WILL THE "ISOLATED" HOLDING WITH REGARD TO THE "NARROW" QUESTION PRESENTED IN *STERN V. MARSHALL* HAVE A SIGNIFICANT IMPACT ON THE BANKRUPTCY COURT'S EXERCISE OF JURISDICTION IN GARDEN VARIETY ADVERSARY PROCEEDINGS?[1]

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On June 23, 2011, the United States Supreme Court issued its decision in *Stern v. Marshall*, 564 U.S. ___, 131 S.Ct. 2594 (2011). Since that time, the Internet has been inundated with articles proclaiming that the holding in *Stern* will significantly limit the exercise of jurisdiction by the bankruptcy courts under 28 U.S.C. § 1334(b) in run of the mill adversary proceedings. The author of this article disagrees.

The statutory framework relative to bankruptcy court jurisdiction

Bankruptcy courts, like all federal courts, are courts of limited jurisdiction. The district courts have original and exclusive jurisdiction of all cases filed under title 11. 28 U.S.C. § 1334(a). The United States Bankruptcy Code is codified as 11 U.S.C. § 101, *et seq.* (the "Code"). The reference to "title 11" in 28 U.S.C. § 1334(a) is a reference to the Code. The vast majority of cases filed under the Code are under Chapters 7 (liquidation), 11 (reorganization of businesses and individuals) and 13 (reorganization of wage earners).

Under 28 U.S.C. § 157(a), each district court may provide that any and all cases filed under the Code be referred to bankruptcy judges for the district. This is done by local rules of the district court. In Kentucky, cases are automatically referred to bankruptcy judges in the Eastern and Western District of Kentucky under Local Rule 83.12 of the United States District Court for the Eastern and Western Districts of Kentucky.

The district courts, and bankruptcy courts when cases filed under the Code are referred to bankruptcy judges, have "original jurisdiction but not exclusive jurisdiction of all civil proceedings arising under title 11, or arising in or related to cases under title 11." 28 U.S.C. § 1334(b). Sections 1334(a)-(b) list four types of matters over which the district courts have jurisdiction:

> (1) "cases under title 11," (2) "proceedings arising under title 11," (3) proceedings "arising in" a case under title 11, and (4) proceedings "related to" a case under title 11.

Michigan Employment Security Commission v. Wolverine Radio Co., Inc. (In re Wolverine Radio Co.), 930 F.2d 1132, 1141 (6th Cir. 1991). 28 U.S.C. §§ 1334(b) and

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157(b)(1) equate "core proceedings" with the categories of "arising under" and "arising in" proceedings. *Stern*, 131 S.Ct. at 2605; *Wolverine Radio* at 1144. The phrase "arising under title 11" describes "those proceedings that involve a cause of action created or determined by a statutory provision of title 11 [the Code]," and "arising in" proceedings are "those that, by their very nature, could arise only in bankruptcy cases." *Wolverine Radio* at 1144 If a case is "related to" a case under the Code, it is a noncore proceeding. The difference between core and noncore proceedings is significant.

With regard to core proceedings, a bankruptcy judge "may enter appropriate orders and judgment, subject to review" under 28 U.S.C. § 158. In other words, a bankruptcy judgment may enter "final" orders and a judgment in a core proceeding. *Stern* at 2603. A nonexhaustive list of core proceedings is set forth in 28 U.S.C. §§ 157(b)(2)(A)-(P). Section 157(b)(2)(A) ("matters concerning the administration of the estate") and 157(b)(2)(O) ("other proceedings affecting the liquidation of the assets of the estate or the adjustment of the debtor-creditor or the equity security holders relationship, except personal injury tort or wrongful death claims") are commonly referred to as the "catchalls." The core statutory provision at issue in *Stern* was 28 U.S.C. 157(b)(2)(C) ("counterclaims by the estate against persons filing claims against the estate").

In noncore proceedings, a bankruptcy judge may only enter final orders and a judgment with the consent of the parties. 28 U.S.C. § 157(c)(2). Absent such consent, a bankruptcy judge "may hear a proceeding that is not a core proceeding but that is otherwise related to a case under title 11," but "shall submit proposed findings of fact and conclusions of law to the district court, and any final order or judgment shall be entered by the district court after considering the bankruptcy judge's proposed findings and conclusions and after reviewing de novo those matters to which any party has timely and specifically objected." 28 U.S.C. § 157(c)(1); *Stern* at 2604. The most widely accepted test for determining whether a proceeding is noncore was espoused in *Pacor, Inc. v. Higgins*, 743 F.2d 984 (3d Cir. 1984) and is known as the "*Pacor* test." It provides:

> The usual articulation of the test for determining whether a civil proceeding is related to a bankruptcy is whether *the outcome of that proceeding could conceivably have any effect on the estate being administered in bankruptcy.* [citations omitted]. Thus, the proceeding need not necessarily be against the debtor or against the debtor's property. An action is related to a bankruptcy if the outcome could alter the debtor's rights, liabilities, options, or freedom of action (either positively or negatively) and which in any way impacts upon the handling and administration of the bankruptcy estate.

Id. at 994 (emphasis in original). The Sixth Circuit has "accepted the *Pacor* articulation" (*Robinson v. Michigan Consolidated Gas Co., Inc.*, 918 F.2d 579, 584 (6th Cir. 1990)), albeit with the caveat that "situations may arise where an extremely tenuous connection to the estate would not satisfy the jurisdictional requirement." *Kelley v. Salem Mortgage Co. (In re Salem Mortgage Co.)*, 783 F.2d 626, 634 (6th Cir. 1986).[2]

For "cause shown," the district court may withdraw the reference of any case or proceeding referred to a bankruptcy judge under 28 U.S.C. § 157(a) and a local rule. 28 U.S.C. § 157(d). Upon timely motion of any party, withdrawal of a proceeding is mandatory if the district court determines that resolution of the proceeding "requires consideration of both title 11 and other laws of the United States regulating organizations or activities affecting interstate commerce." *Id.*

The two issues presented in Stern

The "narrow" questions presented for decision in *Stern* were: (1) whether the bankruptcy court had the statutory authority under 28 U.S.C. § 157(b)(2)(C) to issue a final judgment on the counterclaim asserted by Vickie Lynn Marshall (known to the public as Anna Nicole Smith) ("Vickie") against E. Pierce Marshall ("Pierce"), who filed a proof of claim in Vickie's Chapter 11 bankruptcy case; and (2) if so, whether conferring authority on the bankruptcy court to enter such a judgment is constitutional. *Id.* at 2600, 2620.

The extraordinary facts in Stern

A complete recitation of the facts in, and procedural history of, *Stern* is beyond the scope of this article. In fact, the more than sixteen-year legal battle between Vickie and Pierce was litigated in a Texas state probate court, the United States Bankruptcy Court for the Central District of California (the "Bankruptcy Court"), the Texas and federal appellate courts, and ultimately the United States Supreme Court (the "Supreme Court"). The first trip by Vickie and Pierce to the Supreme Court was in 2006 in *Marshall v. Marshall*, 547 U.S. 293 (2006); the second trip culminated with the decision in *Stern*.

At issue in *Stern* were two claims filed by Vickie in an attempt to secure one-half of the fortune of her deceased spouse, J. Howard Marshall (a man believed to be one of the richest people in Texas). *Id.* at 2600-2601. Vickie was J. Howard Marshall's third

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[2] The First, Fourth, Fifth, Eighth, Ninth, Tenth and Eleventh Circuits have adopted the *Pacor* test for "related to" jurisdiction "with little or no variation." *In re G.S.F. Corp.*, 938 F.2d 1467, 1475 (1st Cir. 1991); *A.H. Robbins Co. v. Piccinin*, 788 F.2d 994, 1002 n.11 (4th Cir.), *cert. denied*, 479 U.S. 876 (1986); *Wood v. Wood (In the Matter of Wood)*, 825 F.2d 90, 93 (5th Cir. 1987); *Dogpatch Properties, Inc. v. Dogpatch U.S.A., Inc. (In re Dogpatch U.S.A., Inc.)*, 810 F.2d 782, 786 (8th Cir. 1987); *Fietz v. Great Western Sav. (In re Fietz)*, 852 F.2d 455, 457 (9th Cir. 1988); *Gardner v. United States (In re Gardner)*, 913 F.2d 1515, 1518 (10th Cir. 1990); *Miller v. Kemira, Inc. (In re Lemco Gypsum, Inc.)*, 910 F.2d 784, 788 n.19 (11th Cir. 1990).

wife and married him about a year before his death. *Id.* at 2561. Although J. Howard gave Vickie many gifts (monetary and otherwise) during their short courtship and marriage, he did not include her in his will. *Id.* Before J. Howard passed away, Vickie filed suit in a Texas probate court, asserting that Pierce, one of J. Howard's sons, fraudulently induced J. Howard to sign a living trust that did not include Vickie. *Id.* Vickie claimed that J. Howard meant to give her one-half of his property. *Id.* Not surprisingly, Pierce denied any fraudulent activity and defended the validity of his father's trust and, eventually, his will. *Id.*

After J. Howard's death, Vickie filed a voluntary petition for relief under Chapter 11 of the Code with the Bankruptcy Court. *Id.* at 2601. Pierce filed an adversary complaint with the Bankruptcy Court, contending that Vickie had defamed him by inducing her lawyers to tell members of the press that he had engaged in fraud to gain control of his father's assets. *Id.* The complaint by Pierce sought a declaration that his defamation claim against Vickie was not dischargeable in her bankruptcy case. *Id.* Pierce subsequently filed a proof of claim in Vickie's bankruptcy case on account of his alleged defamation claim, meaning that he sought to recover damages for such claim from Vickie's bankruptcy estate. *Id.*

Vickie responded to Pierce's nondischargeability complaint by asserting truth as a defense to the alleged defamation claim; she also asserted a counterclaim in response to his proof of claim for tortious interference with her expected inheritance from J. Marshall. *Id.* at 2601. As she had in the Texas probate court action, Vickie alleged that Pierce had wrongfully prevented J. Howard from taking the legal steps necessary to provide her with one-half of his assets. *Id.* The filing of Vickie's counterclaim against Pierce (a person who had filed a proof of claim against her bankruptcy estate) triggered a core proceeding under the plain language of 28 U.S.C. § 157(b)(2)(C), a fact acknowledged by the *Stern* court. *Id.* at 2604.

On November 5, 1999, the Bankruptcy Court granted Vickie summary judgment on Pierce's defamation claim. *Id.* at 2601. On September 27, 2000, after a bench trial, the Bankruptcy Court entered a judgment in favor of Vickie and against Pierce on her counterclaim, and later awarded her $400 million in compensatory damages and $25 million in punitive damages. *Id.* In post-trial proceedings, Pierce argued that the Bankruptcy Court lacked jurisdiction over Vickie's counterclaim because the counterclaim was not a "core proceeding" under 28 U.S.C. § 157(b)(2)(C). *Id.* Pierce was unsuccessful in post-trial proceedings in that the Bankruptcy Court held that Vickie's counterclaim was in fact a "core proceeding" under 28 U.S.C. § 157(b)(2)(C) and that it had the power to enter a final judgment on such claim under 28 U.S.C. § 157(b)(1). *Id.* at 2602.

On appeal, the United States District Court for the Central District of California (the "District Court") concluded that Vickie's counterclaim was not core and that it was required to treat the Bankruptcy Court's judgment as "proposed[,] rather than final," and engage in an "independent review of the record." *Id.* at 2602. Although the Texas probate court had by that time conducted a jury trial on the merits of the parties' dispute

and entered a judgment in favor of Pierce, the District Court declined to give that judgment preclusive effect and went on to decide the matter itself. *Id.* Like the Bankruptcy Court, the District Court found that Pierce tortiously interfered with Vickie's expectancy gift from J. Howard and awarded her compensatory and punitive damages, each in the amount of $44,292,767.33. *Id.* The United States Court of Appeals for the Ninth Circuit reversed the District Court on a different ground, and the Supreme Court, in the first visit of Vickie and Pierce to the nation's highest court, reversed the Ninth Circuit. *Id.*

On remand from the Supreme Court, the Ninth Circuit held that 28 U.S.C. § 157 mandates a "two-step approach" under which a bankruptcy judge may issue a final judgment in a proceeding only if the matter both "meets Congress' definition of a core proceeding *and* arises under or arises in title 11." *Id.* The Ninth Circuit reasoned that allowing a bankruptcy judge to enter final judgments on all counterclaims raised in bankruptcy proceedings "would certainly run afoul" of the Supreme Court's decision in *Northern Pipeline Construction Co. v. Marathon Pipe Line Co.*, 458 U.S. 50 (1982).[3] *Id.* With these concerns in mind, the Ninth Circuit concluded that a "counterclaim under § 157(b)(2)(C) is properly a 'core' proceeding 'arising in a case under' the [Bankruptcy] Code only if the counterclaim is so closely related to [a creditor's] proof of claim that the resolution of the counterclaim is necessary to resolve the allowance or disallowance of the claim itself." *Id.* (brackets in original). The Ninth Circuit ruled that Vickie's counterclaim against Pierce did not meet that test, which made the Texas probate court's judgment the earliest final judgment on matters relevant to the dispute between Vickie and Pierce. *Id.* The Ninth Circuit held that the District Court should have given the Texas probate court's judgment in favor of Pierce on his defamation claim preclusive effect. *Id.* at 2602-03. The Supreme Court again granted *certiorari* and affirmed the Ninth Circuit's ruling in a 5-4 decision. *Id.*

The limited holding in Stern

The Supreme Court agreed with Vickie that her counterclaim against Pierce was a core proceeding under the plain text of 28 U.S.C. § 157(b)(2)(C). *Stern* at 2604. Although the *Stern* court concluded that Section 157(b)(2)(C) permitted the Bankruptcy

[3] The issue before the *Northern Pipeline* court was "whether the assignment by Congress to bankruptcy judges of the jurisdiction granted in 28 U.S.C. § 1471 (1976 ed., Supp. IV) by § 241(a) of the Bankruptcy Act of 1978 violates Art. III of the Constitution." 458 U.S. at 52. Under Section 1471, Congress granted bankruptcy courts jurisdiction over "all civil proceedings arising under title 11 [the Code] or arising in or *related to* cases under title 11." *Northern Pipeline*, 458 U.S. at 54 (brackets and emphasis in original). *Northern Pipeline* held that such a broad grant of jurisdiction to bankruptcy judges, who are Article I judges, violated Article III of the Constitution. *Id.* at 87. *Northern Pipeline* was decided on June 28, 1982, but the Supreme Court stayed its judgment until October 4, 1982 to "afford Congress an opportunity to reconstitute the bankruptcy courts or to adopt other valid means of adjudication, without impairing the interim administration of the bankruptcy laws." *Id.* at 88. Congress sought to remedy the constitutional defect in 28 U.S.C. § 1471 with the passage of the Bankruptcy Amendments and Federal Judgeship Act of 1984 ("BAFJA"). *The Cain Partnership, Ltd. v. Pioneer Investment Services Co. (In re Pioneer Investment Services Co.)*, 946 F.2d 445, 448 (6th Cir. 1991). Under the Code, as amended by BAFJA, the jurisdiction of all cases under title 11, and all civil proceedings arising under title 11, or arising in or related to cases under title 11 is governed by 28 U.S.C. §§ 1334(a)-(b). *Id.*

Court to enter a final judgment on Vickie's counterclaim, it held that Article III of the Constitution did not. *Id.* at 2605, 2608. The Supreme Court emphasized that the Bankruptcy Court, an Article I court, exercised the "judicial power of the United States in purporting to resolve and enter final judgment on a state common law claim, just as the court did in *Northern Pipeline*" in violation of Article III, § 1 of the Constitution. *Id.* at 2611. The *Stern* court concluded that Vickie's counterclaim was "a state law claim independent of the federal bankruptcy law and not necessarily resolvable by a ruling on the creditor's [Pierce's] proof of claim in bankruptcy." *Id.* It held that "Pierce's claim for defamation in no way affects the nature of Vickie'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 *Granfinanciera* must be decided by an Article III court." *Id.* at 2616.

Stern has no application to postpetition claims of the bankruptcy estate

Claims of the bankruptcy estate (the "Estate") can be either prepetition or arise postpetition. The claims that the Supreme Court found could not be constitutionally adjudicated by bankruptcy courts in *Stern* and *Northern Pipeline* were prepetition claims. *Stern* at 2601(noting that Vickie's Texas state court probate action against Pierce was filed before J. Howard passed away and her bankruptcy case was filed after he passed away); *Northern Pipeline*, 458 U.S. at 84 ("[T]he case before us, which centers upon appellant Northern's claim for damages for breach of contract and misrepresentation, involve a right created by *state* law, a right independent of and **antecedent to the reorganization petition** that conferred jurisdiction upon the Bankruptcy Court.") (first emphasis in original; second emphasis added).

Long after *Northern Pipeline* was decided, numerous courts held that postpetition claims of the Estate are core. *See, e.g., Arnold Print Works, Inc. v. Apkin (In re Arnold Print Works, Inc.)*, 815 F.2d 165, 170-71 (1st Cir. 1987) (debtor in possession's action to collect an account receivable, arising out of contract made after the debtor was in bankruptcy, was a core proceeding because "[p]arties who contract with a bankrupt company's trustee or with a debtor-in-possession know that they are dealing with an agent responsible to a bankruptcy court; that the bankruptcy court would resolve subsequent disputes should therefore come as no surprise."); *Harris v. Wittman (In re Harris)*, 590 F.3d 730, 738-39 (9th Cir. 2009) (claim against a Chapter 7 trustee for breach of a postpetition settlement agreement with respect to sale of property of the estate is a core proceeding under 28 U.S.C. § 157(b)(2)(A)); *Ben Cooper, Inc. v. The Ins. Co. of the State of Pennsylvania (In re Ben Cooper, Inc.)*, 896 F.2d 1394, 1399-1400 (2d Cir. 1990) (bankruptcy court had core jurisdiction over state law breach of contract and negligence claims relating to a postpetition insurance contract because adjudication of such claims is an essential part of administering the estate); *Gentry v. Gentry*, 207 B.R. 146, 150 (E.D. Ky. 1997) (Chapter 11 debtor's postpetition action alleging that collateral was not sold in a commercially reasonable manner arose in a case under the Code and was therefore within the core jurisdiction of the bankruptcy court under 28 U.S.C. § 157(b)(2)(A)); *Martino v. Weisman (In re Elegant Equine, Inc.)*, 155 B.R. 189, 190-91 (Bankr. N.D. Ill. 1993) (claim against Chapter 11 trustee for breach of fiduciary duty and

negligent postpetition liquidation of assets of the estate was a matter involving the administration of the estate under 28 U.S.C. § 157(b)(2)(A) and was therefore a core proceeding); *Umbreit v. Stump, Harvey & Cook, Inc. (In re Baltimore Motor Coach Co.)*, 103 B.R. 103, 105 (D. Md. 1989) (action filed by Chapter 7 trustee against insurers for postpetition misconduct committed against the debtor in possession is core); *Allied Stores Corp. v. Fed. Ins. Co. (In the Matter of Federated Dept. Stores, Inc.)*, 144 B.R. 993, 996 (Bankr. S.D. Ohio 1992) (adversary proceeding alleging postpetition breach of a postpetition contract is a core proceeding under 28 U.S.C. § 157(b)(2)(A)); *Woodward v. Sanders (In re SPI Communications & Marketing, Inc.)*, 112 B.R. 507, 511 (Bankr. N.D.N.Y. 1990) (legal malpractice claim against attorney who represented Chapter 11 debtors was core where complained of negligence occurred postpetition); *Burns v. Massachusetts Property Ins. Underwriting Ass'n (In re Mike Burns Inn, Inc.)*, 70 B.R. 863, 867-68 (Bankr. D. Mass. 1987) (causes of action alleging breach of contract and deceit which arose postpetition are core); *Pester Refining Co. v. MAPCO Gas Products (Matter to Pester Refining Co.)*, 66 B.R. 801, 817-18 (Bankr. S.D. Iowa 1986) (action brought by DIP against prepetition creditor who converted property of the estate postpetition is core); *L.A. Clarke and Son, Inc. v. Bullock Constr., Inc. (In re L.A. Clarke and Son, Inc.)*, 51 B.R. 31, 33 (Bankr. D.C. 1985) (Both claim and counterclaim were a core proceeding where "[a]ll operative events giving rise to the claim and counterclaim occurred during the period after the Debtor's Chapter 11 petition was filed, while the Debtor was a Debtor-in-possession, and they all involved the activities of the Debtor as Debtor-in-possession, operating under the aegis of the Court's protection and authority.").

The fact pattern in *Stern* was extraordinary in that cases between Vickie and Pierce involving essentially the same claims were being litigated simultaneously in state and federal court. The author is of the view that *Stern* has no impact on well-settled law holding claims of the Estate which accrue postpetition are core. Under these circumstances, a bankruptcy judge may enter final orders and a judgment.

The implication of Stern as to prepetition claims that are "related to" a case under the Code

The *Pacor* test is very broad. At the commencement of a bankruptcy case, all the prepetition claims of a debtor become property of the Estate under 11 U.S.C. § 541(a)(1). Proceedings involving such claims "*could conceivably have an[] effect on the estate being administered in bankruptcy*" (*Pacor*, 743 F.2d at 994 (emphasis in original)) and are therefore noncore. By the same token, proceedings involving claims by creditors against the Estate meet the *Pacor* test because they "*could conceivably have an[] effect on the estate being administered in bankruptcy.*" *Id.*

It is critical to keep in mind that dismissal of claims however denominated (i.e., cross-claims, counterclaims, etc.) was not at issue in *Stern*, but rather whether a bankruptcy court had statutory and constitutional authority to enter a final judgment on a prepetition counterclaim of the Estate against a creditor who filed a proof of claim against the Chapter 11 debtor's Estate. Nothing in *Stern* supports or mandates an outright dismissal of noncore claims, provided they pass the *Pacor* test. If such claims do not

meet the *Pacor* test, they are subject to dismissal for lack of subject matter jurisdiction under Fed. R. Civ. P. 12(b)(1).

Although a bankruptcy court cannot enter final orders and a judgment in a noncore proceeding without the consent of all parties, it is empowered and required to submit proposed findings of fact and conclusions of law to the district court, and any final order or judgment shall be entered by the district judge after considering the bankruptcy judge's proposed findings and conclusions and after reviewing *de novo* those matters to which any party has timely and specifically objected. 28 U.S.C. § 157(c)(1). Had the Bankruptcy Court and District Court in *Stern* abided by the process spelled out in Section 157(c)(1) prior to the entry of judgment by the Texas probate court, there is little doubt that the judgment of the District Court would not have been vacated on jurisdictional grounds.

Parting thoughts

The proclamations that the jurisdiction of the bankruptcy courts has been eviscerated by the holding in *Stern* are much exaggerated. No doubt, many motions predicated upon *Stern* have been filed, and will continue to be filed, by defendants and creditors seeking to exit the perceived unfriendly confines of the bankruptcy court. In fact a motion to dismiss an adversary complaint for lack of subject matter jurisdiction and a complaint filed in district court seeking a declaratory judgment as to a bankruptcy court's alleged lack of subject matter jurisdiction to enter a consented to judgment in an adversary proceeding, both of which relied exclusively upon *Stern*, were the impetus for this article. When dealing with a *Stern* motion, be quick to point out that the question presented therein was a "narrow" one and that the Court found that Congress exceeded its authority in "one isolated respect" by vesting bankruptcy courts with core jurisdiction as to all counterclaims filed by the Estate against persons filing claims against the Estate.

For more information about this topic or any other litigation matter, please contact Mike Gartland or any of the other attorneys at DelCotto Law Group at (859) 231-5800 or visit our website at www.dlgfirm.com.