with certainty) could be enjoined under the *Ex parte Young* doctrine.

Prior to that time, however, the Court is being asked to, in reality, decide advisory issues and legislate in a vacuum.

That position has been presented to a number of debtors by the States and, as the Debtor here suggests in its paper, a form of order has been prepared that deals with those issues. It does so, by giving the Debtor the authorization it needs from this court in order to hold the sale at all. It also assures that any aspects of generally applicable law can still be enforced against the Debtor under the normal police and regulatory exceptions to the automatic stay. It also provides for service of the final, authorized order upon the relevant state offices and an additional period of time for those offices to inform the Debtor as to whether they believe there is a concrete violation of *their* law under the facts of *this* case. If so, then such a dispute will be brought to this court and the preemption issues can be tried at that time. In the meantime, the sale can proceed. The order also clarifies that this procedure does not apply with respect to any alleged prepetition violations of the state or local liquidation laws which will be treated as normal police and regulatory matters. To the extent that the Debtor properly complied with laws applicable to beginning the sale, it has no concern with the sales and the application of those laws to the continuation and termination of the sales will be reserved to this court.

On the basis of those terms of the Order, the undersigned states are prepared not to object to the Debtor's proposed form of Order. Nothing herein should be taken, however, as the agreement of

the States to the disputed propositions of law expressed by the Debtor in its Motions and the States request that the Court reject those assertions as the basis for the relief granted herein.