

Clients & Friends Memo

Stern v. Marshall: How Big Is It?

July 14, 2011

On June 23, 2011, the Supreme Court ruled 5-4, in an opinion by Chief Justice Roberts, that a Bankruptcy Judge lacked constitutional authority to issue a final ruling on state law counterclaims by a debtor against a claimant. This is the latest round of a well-known case involving the estate of former model Anna Nicole Smith and the estate of her late husband, wealthy oil magnate J. Howard Marshall.

While *Stern v. Marshall* is probably the Court's most significant ruling on bankruptcy jurisdiction since its seminal *Northern Pipeline*¹ case, the impact is not yet clear. It may create leverage for non-debtors in the form of potential delay of key litigation and may pave the way for more matters to be heard in the District Courts. However, in practice, District Courts have allowed Bankruptcy Courts to manage cases up to the point of trial and would likely permit the same process for a non-core counterclaim. To the extent District Courts are overburdened they may be inclined to defer to the Bankruptcy Court's findings and conclusions. Moreover, the opinion may be restricted by its facts to counterclaims with little or no relation to the underlying bankruptcy claim. Most counterclaims will have a closer relation to the underlying claim than was the case here and core jurisdiction for the Bankruptcy Court may remain constitutional in those cases, particularly with respect to compulsory counterclaims. [*Stern v. Marshall*, No 10-179 \(U.S. June 23, 2011\)](#).

Background

The litigation springs from the bankruptcy of Vickie Lynn Marshall, known to the public as Anna Nicole Smith. As is well-known from the tabloids, Smith married aging oil executive J. Howard Marshall shortly before his death. J. Howard Marshall did not include Smith in his will. Prior to Marshall's death, Smith sued Marshall's son, Pierce Marshall, in Texas probate court, alleging that Pierce Marshall fraudulently induced his father to exclude Smith from his estate.

Following J. Howard Marshall's death, Smith filed for bankruptcy. Pierce Marshall filed a complaint in the Smith bankruptcy alleging defamation and sought a declaration from the bankruptcy court

¹ *Northern Pipeline Constr. Co. v. Marathon Pipe Line Co.*, 458 U.S. 50 (1982).

that the defamation claim was not dischargeable. He later filed a proof of claim in Smith's bankruptcy, seeking damages for the defamation claim. Smith responded by filing a counterclaim for tortious interference by Pierce Marshall with respect to the gift she expected from J. Howard Marshall.

The Bankruptcy Court granted summary judgment for Smith on the defamation claim. Subsequently, the Bankruptcy Court ruled in Smith's favor on her state law tortious interference counterclaim, and ultimately awarded her over \$400 million in damages. Pierce Marshall later argued that the Bankruptcy Court lacked jurisdiction over the state law counterclaim. Marshall asserted that bankruptcy courts have only limited jurisdiction over counterclaims that are non-core and argued that the Bankruptcy Court could only submit proposed findings of fact and conclusions of law to the federal district court with respect to the state law counterclaim. Pierce Marshall argued the tortious interference counterclaim was not core because it did not relate closely to the initial claim.

Opinion

Justice Roberts began his majority opinion by examining 28 U.S.C. § 157, which "divide[s] bankruptcy proceedings into three categories: those that 'arise[e] under title 11'; those that 'aris[e] in a Title 11 case'; and those that are 'related to a case under title 11.'"² "Bankruptcy judges may hear and enter final judgment in 'all core proceedings arising under title 11, or arising in a case under title 11.'"³ 11 U.S.C. § 157(b)(2)(C) details 16 types of core proceedings, including counterclaims by a debtor against a claimant.⁴ The majority found that Smith's counterclaim against Pierce Marshall for tortious interference constituted a "core proceeding" under the plain text of the statute. The majority held that as a statutory matter, the Bankruptcy Court had authority to enter a final judgment on the debtor's counterclaim for tortious interference.⁵

However, the analysis did not end there.⁶ Despite finding that 28 U.S.C. § 157 permitted the Bankruptcy Court to enter a final order in the matter, the majority agreed with Pierce Marshall that

² *Stern v. Marshall*, 2011 WL 2472792, at *9.

³ *Id.*

⁴ *Id.*

⁵ *Id.* at *10.

⁶ Pierce Marshall made several other arguments, including that, pursuant to 28 U.S.C. §157(b)(5), only the District Court had jurisdiction to hear his defamation claim. This statutory provision states that "personal injury torts or wrongful death claims shall be tried in the district court in the district in which the claim arose." Pierce Marshall asserted the defamation claim was a "personal injury tort." The majority rejected this argument on the grounds that this provision was not jurisdictional, but rather a venue provision and that Mr. Marshall consented to venue in the bankruptcy court by filing his proof of claim in the bankruptcy court and permitting the litigation to continue subsequently in the bankruptcy court.

Article III of the Constitution rendered this statutory provision unconstitutional and held that the Bankruptcy Court could not enter a final order on the state law counter-claim.

“Article III, §1 of the Constitution mandates that the judicial Power of the United States shall be vested in one Supreme Court, and in such inferior Courts as the Congress may from time to time ordain and establish.”⁷ The Judges in those courts “shall hold their Offices during good Behaviour’ and ‘receive for their Services [] a Compensation [] [that] shall not be diminished’ during their tenure.”⁸ The Supreme Court stated that while it has recognized that the three branches are not “hermetically sealed” from one another, “Article III imposes some basic limitations that the other branches may not transgress.”⁹ Those limitations “are intended, in part, to protect each branch of government from incursion by the others.”¹⁰ However, the Court held: “Article III could neither serve its purpose in the system of checks and balances nor preserve the integrity of the judicial decision making if other branches of the Federal Government could . . . [grant] ‘judicial Power’ on entities outside Article III. That is why . . . Congress may not ‘withdraw from judicial cognizance any matter which, from its nature, is the subject of a suit at the common law, or in equity, or admiralty.’”¹¹

The Court noted the similarities between this case and its seminal decision on the jurisdiction of the bankruptcy courts in *Northern Pipeline*.¹² In that case, the Court considered whether bankruptcy judges, lacking lifetime tenure and salary guarantees of Article III judges “could ‘constitutionally be vested with jurisdiction to decide [a] state law contract claim’ against an entity that was not otherwise part of the bankruptcy proceedings.”¹³ In *Northern Pipeline*, the Supreme Court rejected arguments that the Bankruptcy Court had jurisdiction to enter a final order adjudicating a state law claim. Subsequently Congress revised the bankruptcy jurisdiction statutes, permitting bankruptcy judges to enter final rulings only on “core” proceedings.

Justice Roberts, here proclaimed: “It is clear that the Bankruptcy Court in this case exercised the ‘judicial power of the United States’ in purporting to resolve and enter final judgment on a state

⁷ *Id.* at *14.

⁸ *Id.*

⁹ *Id.*

¹⁰ *Id.* (quoting *Bond v. United States*, 131 S. Ct. 2355 (2011)).

¹¹ *Id.* (quoting *Murray’s Lessee v. Hoboken Land & Improvement Co*, 59 U.S. 272 (1855)).

¹² *Id.* at *15.

¹³ *Id.* (quoting *Northern Pipeline*, 458 U.S. at 53).

common law claim, just as the court did in *Northern Pipeline*. We conclude that . . . the Bankruptcy Court . . . lacked the constitutional authority to do so.”¹⁴

Smith sought to distinguish this case from *Northern Pipeline* on the grounds that Pierce Marshall was a creditor in the bankruptcy and thus had consented to Bankruptcy Court jurisdiction. The Court rejected this argument on the grounds that Smith’s tort counterclaim is a state law action independent of federal bankruptcy law and “not necessarily resolvable by a ruling on the creditors’ proof of claim in bankruptcy.”¹⁵ Thus the Bankruptcy Court could not exercise the “judicial power of the United States” by entering a final order on the state law counter-claim.¹⁶

The Court held:

it is hard to see why [Pierce Marshall’s] decision to file a claim should make any difference with respect to the characterization of [Smith’s] counterclaim. “[P]roperty interests are created and defined by state law,” and “[u]nless some federal interest requires a different result, there is no reason why such interests should be analyzed differently simply because an interested party is involved in a bankruptcy proceeding. . . . [Pierce Marshall’s] claim for defamation in no way affects the nature of [Smith’s] counterclaim for tortious interference as one at common law that simply attempts to augment the bankruptcy estate – the very type of claim that we held in *Northern Pipeline* and *Granfianciera* must be decided by an Article III court.”¹⁷

Smith also argued that the Bankruptcy Court’s final judgment on her state law counterclaim was constitutional because the Bankruptcy Court serves as an adjunct of the District Court. The Court rejected this argument, as it rejected a similar argument in *Northern Pipeline* on the grounds that adjuncts of Article III courts only make “specialized, narrowly confined factual determinations regarding a particularized area of law.” Here, the Bankruptcy Court was being charged by the statute to “resolve ‘[a]ll matters of fact and law in whatever domains of law to which’ the parties’ counterclaims might lead.”¹⁸

¹⁴ *Id.* at *16.

¹⁵ *Id.*

¹⁶ *Id.*

¹⁷ *Id.* at *21.

¹⁸ *Id.* at *24 (citing *Northern Pipeline*, 458 U.S. at 91).

Finally, the Supreme Court rejected Smith's argument that restrictions on a Bankruptcy Court's ability to resolve counterclaims "will create significant delays and impose additional costs on the bankruptcy process."¹⁹ The Court stated: "It goes without saying that 'the fact that a given law or procedure is efficient, convenient, and useful in facilitating functions of government, standing alone, will not save it if it is contrary to the Constitution.'"²⁰ Moreover, the Supreme Court predicts that prohibiting Bankruptcy Courts from entering final rulings on federal counterclaims will not have the detrimental effect predicted by the dissent or the Smith and *amici* briefs. The opinion does not state how the Court expects courts to address claims and counter-claims going forward.²¹

Analysis

While the ruling represents the most significant Supreme Court ruling on Bankruptcy Court jurisdiction in nearly 30 years, its impact may be less significant than some critics anticipate. The Supreme Court does not prohibit the Bankruptcy Court from the hearing counter-claims, only from entering a final order. Thus, District Courts, already facing overwhelming caseloads, may continue to permit Bankruptcy Courts to hold full hearings on the relevant matters and then submit findings of fact and conclusions of law to the District Court. The District Court could then review those findings and conclusions and issue a final order, perhaps using an expedited, dedicated panel of District Court judges. This may not require substantially increased delay or expense especially as compared with an appeal. In addition, many parties may consent to the Bankruptcy Court hearing the matter in the interest of efficiency and economy.

Roberts dwells on the fact that there was very little overlap between the underlying claim and the state law counter-claim. Thus, unusual facts here may have created unusual law. To the extent counterclaims, particularly compulsory counterclaims, share key questions of fact and law with the original claim they may remain subject to "core" jurisdiction. It is not clear from the opinion's face how this ruling will play out in cases with greater overlap between claim and counterclaim.

¹⁹ *Id.* at *26.

²⁰ *Id.* at *24 (quoting *INS v. Chadha*, 462 U.S. 919, 944 (1983)).

²¹ Justice Breyer wrote a dissent on behalf of four justices. In addition to his focus on the procedural inefficiencies created by the majority's "constitutionally required game of jurisdictional ping-pong" (Opinion at *37), Justice Breyer stated that the case law requires the Court to determine "whether a congressional delegation of adjudicatory authority to a non-Article III judge violates the separation-of-powers principles inherent in Article III." *Id.* at *32. The dissent proposed determining through an examination of certain relevant factors whether the delegation of authority constituted a "significant encroachment by the Legislative or Executive Branches of Government upon" Article III authority. Those factors include: (i) the nature of the claim to be adjudicated; (ii) that nature of the non-Article III tribunal; (iii) the extent to which Article III courts control the proceedings; (iv) the presence of party consent; and (v) the nature and importance of the legislative purpose in granting adjudicatory rights to non-article III judges. Applying those factors, Justice Breyer concluded that the delegation of core adjudicatory authority to the bankruptcy court was constitutional.

Nevertheless, non-debtors may use this ruling to create delay (and thus leverage) on critical issues. Non-debtors may seek to have matters heard before the District Court or to wait for the District Court to enter a final order on a counterclaim before agreeing to resolve the underlying claim. This could frustrate efforts to confirm plans and could lead to leverage and better recoveries for creditors (or fewer counter-claims from debtors).

As with most Supreme Court rulings, the impact is known only after lower courts have begun to apply it to new sets of facts. The *Travelers*²² case from 2007 received great attention at the time, but has had little direct impact on bankruptcy process or jurisprudence. For now, it is not clear whether the *Stern v. Marshall* decision will have any major impact on the bankruptcy world, or whether it will instead prove as evanescent as Ms. Smith's impact on American culture.

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²² *Travelers Cas. & Surety Ins. Co. of Am. v. Pac. Gas & Electric Co.*, 549 U.S. 443 (2007).