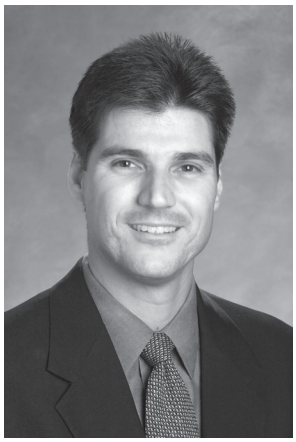

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Stern v. Marshall: A Quagmire for the Future of Bankruptcy Jurisdiction or Just a Bad Joke? Part I

Sometimes in a case, facts and circumstances seem to come together to make the case ripe. Ripe not in the sense that warrants judicial review, but ripe for the makings of a bad joke. The Supreme Court of the United States' decision in *Stern v. Marshall*, 131 S. Ct. 2594 (2011) may be such a case. The joke goes something like this: "Anna Nicole Smith, the Bankruptcy Code, and the Supreme Court walk into a bar . . . ." Of course, the problem with jokes is often that the listener does not understand the punch line. *Stern v. Marshall* fits this bill.

This is not to suggest that the opinion itself is a joke; it is far from it. Instead, the question is what *Stern v. Marshall* means for the future of bankruptcy jurisdiction in the United States. What is its punch line? In the past six months, bankruptcy judges, practitioners, and scholars have written, spoken, and even podcasted about *Stern v. Marshall* in an effort to answer this question. This two-part article offers a look into the basics of *Stern v. Marshall*, the recent discussion of its import, and a glimpse into its impact on the future of bankruptcy court jurisdiction.

The Preface: Background of Bankruptcy Jurisdiction

Before examining *Stern v. Marshall* itself and the impact it has had and will have on bankruptcy court jurisdiction, some background about bankruptcy court jurisdiction may be helpful. In 1978, Congress enacted the Bankruptcy Code[1] and created bankruptcy courts and judges to replace the referees of the old bankruptcy system. The authority of the bankruptcy courts that Congress created stems not from the judicial power of Article III of the Constitution, but from the Article I legislative power. This is significant because of the protections afforded judges under Article III to ensure their independent judgment. Those protections are (1) life tenure – at least "during good Behaviour" – and (2) an absolute prohibition on decreasing compensation.[2] Also, the constitutional mandate of separation of powers prohibits Congress from encroaching on or usurping the judicial authority established under Article III. Bankruptcy judges, however, do not have these Article III protections. Instead, they are creatures of Congress, and Congress cannot exercise the judicial power of the United States.

Thus, soon after the enactment of the Code, Congress averted a potential constitutional crisis[3] by attempting to construct a bankruptcy system that honored the separation of powers by establishing original jurisdiction over bankruptcy cases in the federal district courts. Then Congress created rules that allow the district courts to refer cases to the bankruptcy courts for resolution.[4] In practice, most, if not all, district courts, including the Middle District of Florida, have a Standing Order of Reference that refers all bankruptcy cases to the bankruptcy courts.

Despite standing orders to refer cases, there still exist certain constitutional limits on the authority of the bankruptcy courts to which the cases are referred. Congress tried to delineate which matters are appropriate by defining what is "core" to a bankruptcy case.[5] Any matter considered "core" to the bankruptcy case is a matter over which the bankruptcy courts have authority and can therefore issue final and binding judgments. For matters that are considered "non-core," the district court generally must render the final judgment, often after reviewing and then adopting the findings of the bankruptcy court.[6]

The Story: How Anna Nicole Smith, the Bankruptcy Code, and the Supreme Court Found Each Other

Stern v. Marshall is the culmination of a sixteen-year "dispute between Vickie Lynn Marshall [better known as Anna Nicole Smith] and E. Pierce Marshall ("Pierce") over the fortune of J. Howard Marshall II ("J. Howard"), a man believed to have been one of the richest people in Texas."[7] Vickie, as the Court calls her, married J. Howard in 1994. Upon discovering that she was not included in J. Howard's will but that Pierce, J. Howard's son, was the beneficiary of a living trust executed by J. Howard, Vickie sued in Texas probate court to establish that Pierce fraudulently induced the creation of the trust. In 1995, J. Howard died and Vickie filed bankruptcy in California. In Vickie's bankruptcy case, Pierce filed a proof of claim based on defamation related to her fraudulent inducement assertions, and sought to establish that his claim was nondischargeable. In response, Vickie asserted a counterclaim to Pierce's proof of claim, which essentially mirrored her allegations in the Texas probate court. The bankruptcy court entered summary judgment on the defamation claim in Vickie's favor and entered judgment against Pierce for Vickie's tortious interference counterclaim. Pierce then challenged the bankruptcy court's jurisdiction over Vickie's counterclaim. On appeal, the district court found that Vickie's counterclaim was a "core" proceeding within the meaning of 28

U.S.C. § 157(b)(2)(C), but that the bankruptcy court was constitutionally prohibited from issuing a final judgment on the counterclaim. Thus, the district court treated the bankruptcy court's judgment as a proposal to be reviewed *de novo*, but it agreed with the bankruptcy court and entered judgment against Pierce. The only problem with the district court's judgment was that it came *after* the Texas probate court entered judgment in Pierce's favor on essentially the same claim.[8]

These conflicting judgments gave rise to the ultimate question presented to the Court: was the judgment issued by the bankruptcy court final and binding? [9] If the bankruptcy court's judgment was binding, it would have preclusive effect, as it was rendered prior to the Texas probate court judgment, and thus Vickie would win. If the bankruptcy court's judgment was not binding and was merely a proposal for the district court to accept or reject, the judgment rendered by the Texas probate court would have preclusive effect, as it was rendered prior to the district court's final judgment; thus Pierce would win.

The Set-up: How the Supreme Court Chipped Away at Bankruptcy Court Jurisdiction

The short answer: Pierce wins. After first determining that the bankruptcy court had statutory authority under 28 U.S.C. § 157(b)(2)(C) to enter a final judgment on Vickie's counterclaim, the Court turned to whether the bankruptcy court had constitutional authority to render the final judgment.[10] The Court held that "[t]he Bankruptcy Court below lacked the constitutional authority to enter a final judgment on a state law counterclaim that is not resolved in the process of ruling on a creditor's proof of claim."[11] As mentioned previously, bankruptcy courts are creatures of Congress and cannot exercise the judicial authority of the United States. The question then is, what adjudicative power can Article I courts possess?

As the Supreme Court admits,[12] and as Justice Scalia's concurrence further elaborates,[13] the answer is not always clear. Constitutional jurisprudence in drawing the line between Article I and Article III is based on the "public rights exception."[14] In applying the public rights exception and its presumption in favor of Article III to Vickie's counterclaim, the Court thoroughly examined a series of prior cases, especially *Northern Pipeline Construction Co. v. Marathon Pipe Line Co.*, 458 U.S. 50 (1982), and *Granfinanciera, S.A. v. Nordberg*, 492 U.S. 33 (1989), both of which changed the bankruptcy landscape in significant ways. The result of the Court's lengthy analysis essentially boils down to this: If the action would augment the bankruptcy estate, as opposed to simply establishing pro rata distribution of the estate, and the action does not stem from the bankruptcy itself or would not necessarily be resolved in the claims allowance process, then the power to issue a final judgment in the action rests with the district court.[15]

The Pause: Do You Get It?

Downplay

Like any case, however, the holding is limited to its facts. The Court itself even recognizes that its holding is very narrow.[16] Perhaps in an effort to preempt criticism, the Court also concedes that the decision may have very little impact: "If our decision today does not change all that much, then why the fuss?"[17] The fuss really is about upholding the constitutional principles of separation of powers and the protection of individual rights. But the Court also acknowledges that delay and inefficiency could stem from its decision, primarily in what Justice Breyer's dissent called "a constitutionally required game of jurisdictional ping-pong."[18] Yet delay and inefficiency, the Court notes, are insufficient reasons for validating otherwise unconstitutional legislation. Plus, that "game of ping-pong" is the system Congress contemplated: one where "certain state law matters in bankruptcy cases will be resolved by judges other than those of the bankruptcy

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Orange County Bar Association

Election Notice

Election of Officers and Members of the Executive Council of the OCBA

The following positions are open for election:

- Vice President/President-Elect (1-year term)
- Treasurer (1-year term)
- Secretary (1-year term)
- Three (3) Executive Council Seats (3-year term) June 1, 2012 through May 31, 2015
- One (1) Executive Council Seat (2-year term) June 1, 2012 through May 31, 2014

Election of Trustees of the Board of Trustees of the Legal Aid Society of the OCBA, Inc.

The following position is open for election:

- One (1) Board of Trustees Seat (3-year term) June 1, 2012 through May 31, 2015

Election of At-Large Members of the Board of Directors of the Young Lawyers Section of the OCBA

The following positions are open for election:

- Five (5) At-Large Board Member Seats (2-year term) June 1, 2012 through May 31, 2014

Anyone interested in running for any of these positions should file a written petition at the Orange County Bar Association (OCBA) office, 880 N. Orange Ave., Orlando, FL 32801, signed by not less than five (5) members of the OCBA. Blank petitions are available at the OCBA office and on the website at www.orangecountybar.org.

Petitions must be received no later than 5:00 p.m. on Friday, February 3, 2012. Petitions may be mailed or couriered to the OCBA office at 880 N. Orange Ave., Orlando, FL 32801.

Nominees must endorse their written acceptance on the petition and may NOT accept nominations for more than one (1) office.

No nomination for the office of Vice President shall be accepted unless the nominee has served on the Executive Council at least one (1) year.

Thereafter, the nominating petitions will be canvassed and tabulated by the President and Secretary, who shall thereupon certify the names of all members who have been properly nominated.

Voting shall be by secret ballot mailed to each voting member of the OCBA on or before **Thursday, March 1, 2012.**

Voted ballots must be returned to the OCBA office no later than **5:00 p.m., Friday, March 30, 2012**. In order for your vote to be counted, you must sign **and** print your name on the back of the return envelope. Mail or bring voted ballots to the OCBA office, 880 N. Orange Ave., Orlando, FL 32801.

Red, White and Blue Luncheon

On November 11, 2011, CFAWL hosted its **Red, White and Blue Luncheon**, featuring Immediate Past President of The Florida Bar**, Mayanne Downs.** Mayanne spoke about the value of servant leadership, and how community involvement and helping others makes us better lawyers and sets us apart from other attorneys. Attendees wore red, white and blue in honor of America's veterans.

GOAABA

On November 8, 2011, the **Greater Orlando Asian American Bar Association** hosted an **In-house Corporate Counsel Panel Discussion and Mixer** at the Lake Eola office of Lowndes, Drosdick, Doster, Kantor & Reed, P.A. Members of GOAABA, the **Central Florida Gay and Lesbian Law Association**, the **Hispanic Bar Association of Central Florida** and the **Paul C. Perkins Bar Association** were invited. GOAABA members **Sandra Chen** of Universal Orlando, **Jae Im** of Wyndham Worldwide, and **Renee Yuen** of Walt Disney World Resort were our captive panelists and answered questions about in-house practice and the relationship with external counsel.

Through a joint effort of **The Florida Bar Equal Opportunity in Law Section**, a committee of the Orlando minority bar associations and the Orange County Bar Association (Diversity Committee and YLS), the **Central Florida Diversity Picnic** will occur in Orlando in February 2012. If you are interested in helping with the inaugural Orlando picnic, please contact **Kim Nguyen** at Kim.Nguyen@lowndes-law.com.

The **Alien Land Law Committee** is moving toward organizing a ballot initiative. It's not too late to join in this community service event! If you are interested in helping with the ballot initiative, please contact **Christine Ho** at CHo@litchris.com.

We'd love to hear from other local voluntary bars! Please send your news to me at any time! You can reach me at sunny@hillarylaw.com or 407-237-0911.

Sunny Lim Hillary, Hillary, P.A., has been a member of the OCBA since 2005.

Stern v. Marshall

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courts."[19] Thus, in its closing remarks, the Court downplays the significance of its decision in *Stern*.

Despite the Court's attempt at downplaying the results of its decision, the *Stern* opinion tees up a formal analysis of bankruptcy court jurisdiction that impacts some of the most important functions of bankruptcy itself. This could even lead to a successful challenge to the role Article I judges play not only in bankruptcy as a whole, but also in magistrate functions.[20]

So Anna Nicole Smith, the Bankruptcy Code, and the Supreme Court walk into a bar . . . . What happens? Part II will discuss (1) how federal bankruptcy, district, and circuit courts are handling *Stern*, (2) the practical impact of *Stern* and what attorneys should prepare for in dealing with *Stern* issues, and (3) the punchline: how *Stern* may impact the future of bankruptcy courts. In the meantime, read the recent opinion in *In re Safety Harbor Resort and Spa*, 2011 Bankr. LEXIS 3238 (Bankr. M.D. Fla. Aug. 30, 2011), which the author, Judge Michael G. Williamson from the Tampa Division, refers to as the "CliffsNotes" on *Stern*.

Part Two of "*Stern v. Marshall*: A Quagmire for the Future of Bankruptcy Jurisdiction or Just a Bad Joke?" will appear in an upcoming issue of *The Briefs*.

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[1] 11 U.S.C. § 101 et. seq. (1982).

[2] U.S. Const. art. III, § 1.

[3] *See Northern Pipeline Construction Co. v. Marathon Pipe Line Co.*, 458 U.S. 50 (1982) (plurality opinion).

[4] *See* 28 U.S.C. § 157 (1988).

[5] 28 U.S.C. § 157(b)(2) (2006).

[6] 28 U.S.C. § 157(c)(1) (2006).

[7] 131 S. Ct. at 2600.

[8] *See Marshall v. MacIntyre* (Estate of Marshall), No. 276-815-402 (Harris County., Tex. Dec. 7, 2001).

[9] The Supreme Court's opportunity to answer the jurisdictional question came after the case took an initial trip through the Ninth Circuit, *In re Marshall*, 392 F.3d 1118 (9th Cir. 2004), up to the Supreme Court, *Marshall v. Marshall*, 547 U.S. 293 (2006), and remanded back to the Ninth Circuit based on other grounds. On remand, the Ninth Circuit held that the judgment entered by the bankruptcy court was not final as the bankruptcy court did not have statutory jurisdiction to rule on Vickie's counterclaim. *In re Marshall*, 600 F. 3d 1037 (9th Cir. 2010).

[10] 131 S. Ct. at 2605.

[11] *Id.* at 2620.

[12] *Id.* at 2611.

[13] *Id.* at 2620-21 (Scalia, J., concurring).

[14] First recognized by the Court in *Murray's Lessee v. Hoboken Land & Improvement Co.*, 59 U.S. 272 (1856), the public rights exception in essence provides an analysis by which a court determines what constitutes the exercise of judicial power reserved solely for the courts and what constitutes the exercise of authority that conceivably falls within the authority of the legislature or executive. As the Court noted in *Stern v. Marshall*, the "[e]xception applies where the Government is involved in its sovereign capacity under a statute creating enforceable public rights, while wholly private tort, contract, and property cases, as well as a vast range of other cases are not at all implicated." 131 S. Ct. at 2613 (majority opinion) (quoting *Ex parte Bakelite Corp.*, 279 U.S. 438, 451-52 (1929)) (internal quotations omitted).

[15] 131 S. Ct. at 2617.

[16] *Id.* at 2620.

[17] *Id.*

[18] *Id.* at 2630 (Breyer, J., dissenting).

[19] *Id.* at 2619.

[20] *See Technical Automation Services Corp. v. Liberty Surplus Insurance Corp.*, No. 10-20640, p. 2 (5th Cir. Sept. 9, 2011).