THE FOLLOWING ORDER
IS APPROVED AND ENTERED
AS THE ORDER OF THIS COURT:

DATED: April 13, 2020

Katherine Maloney Perhach
United States Bankruptcy Judge

UNITED STATES BANKRUPTCY COURT
FOR THE EASTERN DISTRICT OF WISCONSIN

In re:
Anthony B. Dalton and
Krystle J. Dalton,
Debtors.

Chapter 7

Case No. 19-26478-kmp

Anthony Dalton and
Krystle Dalton,
Plaintiffs,

v.

Navient,
Defendant.

Adv. No. 19-2175

ORDER GRANTING MOTION TO DISMISS

The Debtors in this bankruptcy case filed an adversary complaint on October 11, 2019 against "Navient," that is, Navient Solutions, LLC, the holder of several private student loans.[1]

[1] Navient states that Debtor Anthony Dalton is liable on at least three types of student loans. First, Mr. Dalton is indebted to Navient pursuant to five educational loan promissory notes. Second, he is liable on several Stafford Student Loans made under the Federal Family Education Loan Program. Navient services these loans and Great Lakes Higher Education Corporation, now known as Ascendium Education Group is the guarantor. Finally, Mr. Dalton is liable on Department of Education Direct Stafford Student Loans. Navient also services these loans. Neither Ascendium nor the United States Department of Education are named as defendants in this adversary proceeding; therefore, the Debtors' claims are limited to the five loans held by Navient. The loans serviced by Navient are not part of this adversary proceeding because the guarantor/holder of those loans have not been named as defendants in this case.

The Complaint contains one count, "Rescission of Contracts for Intentional Misrepresentation." The Debtors seek "reformation of the private loan contracts and to void any contract procured through forgery. Also, if applicable for any statutory or reasonable attorney's fees." The Complaint alleges that Mr. Dalton enrolled in an ITT Educational Services program based on numerous misrepresentations by ITT recruiters, and that his student loan agreements contained a number of defects, including a forged signature. Although Mr. Dalton graduated and received a certificate from ITT, he alleges that the certificate was worthless and he was not qualified to find employment in his field.

Before the Debtors filed the Complaint, the Trustee in the Debtors' Chapter 7 bankruptcy case filed a Report of No Distribution on August 13, 2019, reporting that he determined that "there is no property available for distribution from the estate over and above that exempted by law." He also certified that "the estate of the above-named debtor(s) has been fully administered." The Debtors received a Chapter 7 discharge on December 13, 2019.

Navient has filed a motion to dismiss this adversary proceeding for lack of subject-matter jurisdiction pursuant to Rule 12(b)(1) of the Federal Rules of Civil Procedure, incorporated in adversary proceedings by Bankruptcy Rule 7012.[2] For the reasons that follow, the Court grants Navient's Motion and will dismiss the adversary proceeding.

Discussion

As the Supreme Court explains, "[t]he jurisdiction of the bankruptcy courts, like that of other federal courts, is grounded in, and limited by, statute." *Celotex Corp. v. Edwards*, 514 U.S.

[2] The Motion also requested dismissal based on insufficient service of process because the Debtors did not timely serve the summons and a copy of the Complaint before the summons became stale. *See* Fed. R. Civ. P. 12(b)(5); Fed. R. Bankr. P. 7012. However, the Clerk issued a new summons at the Debtors' request, *see* Fed. R. Bankr. P. 7004(e), and counsel for Navient confirmed at a pretrial conference on December 3, 2019 that timely service of the new summons resolved the insufficient service of process concern to Navient's satisfaction. *See also* Navient's Reply Brief, Docket No. 13, p. 2 ("the issues related to insufficient service of process appear to have been resolved.").

300, 307 (1995). Bankruptcy courts derive their jurisdiction from two sections of title 28 of the United States Code. Section 1334(a) vests in the district courts original and exclusive jurisdiction of "all cases under title 11," and § 1334(b) vests in the district courts "original but not exclusive jurisdiction of all civil proceedings arising under title 11, or arising in or related to cases under title 11." Section 157(a) allows the district courts to refer such cases and proceedings to the bankruptcy judges for the district, and the Eastern District of Wisconsin has made such a reference. *See* Order of Reference (E.D. Wis. July 10, 1984) (available at www.wied.uscourts.gov/local-rules-and-orders). For the Court to have jurisdiction over the Debtors' adversary proceeding, it must fall into one of the categories of bankruptcy court jurisdiction. It must be either (1) a proceeding "arising under" the Bankruptcy Code; (2) a proceeding "arising in" a bankruptcy case; or (3) a proceeding "related to" a bankruptcy case. 28 U.S.C. §§ 157, 1334.

I. The Court Does Not Have Independent Subject Matter Jurisdiction Over the Debtors' Claim.

The Debtors' claim does not fall into any of the categories of the bankruptcy court's subject matter jurisdiction. The claim does not "arise under" the Bankruptcy Code. Claims "arising under" the Bankruptcy Code "depend on a right created or determined by a statutory provision of title 11," which this intentional misrepresentation claim does not. *Nelson v. Welch (In re Repository Techs., Inc.)*, 601 F.3d 710, 719 (7th Cir. 2010) (quotation omitted). Instead, the claim is based on Wisconsin state law, as demonstrated by the repeated references to Wisconsin case law in the Debtors' Complaint. The claim does not "arise in" the bankruptcy case either. Proceedings "arising in" bankruptcy cases are "administrative matters that arise *only* in bankruptcy cases" but have "no existence outside of bankruptcy." *Id*. (emphasis in original). A state law intentional misrepresentation claim exists independent of any bankruptcy case.

In briefing, the Debtors suggest that an administrative discharge of loans would be appropriate under 34 C.F.R. § 682.402(e) based on false certification by a school of a student's eligibility to borrow or unauthorized disbursements. If this statement is intended to suggest that the Debtors' intentional misrepresentation claim "arises under" the Bankruptcy Code or "arises in" a bankruptcy case because in the Debtors' opinion it forms the basis for an administrative discharge, this argument fails to differentiate between two types of relief. A "discharge" in bankruptcy has the effects spelled out in 11 U.S.C. § 524. It operates as an injunction against collection of a debt as a personal liability of the debtor, among other things. That relief is subject to 11 U.S.C. § 523, and under § 523(a)(8), certain types of student loans are only discharged in a bankruptcy case if the court determines that excepting them from discharge would cause an "undue hardship on the debtor and the debtor's dependents." (The Debtors do not request a determination that debt Mr. Dalton owes to Navient is the type of loan covered by § 523(a)(8) and that it ought to be discharged.) A person can also receive a "discharge" of student loan debt outside of bankruptcy. Subject to applicable law and implementing regulations, borrowers can receive an administrative discharge of certain types of loans under certain circumstances. However, this process is entirely separate from the discharge of debts in bankruptcy, not the type of proceeding that could only occur in a bankruptcy case.

The intentional misrepresentation claim is also not "related to" a case under the Bankruptcy Code. A proceeding is "related to" a bankruptcy case when resolution of the dispute "affects the amount of property for distribution [i.e., the debtor's estate] or the allocation of property among creditors." *In re FedPak Sys.*, 80 F.3d 207, 213-14 (7th Cir. 1996). The Seventh Circuit recently discussed *FedPak* and reiterated that "related to jurisdiction" "is satisfied when the resolution has a potential effect on other creditors," adding the qualifying

statement that jurisdiction "must be assessed at the outset of the dispute." *Bush v. United States*, 939 F.3d 839, 846 (7th Cir. 2019).

Bush provides an illustration of the type of case where bankruptcy courts have "related to" jurisdiction. The case was a Chapter 7 asset case, and at the time the debtors asked the bankruptcy judge to determine their tax liabilities, the determination could have affected the allocation of assets among creditors. Here, by contrast, looking at the property that came into the Debtors' bankruptcy estate when the case was commenced, the Chapter 7 Trustee determined that there were no non-exempt assets available for the Trustee to administer. Creditors did not receive any distribution in this case and the Chapter 7 Trustee has completed his inquiry and requested that he be discharged from his duties. Because there is no property available for distribution, the Debtors' claim does not initiate a dispute that could affect the allocation of property among creditors.

II. The Court Cannot Exercise Ancillary Jurisdiction Over the Debtors' Misrepresentation Claim.

The Debtors' reliance on the doctrine of ancillary jurisdiction is misplaced because they do not assert any claim over which the bankruptcy court has independent subject matter jurisdiction. Therefore, there is nothing to which the Debtors' misrepresentation claim could be linked. Relying on a case discussing the bankruptcy court's ability to interpret and enforce its own orders, the Debtors argue that the bankruptcy court has ancillary jurisdiction over the misrepresentation claim. The Supreme Court has "asserted ancillary jurisdiction (in the very broad sense in which that term is sometimes used) for two separate, though sometimes related, purposes: (1) to permit disposition by a single court of claims that are, in varying respects and degrees, factually interdependent, . . . and (2) to enable a court to function successfully, that is, to manage its proceedings, vindicate its authority, and effectuate its decrees." *Kokkonen v.*

Guardian Life Ins. Co. of Am., 511 U.S. 375, 379-80 (1994). *In re Olsen*, 559 B.R. 879 (Bankr. E.D. Wis. 2016), the case cited by the Debtors, discusses the second basis, including the Supreme Court's statement in *Travelers Indemnity Co. v. Bailey*, 557 U.S. 137, 151 (2009) that "the Bankruptcy Court plainly had jurisdiction to interpret and enforce its own prior orders." *Travelers* relied on *Local Loan Co. v. Hunt*, 292 U.S. 234, 239-40 (1934), which recognized "[t]hat a federal court of equity has jurisdiction of a bill ancillary to an original case or proceeding in the same court, whether at law or in equity, to secure or preserve the fruits and advantages of a judgment or decree rendered therein, is well settled" and that "[t]hese principles apply to proceedings in bankruptcy." In this case, the Debtors are seeking to litigate an intentional misrepresentation claim in the bankruptcy court. They are not relying on the Court's enforcement authority to manage its proceedings, vindicate its authority, and effectuate its decrees in order to do so.

To the extent the Debtors rely on *Kokkonen*'s first purpose, at least part of the doctrine of ancillary jurisdiction is codified in 28 U.S.C. § 1367 as "supplemental jurisdiction." The Seventh Circuit has not weighed in on the question of whether bankruptcy courts have supplemental jurisdiction. *See Townsquare Media, Inc. v. Brill*, 652 F.3d 767, 771-72 (7th Cir. 2011). Regardless, it is unnecessary to address the precise scope of the bankruptcy court's "ancillary jurisdiction" because this case does not implicate supplemental jurisdiction or any other type of ancillary jurisdiction that involves a "court's power to hear claims that are closely linked to other claims over which the court's jurisdiction is otherwise secure." *United States v. Wahi*, 850 F.3d 296, 300 (7th Cir. 2017). Either scenario requires a claim over which the court has independent subject matter jurisdiction. Supplemental jurisdiction requires a claim over which the district court has original jurisdiction, and only then will the court "have supplemental

jurisdiction over all other claims that are so related to claims in the action within such original jurisdiction that they form part of the same case or controversy." 28 U.S.C. § 1367(a). Similarly, ancillary jurisdiction as described in *Wahi* requires a claim "over which the court's jurisdiction is otherwise secure" to which other claims may be linked. In this case, the Debtors' Complaint contains one claim, the intentional misrepresentation claim. The claim cannot be "supplemental" or "ancillary" to another claim because it is the only claim the Debtors are asserting.

III. This Case is Distinguishable from the ITT Bankruptcy Case Because the Claim is Against a Creditor, Not the Debtor.

The Debtors have taken large portions of their Complaint from a complaint filed in the ITT Educational Services bankruptcy case in the Southern District of Indiana. They assert that "this adversarial proceeding is hardly unique and relief to ITT student loan debtors being awarded the remedy of discharge by bankruptcy courts is the norm, not the exception." (Docket No. 12 at 4-5.) According to the Complaint, "this Debtor has experienced the same grounds to argue for rescission as the *Villalba* Plaintiffs and experienced the same abuses from ITT during the same material periods as the class action." (Complaint at ¶ 5.)

It is true that students filed a class action adversary proceeding against ITT and affiliated debtors, as well as class proofs of claim. *Villalba v. ITT Educational Services, Inc. (In re ITT Educational Services, Inc.)*, Ch. 7 Case No. 16-07207, Adv. No. 17-50003. The bankruptcy court authorized the Chapter 7 trustee to enter into a settlement of the students' class action. *ITT Educational Services, Inc.*, No. 16-07207 (Bankr. S.D. Ind. Nov. 30, 2018) (Docket No. 3079). The key difference between the instant adversary proceeding and the proceedings in the ITT case is the identity of the debtor. The students in the ITT case brought claims against ITT, the debtor in the bankruptcy proceedings, and sought allowance of the claims and payment from the ITT

bankruptcy estate. Part of the material quoted in the Debtors' Complaint makes this clear: "ITT students are the true creditors of ITT. They seek recognition as creditors in this bankruptcy, a fair apportionment of the remaining estate, and an adjudication of their claims that will clear the path to loan cancellation in collateral proceedings." (Complaint at ¶ 5) (quoting *Villalba*, Ch. 7 Case No. 16-07207, Adv. No. 17-50003, Docket No. 1 at 2). Here, by contrast, the Debtors are asserting a claim against a creditor. The outcome of the dispute does not affect the allocation of property to the Debtors' other creditors. Creditors will not receive any distribution in this case, and there is no "remaining estate" to apportion.

Conclusion

Because resolution of the Debtors' state law intentional misrepresentation claim does not affect the allocation of property among creditors and would have no effect on creditors besides Navient, the Court does not have jurisdiction over the Complaint. Accordingly,

IT IS THEREFORE ORDERED: this adversary proceeding is dismissed.

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