



June 2011

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Supreme Court Limits Bankruptcy Court Jurisdiction Over Some Claims

The US Supreme Court has ruled in [Stern v. Marshall](#) (June 23, 2011) that a bankruptcy court lacks jurisdiction to render final judgment on a bankruptcy estate's compulsory counterclaim against a creditor arising under common law, despite a statutory grant of jurisdiction. This ruling could have wide-ranging implications for a bankruptcy court's ability to preside over litigation of claims within bankruptcy cases and could signal a huge change in the statutory and constitutional underpinnings of bankruptcy court jurisdiction.

Constitutional Limits on "Core Proceeding" Designation

With *Stern v. Marshall*, the US Supreme Court has, for the second time in five years, written a crucial chapter in the lurid tale of the late Vickie Lynn Marshall (known to the popular culture as Anna Nicole Smith) and her wealthy, deceased husband, J. Howard Marshall. The Court's decision arises from a proof of claim filed by Howard's son Pierce, for defamation against Vickie in her bankruptcy case, and the (ostensibly) compulsory counterclaim Vickie asserted against Pierce for tortious interference with the gift Vickie expected to get from Howard (half of Howard's estate). In September 2000, following a bench trial, the bankruptcy court (which had previously entered summary judgment in Vickie's favor on Pierce's claim) awarded Vickie more than \$400 million on the counterclaim. Pierce argued that the bankruptcy court lacked jurisdiction to enter a final

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judgment on the counterclaim, but the bankruptcy court cited 28 U.S.C. § 157(b)(2)(C) in holding that Congress had expressly given bankruptcy courts jurisdiction over "core proceedings," which expressly include "counterclaims by the estate against persons filing claims against the estate"—counterclaims like Vickie's. The US district court, hearing the matter on Pierce's appeal from the bankruptcy court, disagreed, holding that, although Vickie's counterclaim fell within the "literal language" of 28 U.S.C. § 157(b)(2)(C), there were nonetheless constitutional limits to what is a "core proceeding" on which a bankruptcy judge—not a lifetime-appointed judge under Article III of the US Constitution—can enter a final judgment. Following this reasoning, the district court held the counterclaim to be "non-core" because it was not sufficiently closely related to the claim against Vickie's bankruptcy estate. The district court treated the bankruptcy court's findings of fact and conclusions of law as "recommended," and based its own judgment in Vickie's favor on an "independent review" of those findings and conclusions.

But by the time the district court entered a judgment in Vickie's favor, a Texas state court had conducted a jury trial on essentially the same issues and entered a judgment in Pierce's favor. When Pierce appealed the district court's judgment to the Ninth Circuit Court of Appeals, that court agreed that the counterclaim could not constitutionally be considered a "core proceeding," but went a step further than the district court, holding that the Texas state court judgment in Pierce's favor preceded and, therefore, precluded the district court's judgment in Vickie's favor. Vickie's estate sought further review in the Supreme Court, and for the second time in the litigation, the Supreme Court granted *certiorari* to consider the Ninth Circuit's ruling. In affirming the Ninth Circuit in its June 23, 2011 ruling, the Supreme Court has now called into serious question the constitutionality of Congress' 27-year-old statutory grant of jurisdiction to bankruptcy courts.

The Supreme Court agreed with the district court and the Ninth Circuit Court of Appeals in holding that, despite the unambiguous language of 28 U.S.C. § 157(b)(2)(C) (which regards as "core" all counterclaims to claims against the estate), not all counterclaims are "core proceedings" with respect to which bankruptcy judges can constitutionally enter judgment. Put most succinctly by Justice Roberts for the Court: "Although we conclude that § 157(b)(2)(C) permits the bankruptcy court to enter final judgment on Vickie's counterclaim, Article III of the Constitution does not."

Historical Significance

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A bit of bankruptcy history brings into sharper focus why the Supreme Court's latest ruling is so notable and potentially so important. Congress enacted the current version of 28 U.S.C. § 157 in 1984, creating the very concept of the "core proceeding" as a direct response to the Supreme Court's 1982 decision in *Northern Pipeline Constr. Co. v. Marathon Pipe Line Co.*, which declared unconstitutional previous Congressional grants of jurisdiction to bankruptcy courts under the then-relatively new Bankruptcy Code of 1978. That the Supreme Court now has held as unconstitutional (or, at least, unconstitutionally broad) one of the enumerated "core proceedings" in 28 U.S.C. § 157(b)(2)—that is, Congress' attempt to address *Marathon*—could make *Stern v. Marshall* the *Marathon* of this generation.

If what the Supreme Court found unconstitutional is a bankruptcy court entering a judgment on a legal claim that does not pertain directly to federal bankruptcy law, then it is not much of a conceptual leap to the notion that many types of state law or common law claims against a bankruptcy estate cannot constitutionally be heard to judgment in a bankruptcy court. Is there really any difference between a bankruptcy estate's counterclaim based on state tort law and a claim against the bankruptcy estate based on state tort law? How much of what has been, for more than a quarter century, regarded as "core" to a bankruptcy case could now fall outside the Supreme Court's constitutional boundaries for non-Article III bankruptcy judges?

If even compulsory counterclaims brought in the bankruptcy court in response to a claim filed against the bankruptcy estate must be ruled on by a district court judge rather than the bankruptcy judge hearing the same facts—and this appears to be exactly what the Supreme Court now requires—then at least two different federal courts will be called on to make rulings arising from the same facts and affecting the same bankruptcy estate. A district court judge will be, in a very real sense, determining the ultimate course of the bankruptcy case—something surely most district court judges would regard as both surprising and probably a little bit scary. They are, in the main, hardly the specialists that bankruptcy judges are when it comes to bankruptcy administration, and they could never be expected to have the same perspective as a presiding bankruptcy judge on how one claim's resolution affects an entire bankruptcy estate. As Justice Breyer's dissent notes, the Supreme Court's approach engenders a "game of jurisdictional ping-pong between courts [that] would lead to inefficiency, increased cost, delay, and needless additional suffering among those faced with bankruptcy."

Squire Sanders' restructuring lawyers play central roles in bankruptcy proceedings throughout the United States and will continue to be well-situated to follow closely—and even to influence—the implications of this latest ruling in the coming months. For more information on how *Stern v. Marshall* may affect our clients' experiences in the Chapter 11 context, please contact your principal Squire Sanders lawyer or one of the lawyers noted on this alert.



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2011

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