STERN v MARSHALL

AND OTHER HOT TOPICS

IN CHAPTER 11

Michael J. Pankow
Brownstein Hyatt Farber Schreck, LLP
410 Seventeenth Street, Suite 2200
Denver, CO 80202-4432

John F. Young
Markus Williams Young & Zimmermann, LLC
1700 Lincoln St, Ste 4000
Denver, CO 80203-4505

1. STERN v MARSHALL, 130 S. Ct. 2594 (2011)

- "Bankruptcy Courts . . . lack . . . 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."

- The Supreme Court stated that is holding is "narrow" and addresses "one isolated respect." However, its logic may be interpreted as sweeping.

Background

- Vickie Lynn Marshall aka Anna Nicole Smith married eighty-something oilman J. Howard Marshall, one of the richest men in Texas, after meeting him in a strip club.

- J. Howard's son, Pierce, took objection to the relationship. Anna Nicole sued Pierce in Texas Probate Court after J. Howard's passing. She alleged tortious interference with an expected gift. Anna Nicole then filed for bankruptcy.

- In response, Pierce filed a proof of claim in Anna Nicole's bankruptcy case asserting damages on account of Anna Nicole's alleged defamation of him. Pierce also brought an adversary proceeding seeking a determination of nondischargeability under 11 U.S.C. § 523. Anna Nicole counterclaimed raising the same tortious interference claim as in her Texas lawsuit.

- The Bankruptcy Court and the Texas Courts both held trials, with the Bankruptcy Court ruling first. The Bankruptcy Court entered a judgment in favor of Anna Nicole in the amount of $475 million on her tortious interference counterclaim. The Bankruptcy Court's judgment was entered over Pierce's objection that the Bankruptcy Court lack jurisdiction to enter a final order on the counterclaim.

- The Texas Court ruled against Anna Nicole's tortious interference claim.

- Under doctrines of res judicata and full faith and credit, the question of which Court entered final judgment first became critical. If the Bankruptcy Court lacked jurisdiction to enter a final judgment, then the Texas Court entered judgment first.

Supreme Court's Reasoning

- The Supreme Court concluded that the Bankruptcy Court had statutory authority to enter final judgment on Anna Nicole's counterclaim. See 28 U.S.C. § 157(b)(2)(c).

- The Supreme Court held, however, that the Bankruptcy Court lacked constitutional authority to enter final judgment on the counterclaim. Not being an Article III court, the Bankruptcy Court may not exercise judicial power of the United States. See Katchen v Landy, 382 U.S. 323 (1966); Northern Pipeline v Marathon Oil, 458 U.S. 50 (1982). The Bankruptcy Court is constitutionally authorized to enter final judgments only when:

- "the action at issue stems from the bankruptcy itself;" or
- the issue "would necessarily be resolved in the claims allowance process" or
- where the parties' consent to adjudication by a non-Article III court.

- The Supreme Court found that Pierce's filing of a proof of claim did not, by itself, constitute such consent.

Some Court Rulings Interpreting and Applying Stern

In re Teleservices Group, Inc. (Meoli v. Huntington Nat'l Bank), 2011 WL 3610050 (Bankr. W.D. Mich. 2011):

"Every day I am presented with numerous orders that Congress expects me to sign either as final or forward on with a report and recommendation. However, prior to Stern, I did have a standard – 28 U.S.C. § 157(b)(2) – to serve as my guide. But now I am told that the standard is unreliable when tested against the Constitution itself. My frustration with Stern is that it offers virtually no insight as to how to re-calibrate the core/non-core dichotomy so that I can again proceed with at least some assurance that I will not be making the same constitutional blunder with respect to some other aspect of Section 157(b)(2)."

In re Salander O'Reilly Galleries, 2011 WL 2837494 (Bankr. S.D.N.Y. July 18, 2011) (Stern limited to facts of case).

In re Crescent Resources LLC, 2011 WL 302554 (Bankr. W.D. Texas July 22, 2011)

Questions under Stern

- Do Bankruptcy Courts have jurisdiction to enter final judgment on fraudulent transfer claims? Preference claims?
- What types of proceedings "arise out of the bankruptcy itself?"
- What conduct constitutes consent?

<u>Procedures to Call Out Consent</u>

- Scheduling Order
- Local Rule. Does Local Rule 84-1, providing for automatic referral of all bankruptcy related matters to Bankruptcy Court, need to be modified?
- Mere participation not enough

<u>Will Withdrawal of Reference be More Common</u>?

- Bankruptcy Courts may enter proposed findings. <u>See</u> <u>e.g.</u>, <u>In re Canopy Financial Inc.</u>, 2011 WL 3911082 (N.D. Ill. 2011).
- <u>Siegel v FDIC (In re Indymac Bancorp., Inc.</u>, 2011 WL 2883012 (D.D. Col. 2011) (de novo review effectuate).
- Dismissal or remand to state court as a potential alternative

2. <u>United Student Aid Funds, Inc. v. Espinosa</u>, 130 S. Ct. 1367 (2010)

<u>Holding</u>

- Confirmed Chapter 13 plan discharged student loan obligation notwithstanding failure to comply with 11 U.S.C. § 523(a)(8) "undue hardship" requirement.
- Also, student loan not served with summons and complaint, but had actual notice of plan terms. Failure to serve summons and complaint held not a due process protection.

<u>Impacts on Chapter 11 Protection</u>

- Finality of confirmed plan. 11 U.S.C. § 1141(a).
- Adequacy of Notice – bare due process.
- Sua sponte review of orders ("the bankruptcy court must make an **independent determination** of undue hardship before a plan is confirmed, even if the creditor fails to object or appear in the adversary proceeding.")

3. **<u>H.R. 2533 “The Chapter 11 Bankruptcy Venue Reform Act of 2011.”</u>**

- Eliminates state of incorporation as basis for venue.
- Restrictions on “affiliate rule” – limits to controlling shareholder.