

**UNSETTLED, OR UNSETTLING, LAW?  
A REVIEW OF BANKRUPTCY JURISDICTION  
FOLLOWING *STERN V. MARSHALL***

Presented to the South Carolina Bankruptcy Law Association  
November 30, 2011

Presented By:

Julio E. (Rick) Mendoza, Jr., Esquire  
George A. Scott, Jr., Esquire  
NEXSEN PRUET, LLC  
Columbia, South Carolina

Assistance in Preparation of Materials from  
Kyle A. Brannon, Law Clerk  
NEXSEN PRUET, LLC  
Columbia, South Carolina

# TABLE OF CONTENTS

	<b>Page</b>
I. INTRODUCTION .....	1
II. THE STERN V. MARSHALL DECISION.....	2
A. SUMMARY OF THE FACTS .....	2
B. SUMMARY OF THE STERN V. MARSHALL RULINGS .....	4
C. NOTABLE PASSAGES IN STERN V. MARSHALL .....	5
III. PENDING SOUTH CAROLINA CASES.....	6
A. VIEIRA V. FIRST PALMETTO SAVINGS BANK, FSB (IN RE GOODSTEIN) .....	6
B. FORT V. SUNTRUST BANK (IN RE INTERNATIONAL PAYMENT GROUP, INC.).....	7
IV. OTHER DECISIONS IN THE 4TH CIRCUIT .....	9
V. DECISIONS FROM THE 11TH CIRCUIT COURTS .....	10
VI. THE BROWN ESTATE V. DALLAS .....	12
A. FACTS .....	12
B. ARGUMENTS.....	13
C. KEY SIMILARITIES TO STERN .....	13
D. KEY DIFFERENCES FROM STERN.....	14
E. OPINIONS RELEVANT TO STERN V. MARSHALL .....	14
VII. OTHER DECISIONS .....	15
VIII. QUICK SUMMARY OF DECISIONS .....	30
IX. COMMENTS CONCERNING IMPLICATIONS .....	32

**UNSETTLED, OR UNSETTLING, LAW?  
A REVIEW OF BANKRUPTCY JURISDICTION  
FOLLOWING *STERN V. MARSHALL***

**I. INTRODUCTION**

On June 23, 2011, the United State Supreme Court issued its decision in *Stern v. Marshall*, \_\_\_ U.S. \_\_\_, 131 S. Ct. 2594 (2011), holding that a purely state law claim, raised by a Chapter 11 debtor-in possession as a counterclaim to a proof of claim, constituted a “core proceeding” under 28 U.S.C. § 157(b)(2)(C), but the Bankruptcy Court lacked jurisdiction to enter final orders on it, under Article III of the United States Constitution. The decision was upon a 5-4 majority, with Chief Justice Roberts authoring the opinion of the Court, Justice Scalia issuing a concurrence, and Justice Breyer providing the dissent for the four dissenting justices.

The *Stern v. Marshall* decision has created much uncertainty, speculation and a divergence of views regarding its meaning, scope and effect. Questions have been raised as follows:

- Is *Stern v. Marshall* to be limited in application and effect, as the majority suggests in the decision?
- Will *Stern v. Marshall* significantly change what matters Bankruptcy Judges can adjudicate?
- What are the *Stern v. Marshall* decision’s implications for other courts?

More specifically, the questions arise:

- Given that “core proceedings” are, pursuant to 28 U.S.C. § 157(b)(1), matters the Bankruptcy Court is authorized to adjudicate, can a matter be a “core proceeding” which is not referable to the Bankruptcy Court by the District Court?

- Although a claim may fall within the ambit of *Stern v. Marshall*, can the Bankruptcy Court issue a final judgment on the claim if the parties consent?
- If consent can confer authorization upon the Bankruptcy Court to adjudicate the state law claim, can that consent be implied or deemed to be made by failure to challenge the Bankruptcy Court’s jurisdiction? In this regard, what about the rule that subject matter jurisdiction cannot be conferred simply by the consent of the parties?
- If a Bankruptcy Court determines that it cannot enter a final judgment on a claim, per *Stern v. Marshall*, what are its alternatives? For example, is *sua sponte* transfer of the claim to the District Court possible? What is the effect if there is no existing action in state court, such that remand is not possible? What is the effect of abstention, if there is no existing action on the claim in another court (*e.g.*, where a statute of limitations could eliminate the claim)?
- Because 28 U.S.C. § 157(c)(1) expressly applies to non-core proceedings, what is the authorization for a Bankruptcy Court to issue proposed findings of fact and conclusions of law to the District Court, for the District Court to enter the final decision on the matter? Should the District Court adopt a new local rule or enter an operating order providing for this procedure? Is new legislation from Congress required?
- In 28 U.S.C. § 157(c)(2), the provision states that the District Court may refer proceedings to the Bankruptcy Court, with the consent of the parties, to hear and determine, and to enter *appropriate* orders and judgments, “*subject to review under section 158 of this title.*” (emphasis added) However, section 158 (28 U.S.C. § 158) pertains to appeals. Can § 157(c)(2) be read to confer jurisdiction on the Bankruptcy Court to enter final determinations, notwithstanding *Stern v. Marshall*’s holding that jurisdiction cannot be conferred by statute in violation of Article III of the Constitution?
- Can § 157(c)(2) be used as the mechanism for District Court referral to the Bankruptcy Court of claims that *Stern v. Marshall* states the Bankruptcy Court cannot adjudicate, for hearing and proposed findings of fact and conclusions of law, given that § 158 pertains to appeals from Bankruptcy Court decisions?

## II. THE STERN V. MARSHALL DECISION

### A. SUMMARY OF THE FACTS

The *Stern v. Marshall* case involved the actress/model/celebrity Anna Nicole Smith, whose real name was Vickie Lynn Marshall (“Vickie”). She had married the very

wealthy and successful J. Howard Marshall (“J. Howard”) in his last years of life. She was much, much younger than her husband. As often happens in situations of this type, at least one of J. Howard Marshall’s children was not particularly happy with his father’s marriage to Vickie. J. Howard’s younger son, E. Pierce Marshall (“Pierce”) sought to prevent Vickie from receiving a large part of J. Howard’s fortune.

As noted in Chief Justice Roberts’ summary of the background, “Although J. Howard bestowed on Vickie many monetary and other gifts during their courtship and marriage, he did not include her in his will. . . . Before Howard passed away, Vickie filed suit in Texas state probate court, asserting that Pierce . . . fraudulently induced J. Howard to sign a living trust that did not include her, even though J. Howard meant to give her half of his property. Pierce denied any fraudulent activity and defended the validity of J. Howard’s trust and, eventually, his will.” 131 S. Ct. at 2601.

After J. Howard’s death, Vickie filed a Chapter 11 bankruptcy in the Central District of California. Pierce filed both a proof of claim, and an adversary proceeding for exception to discharge under 11 U.S.C. § 523, asserting 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 J. Howard’s assets. Vickie then filed a counterclaim, the counterclaim which is the subject of the *Stern v. Marshall* decision, for tortious interference with the gift she expected to receive from J. Howard.

The Bankruptcy Court found that the counterclaim was a core proceeding under 28 U.S.C. § 157(b)(2)(C), and, after first ruling against Pierce on his claim on November 5, 1999, granted judgment to Vickie on her claim against Pierce on September 27, 2000. The appeals then followed.

Sadly, during the course of the litigation, both Vickie and Pierce died. However, the litigation continued on, culminating in the *Stern v. Marshall* decision.

**B. SUMMARY OF THE STERN V. MARSHALL RULINGS**

- The Supreme Court concluded that, although the Bankruptcy Court had the statutory authority to enter judgment on a purely state law claim against a non-debtor as a counterclaim to a filed proof of claim, under 28 U.S.C. § 157(b)(2)(C), the Bankruptcy Court lacked the constitutional authority to do so. 131 S. Ct. at 2601.
- Even though the counterclaim was a “core proceeding” under § 157(b)(2)(C), and § 157(b)(1) provides that Bankruptcy Judges may adjudicate core proceedings, the Bankruptcy Court lacked jurisdiction to enter a final order on the counterclaim under Article III of the United States Constitution.
- Core proceeding under 28 U.S.C. § 157(b)(2)(C)
- *Stern* decided that the bankruptcy court had the statutory authority under § 157(b)(2)(C) but not the constitutional authority under Article III to hear Marshall’s counterclaim.
- A fundamental issue is that Marshall’s counterclaim is a state law action premised on state common law.
- However, § 157(b)(3) states that “A determination that a proceeding is not a core proceeding shall not be made solely on the basis that its resolution may be affected by state law.”
- The court seems to give short shrift to § 157(b)(3).
- § 157(c)(1) provides that a bankruptcy judge may hear a proceeding that is “non-core” but is otherwise related to a case under Title 11. However, in this situation, the bankruptcy judge shall only submit proposed findings of fact and conclusions of law. Any final order or judgment must be entered by a district judge after conducting a *de novo* review of the proposed findings of the bankruptcy judge.
- Based on Northern Pipeline, the court held that Marshall’s claim (tortious interference with an expected gift) is a state law action independent of the federal bankruptcy law and not necessarily resolvable by a ruling on the creditor’s proof of claim in bankruptcy.

- In essence, the Supreme Court held that under these circumstances 28 U.S.C. § 157(b)(2)(C), which allows for counterclaims by the estate against persons filing claims against the estate to be a core proceeding, violated Article III of the Constitution.
- Further, Marshall’s claim does not fall under the public rights exception to Article III

**C. NOTABLE PASSAGES IN *STERN V. MARSHALL***

The following are notable passages from the majority opinion in *Stern v. Marshall*:

- “When a bankruptcy judge determines that a referred ‘proceeding ... is not a core proceeding but ... is otherwise related to a case under title 11,’ the judge may only ‘submit proposed findings of fact and conclusions of law to the district court.’ § 157(c)(1). It is the district court that enters final judgment in such cases after reviewing *de novo* any matter to which a party objects. *Ibid.*” 131 S. Ct. at 2604.
- “We agree with Vickie that § 157(b)(2)(C) permits the bankruptcy court to enter a final judgment on her tortious interference counterclaim.” 131 S. Ct. at 2605. “... [W]e agree with Vickie that § 157(b)(5) is not jurisdictional, and that Pierce consented to the Bankruptcy Court’s resolution of his defamation claim.” *Ibid.*, at 2606. “Although we conclude that § 157(b)(2)(C) permits the Bankruptcy Court to enter a final judgment on Vickie’s counterclaim, Article III of the Constitution does not.” *Ibid.* at 2608.
- “Here Vickie’s claim is a state law action independent of the federal bankruptcy law and not necessarily resolvable by a ruling on the creditor’s proof of claim in bankruptcy.” *Ibid.* at 2611.
- “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 *Ganfinanciera* must be decided in an Article III court.” *Ibid.* at 2616.
- “The only overlap between the two claims in this case was the question whether Pierce had in fact tortuously taken control of his father’s estate in the manner alleged by Vickie in her counterclaim and described in the allegedly defamatory statements.” *Ibid.* at 2617. “There thus was never reason to believe that the process of ruling on Pierce’s proof of claim would necessarily result in the resolution of Vickie’s counterclaim.” *Ibid.* at 2617-2618.

- “We do not think the removal of counterclaims such as Vickie’s from the core bankruptcy jurisdiction meaningfully changes the division of labor in the current statute; we agree with the United States that the question presented here is a ‘narrow’one.” *Ibid.* at 2620.
- “If our decision today does not change all that much, then why the fuss? Is there really a threat to the separation of powers where Congress has conferred the judicial power outside Article III only over certain counterclaims in bankruptcy? The short but emphatic answer is yes. . . . We cannot compromise the integrity of the system of separated powers and the role of the Judiciary in that system, even with respect to challenges that may seem innocuous at first blush.” *Ibid.* at 2620.

### **III. PENDING SOUTH CAROLINA CASES**

Two cases are presently pending in the District of South Carolina on the effect of the *Stern v. Marshall* decision.

#### **A. VIEIRA V. FIRST PALMETTO SAVINGS BANK, FSB (IN RE GOODSTEIN)**

- In connection with the Chapter 7 bankruptcy case of *In re Goodstein*, Case No. 10-4204-dd in the U.S. Bankruptcy Court for the District of South Carolina, on February 9, 2011, the Chapter 7 trustee filed an adversary proceeding alleging causes of action to avoid a stock pledge as a fraudulent conveyance under 11 U.S.C. § 548(a)(1)(B), and under the South Carolina Statute of Elizabeth (S.C. Code § 27-23-10) pursuant to the trustee’s rights under 11 U.S.C. § 544(b). *See Vieira v. First Palmetto Savings Bank, FSB (In re Goodstein)*, Adv. Pro. No. 11-80010-dd. By Order entered on April 26, 2011, the Court granted the motion of the defendante, First Palmetto Savings Bank, FSB (the “Bank”) to dismiss the first cause of action on the grounds that it was barred by the statute of limitations, leaving only the state law fraudulent conveyance action. On August 18, 2011 the Bank filed a motion for withdrawal of the reference of the adversary proceeding pursuant to 28 U.S.C. § 157(d) and Rule 5011 of the Federal Rules of Bankruptcy Procedure (“Bankruptcy Rule 5011”), *i.e.*, to withdraw the adversary proceeding from the Bankruptcy Court and place it in the U.S. District Court for the District of South Carolina, on the basis of the *Stern v. Marshall* decision. The trustee has objected to the motion on the basis that the alleged action is a core proceeding under 28 U.S.C. §§ 157(b)(2)(H) and (K), not a counterclaim under § 157(b)(2)(C), and that the claim is of the type that bankruptcy courts routinely hear and determine.
- The Bank’s motion for withdrawal of reference is scheduled for hearing before U.S. District Court Judge C. Weston Houck on December 13, 2011. The matter is designated as 2:11-cv-02422-CWH in the District Court.

- It should be noted that motions for the withdrawal of the reference by the District Court to the Bankruptcy Court are filed in the Bankruptcy Court but heard by the District Court. *See* Bankruptcy Rule 5011 and Rule 5011-1 of the U.S. Bankruptcy Court for the District of South Carolina (“SC LBR 5011-1”). The Bankruptcy Court transmits the motion and the designated record of the matter (the parties designate the record for transmittal to the District Court). *See* SC LBR 5011-1.
- Also, it should be noted that a motion for withdrawal of the reference does not stay the pending litigation. *See* Bankruptcy Rule 5011(c) and SC LBR 5011-1(e). Accordingly, parties may proceed with discovery, or seek modification of an existing schedule. In the *Vieira v. First Palmetto Savings Bank, FSB* case, the Bank filed a motion to modify the existing scheduling order, which motion is presently scheduled for hearing on December 20, 2011.

**B. FORT V. SUNTRUST BANK (IN RE INTERNATIONAL PAYMENT GROUP, INC.)**

- In the Chapter 7 bankruptcy case of *In re International Payment Group, Inc.*, Case No. 08-03453-hb in the U.S. Bankruptcy Court for the District of South Carolina, on April 12, 2010, the Chapter 7 trustee filed an adversary proceeding in the Bankruptcy Court alleging eight state law claims against the defendant, SunTrust Bank (“SunTrust”). *See Fort v. SunTrust Bank (In re International Payment Group, Inc.)*, Adv. Pro. No. 10-80049-hb. The Court, *sua sponte*, raised the question of whether *Stern v. Marshall* affected the Bankruptcy Court’s ability to make final determinations on the claims. SunTrust then filed a motion to dismiss the actions on September 22, 2100, on the basis of lack of subject matter jurisdiction pursuant to *Stern v. Marshall*. The Court entered its Order Regarding Motion to Dismiss on November 3, 2011, refraining from ruling on the motion, and, instead, directing that “any challenge to the constitutionality of the referral of this lawsuit to this Court should be addressed to the referring court.” *See* Order Regarding Motion to Dismiss, page 7, a copy of which is attached to these materials.
- In the Order Regarding Motion to Dismiss, the Court noted that *Stern v. Marshall* appears to be applicable, at least to some degree, to the adversary proceeding, and the Court found as follows:
- “Even with these attempts by Plaintiff to distinguish this matter from *Stern*, the facts are quite similar, and Defendant raises valid questions about the referral of the lawsuit to a non-Article III court. Despite Local Rule 83.IX.01 and the statutory authority of § 157(b)(1), it appears, just like *Stern*, the causes of action asserted by Plaintiff are only remotely related, and likely unrelated, to Defendant’s proofs of claim against the estate and there is no reason to believe that ‘the process of adjudicating [the] proof[s] of claim would necessarily resolve [the estate’s]

counterclaim.” See Order Regarding Motion to Dismiss, page 6 (quoting *Stern v. Marshall*, 131 S. Ct. at 2617).

- By the Order Regarding Motion to Dismiss, the Court allowed SunTrust a period of fourteen days in which to file a motion to withdraw the reference, if it so chose to do so; if no such motion was filed within the 14-day period, the Court directed that it would treat the lack of further challenge to the Court’s jurisdiction “as express consent by Plaintiff and Defendant to the jurisdiction of, and entry of a final order by, this Court reviewable pursuant to 28 U.S.C. § 158.” See Order Regarding Motion to Dismiss, page 7.
- SunTrust filed its motion to withdraw the reference of the adversary proceeding on November 17, 2011. The trustee has consented to the motion. As of this date, the motion has not yet been assigned to a District Court Judge.
- SunTrust’s motion reflects concern about the effect of the questions of authority for the Bankruptcy Court to enter final decisions on the claims in the adversary proceeding, and the procedure for the adjudication of the adversary proceeding. Concerns exist about:
  1. The effect of jurisdiction based on the parties consent;
  2. The authority by which the Bankruptcy Court would proceed with the matter; and
  3. Even if the Bankruptcy Court were to treat its determinations as proposed findings of fact and proposed conclusions of law, the authority and process by which the proposed findings and conclusions would be submitted to the District Court, where the District Court had no prior dealings with the adversary proceeding and had not instructed the Bankruptcy Court to send the matter to it with proposed findings and conclusions.
- In short, SunTrust, as might parties in other such matters, was concerned about the finality of any supposedly final decision that might be entered. The District Court might elect to keep the adversary proceeding, or it might refer the matter back to the Bankruptcy Court for the Bankruptcy Court to hear the matter and submit proposed findings of fact and conclusions of law to the District Court; however, even if the matter is sent back to the Bankruptcy Court for it to submit proposed findings and conclusions, the reference to and role of the Bankruptcy Court would be specifically stated, with a defined process for the matter.

#### **IV. OTHER DECISIONS IN THE 4<sup>TH</sup> CIRCUIT**

##### **A. *Kevin R. McCarthy v. Wells Fargo Bank, N.A. (In re Osama M. EL-ATARI)*, 2011 WL 5828013 (E.D.Va. Nov. 18, 2011) (Judge Brinkema)**

- Chapter 7 Trustee filed adversary proceedings against Wells Fargo Bank, N.A (“Wells Fargo”) and over forty other entities under 11 U.S.C. § 548(a) to recover fraudulent conveyances.
- Wells Fargo filed a Motion to Withdraw the Reference of Adversary Proceeding, in which it sought to have the fraudulent conveyance proceeding withdrawn from the Bankruptcy Court to District Court.
- Wells Fargo argued, among other things, that the Bankruptcy Court lacks constitutional authority under *Stern v. Marshall* to hear and decide the adversary proceeding.
- The District Court held that *Stern v. Marshall* does preclude “bankruptcy judges from issuing final orders in fraudulent conveyance proceedings.” However, the Court cautioned that this conclusion does not “lead inexorably to the further conclusion that . . .” Well Fargo’s motion must be granted, because “bankruptcy courts also have jurisdiction to ‘hear a proceeding that is not a core proceeding but that is otherwise related to a case under title 11.’ § 157(c)(1).”
- The District Court went on to find that, regardless of whether the effect of *Stern v. Marshall* is to remove certain proceedings from the list of “core proceedings” under § 157(b)(2), or simply to strike the phrase “and determine” from § 157(b)(1), it does not follow that Bankruptcy Courts have lost all power to hear a fraudulent conveyance proceeding. The District Court found that even if a fraudulent conveyance action, such as the one brought against Wells Fargo, has lost its “vaunted status” as a core proceeding, it is clearly “related to a case under title 11.” *See, e.g., Celotex v. Edwards*, 514 U.S. 300, 308 n. 5 (1995). The District Court held that, as such, the Bankruptcy Court retains the authority to “submit proposed findings of fact and conclusions of law” that the District Court then considers before entering a final judgment. *See* 28 U.S.C. § 157(c)(1).

##### **B. *Jane H. Walter v. Freeway Foods, Inc. et al. (In re Freeway Foods of Greensboro, Inc.)*, 2011 WL 5118419 (Bankr. M.D.N.C. Oct. 26, 2011) (Judge Waldrep)**

- Jane H. Walter (“Plaintiff”) filed an Amended Complaint in an adversary proceeding.
- The Trustee filed a motion to dismiss certain of the Amended Complaint’s claims. Before considering the motion, the Court first gave the parties an opportunity to submit briefs regarding “whether and how the *Stern v. Marshall* ruling applies to the Court’s authority to render final judgment” on the claims in Plaintiff’s Amended Complaint.
- The Court held that “[s]ince the Plaintiff’s First and Fifth Causes of Action are based on alleged breaches of the lease agreement that is the basis for the Plaintiff’s proof of claim in the

Debtor's bankruptcy, it is clear that such causes of action would necessarily be resolved in the claims allowance process.” Therefore, since, as the “Supreme Court explained in *Stern v. Marshall*, a bankruptcy court can enter a final judgment if ‘the action at issue stems from the bankruptcy itself or would necessarily be resolved in the claims allowance process,’” the Court had authority to enter final judgment on such claims.

- The Court also held that the Plaintiff’s claims for interference with contract, fraud, and unfair and deceptive trade practices were noncore, “related to” proceedings and did not invoke a substantive right provided by Title 11, and they are not, by their nature, matters that could arise only in the context of a bankruptcy. Thus, the Court concluded, it must enter proposed findings of fact and conclusions of law with respect to such claims.

## V. DECISIONS FROM THE 11TH CIRCUIT COURTS

Several decisions have been rendered in our neighboring 11<sup>th</sup> Circuit on the effect of the *Stern v. Marshall* decision. These include the following:

### A. *In re Safety Harbor Resort & Spa*, No. 8:10–bk–25886, 2011 WL 3849639, (Bankr. M.D. Fla. Aug. 30, 2011) (Decided by Judge Michael G. Williamson)

- Noted that *Stern* “merely held that Congress exceeded its authority under the Constitution in one isolated instance by granting bankruptcy courts jurisdiction to enter final judgments on counterclaims that are not necessarily resolved in the process of ruling on a creditor's proof of claim.”
- Essentially, all *Stern* held was that bankruptcy courts may not render a final judgment on a state law claim that is not necessary to resolve in ruling on the creditor’s proof of claim.
- This is why the majority in *Stern* noted that its holding would not “meaningfully change” whether a bankruptcy court or district could should render a final judgment on the claim.
- Additionally, “Vickie's claim, in contrast, [was] in no way derived from or dependent upon bankruptcy law; it [was] a state court action that exist[ed] without regard to any bankruptcy proceeding.” Vickie’s tortious interference claim arose entirely under Texas state law.
- *Stern* merely held that Congress overstepped the bounds in Article III by allowing all counterclaims to be core proceedings even when they did not arise in bankruptcy or were necessary in the claims allowance process.
- Counterclaims that do arise in bankruptcy or are necessary in the claims allowance process are still core proceeding under § 157(b)(2)(C).

- The court noted that “in fact, the Supreme Court's holding does not even remove all state-law counterclaims from the bankruptcy court's jurisdiction. The Supreme Court recognized in *Stern* that whether a bankruptcy court can enter a final judgment on a state-law counterclaim has to be decided on a case-by-case basis. If after such analysis it is concluded that the counterclaim stems from the bankruptcy itself or that nothing remains for adjudication of the counterclaim once the bankruptcy judge resolves the claim objection, then the counterclaim can be tried and finally resolved by the bankruptcy court.”
- Undoubtedly, *Stern* only impacts § 157(b)(2)(C) and has no effect on other examples of core proceedings under §157(b)(2).
- Here, the court rejected the notion that *Stern*'s reliance on *Granfinanciera*, a 1989 U.S. Supreme Court case, affected a bankruptcy court's jurisdiction to render a final judgment on a fraudulent conveyance action under § 157(b)(2)(F).
- Of course, *Stern* also did not change the bankruptcy court's ability to render a final judgment in a non-core action if the defendant consented to the bankruptcy court's jurisdiction.
- “For those reasons, this Court agrees with the *Stern* Court that the decision in *Stern* ‘does not change all that much.’”

**B. *In re Peacock*, No. 8:09–bk–28719–CPM, 2011 WL 3874461 (Bankr. M.D. Fla. Sept. 2, 2011) (Decided by Judge Catherine Peek McEwen)**

- Noted that the holding in *Stern* should be narrowly interpreted to the particular facts of the case
- Held that *Stern* applied only to § 157(b)(2)(C) and did not affect bankruptcy jurisdiction for any other type of core proceeding under § 157(b)(2)
- Further, *Stern* does not affect the bankruptcy court's ability to rule on non-core matters under § 157(c).
- Additionally, the defendant already consented to the jurisdiction of the bankruptcy court by admitting in his answer that the trustee's complaint was a core proceeding under § 157(b)(2)(O). Therefore, this effort to challenge jurisdiction was too late.

**C. *FNB Bank v. Carlton (In re Carlton)*, Bankruptcy No. 10–40388–JJR–13, 2011 WL 3799885 (Bankr. N.D. Ala. Aug. 26, 2011) (Decided by Judge James J. Robinson)**

- Adversary complaint filed by bank seeking a declaration that it was not prohibited from post-confirmation foreclosure
- Debtor counterclaimed asserting violation of the confirmation order and violations of the Truth in Lending Act
- Court held that the debtor’s counterclaims were “core” proceedings
- One reason for the court’s decisions was that the debtor and bank both agreed that bank’s adversary complaint and the debtor’s counterclaim were “core” proceedings under 157(b)(2)
- However, the court went on to say that if the bank did challenge this Bankruptcy Court’s jurisdiction based on an argument that a non-Article III judge did not have subject matter jurisdiction to hear the TILA counterclaim, it would have held that the adjudication of the TILA claims was the basis for a reconsideration of allowance of the Bank’s claims via setoff and, therefore, this Court would have subject matter jurisdiction. *Id.* at \*1 n.5

**VI. THE BROWN ESTATE V. DALLAS**

***In re: Albert H. Dallas, Bankr. S.D. GA, (Adv. Pro. No. 10-01120 – The Honorable Susan D. Barrett)***

Russell L. Bauknight, as Personal Representative of the Estate of James Brown, Deceased, and as Trustee of the James Brown 2000 Irrevocable Trust, and James Brown Enterprises, Inc. (the “Brown Estate”)

v.

Albert H. Dallas (“Dallas”)

**A. FACTS**

- James Brown (“Brown”) died in 2006 and the Probate estate of James Brown was established in South Carolina.
- Dallas was Brown’s attorney and, after Brown’s death, he initially served as a Personal Representative (“PR”) of the Brown Estate.

- Dallas filed a claim against the Brown Estate for the following: 1) an amount of unpaid professional fees and a right to royalties (based on an alleged oral contract under which Brown agreed to give Dallas 5% of royalties), and 2) fees for Dallas' services as PR to the Brown Estate (the "Dallas Claim").
- The Brown Estate filed an action against Dallas in South Carolina (the "SC Action") for, among other things, overcharging Brown, breach of fiduciary duty, negligence, and civil conspiracy.
- In the SC Action, Dallas filed an answer denying the Brown Estate's claim and filed the Dallas Claim as a counterclaim.
- While the SC Action and the Dallas Claim were still pending, Dallas filed a Chapter 7 bankruptcy case in the Southern District of Georgia (the "Dallas BK").
- The Brown Estate filed an unliquidated proof of claim in the Dallas BK in regard to any amount the Brown Estate would recover from the SC Action (the "Brown Estate's Claim"). The Brown Estate also filed a complaint objecting to the discharge of the Brown Estate's Claim (the "BK Complaint").
- Dallas filed the Dallas Claim as a counterclaim to the BK Complaint.
- The Brown Estate filed a motion to dismiss the Dallas Claim; Dallas contested such motion.

## **B. ARGUMENTS**

- The Brown Estate argued that under *Stern v. Marshall*, the Bankruptcy Court cannot render a final judgment on the Dallas Claim.
- Dallas argued that *Stern* does not affect the Bankruptcy Court's ability to render a final judgment on the Dallas Claim.

## **C. KEY SIMILARITIES TO STERN**

- Creditor filed a proof of claim and complaint objecting to discharge of such claim against a bankruptcy estate.
- Debtor's counterclaim was based on the same factual issues and on state common law.

**D. KEY DIFFERENCES FROM *STERN***

- Debtor's state law counterclaim was still pending in state court.
- In *Stern*, the debtor's counterclaim was a tort claim based on unsettled state law.
- In *Brown v. Dallas*, the debtor's counterclaim was based on settled state law.
- In *Brown v. Dallas*, the debtor's counterclaim consisted of claims for PR fees and rights to the Brown Estate's continuing income. Such claims required the application of state probate laws.
- In *Brown v. Dallas*, adjudication of the Dallas Claim would have required inclusion of multiple parties not otherwise involved in the Dallas BK and the determination of their respective rights and interests in the assets of the Brown Estate.

**E. OPINIONS RELEVANT TO *STERN V. MARSHALL***

- The Court did not render an opinion on whether *Stern* allowed it to render a final judgment on the Dallas Claim.
- Pursuant to 28 U.S.C. §1344(c)(1), the Court abstained from hearing the Dallas Claim due to, among other reasons, the following:
- Its opinion that the Dallas Claim's resolution required the involvement of state probate matters;
- The resolution of the BK Complaint did not necessarily resolve the probate matters of the Dallas Claim;
- *Stern* brought the court's jurisdiction into question in regards to entering into a final judgment on the Dallas Claim; and
- The Dallas Claim was already pending in the South Carolina Probate Court.

## VII. OTHER DECISIONS

### ***Colony Beach & Tennis Club, Ltd. v. Colony Beach & Tennis Club Ass’n (In re Colony Beach & Tennis Club Ass’n, Inc.)*, 2011 WL 3169486 (M.D. Fla. July 27, 2011) (Judge Merryday)**

- The Colony Beach Partnership sued the Colony Beach Association for breach of contract in state court. Shortly thereafter, the Colony Beach Association filed for bankruptcy.
- “The Partnership filed the state law claims in the bankruptcy proceeding but also moved to remand or for abstention on the ground that the state law claims are not a “core” proceeding within a bankruptcy court's mandatory jurisdiction.”
- The bankruptcy court denied the motion for remand.
- In referencing *Stern* only in a footnote, the District Court held that “Article III confirms that each claim of the Partnership is a non-core proceeding, an affinity—however strong—between a claim and a category of Section 157(b)(2) notwithstanding. If the Partnership's purely state law claims, asserted in state court, qualify as a core proceeding, “virtually any claim would entitle a bankruptcy court to enter final judgment,” and “[ Section] 157 would ignore the constitutional proscription limiting the jurisdiction of bankruptcy courts as set forth by the Supreme Court in Northern Pipeline.”
- While *Stern* is only referred to in a footnote embedded in the above quote, it appears that it made quite an impact on determining that Article III precluded the bankruptcy court from rendering a final judgment on this breach of contract claim.
- Based on the above reasoning, the District Court held that it must look to the bankruptcy court’s order as only the proposed findings and must review these findings *de novo*.

### ***In re Old Prairie Block Owner, LLC*, 2011 WL 3792406 (Bankr. N.D. Ill. Aug. 25, 2011) (Judge Schmetterer)**

- Creditor filed proof of claim for over \$48 Million based on loan contract between creditor and debtor.
- Chapter 11 debtor objected to creditor’s proof of claim and asserted five separate counterclaims:
- Counterclaim I: Debtor sought to rescind the loan contract with the creditor on economic duress grounds.

- Counterclaim II: Debtor sought damages for creditor's tortious interference with the sale of one of Debtor's real estate parcels.
- Counterclaim III: Debtor alleged that creditor breached the loan contract by violating the covenants of good faith and fair dealing.
- Counterclaim IV: Debtor alleged that creditor breached an extra-contractual fiduciary duty.
- Counterclaim V: Debtor alleged that creditor committed negligence.
- The court analyzed each counterclaim separately and noted that "a Bankruptcy Judge 'lack[s] 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.'"
- The court ruled that counterclaims I and III were core proceedings because these counterclaims were related to the loan contract, the document the creditor based its proof of claim upon.
- Therefore, counterclaims I and III were necessary to resolve the creditor's proof of claim.
- However, the Court held that the Bankruptcy court had jurisdiction to render a final judgment on the three remaining "non-core" counterclaims as well because both parties consented to the Bankruptcy Court's jurisdiction on these matters.
- While counterclaims II, IV, and V were like the counterclaims in *Stern* in that they were "state law claims that are not necessarily resolved in ruling on [the Creditor's] proof of claim . . . and are not subject to final adjudication by a Bankruptcy Judge without consent of the parties," because both parties, in their pleadings, expressly consented to final adjudication of all of the counterclaims, even if they were determined to be "non-core."

***Turner v. First Cmty. Credit Union (In re Turner)*, 2011 WL 2708907, (Bankr. S.D. Tex July 11, 2011) (Judge Bohm)**

- After debtor filed under Chapter 13, Creditor froze Debtor's bank accounts and filed three separate proofs of claim.
- Debtor filed this adversary proceeding against creditor for failing to remove the freeze on its bank accounts as a violation of the automatic stay.
- In analyzing the court's jurisdiction over this adversary proceeding, the court noted that "[b]ecause the Debtor's suit against First Community is in effect a

counterclaim against this institution which filed proofs of claim in the Debtor's main case, at first blush it would appear that *Stern* is on all fours and therefore that: (1) this Court does not have the constitutional authority to enter a final judgment in this dispute; and (2) this Court must therefore submit proposed findings of fact and conclusions of law to the District Court, together with a proposed judgment to be signed by that Article III Court."

- However, the Court instead decided that *Stern* did not control in this case and that it did have jurisdiction over the adversary proceeding because: 1) this claim was to be decided by federal law, § 362(a) and (k) of the Bankruptcy Code for violations of the automatic stay, not state law as in *Stern*; and 2) even if *Stern* did apply, this proceeding would fall under the "public rights" exception as laid out in *Stern*.
- Therefore, "because the resolution of this dispute is not based on state common law, *Stern* is inapplicable, and this Court has the constitutional authority to enter a final judgment in this suit pursuant to 28 U.S.C. §§ 157(a) and (b)(1)."
- Further, the court held that this was a "public rights" dispute because "the right is integrally related to particular federal government action" and therefore can be finally adjudicated by an Article I judge.

***In re Salander O'Reilly Galleries*, 453 B.R. 106 (Bankr. S.D.N.Y. 2011) (Judge Morris)**

- Creditor sought relief from stay to enforce a state law arbitration provision in the contract between the Creditor and Debtor that would determine the ownership of a painting prior to Debtor filing for bankruptcy.
- The arbitration provision in the pre-petition consignment contract between Creditor and Debtor provided that all disputes between the parties should be arbitrated in New Jersey under New Jersey law.
- Trustee attempted to avoid the interest of the Creditor per § 544(a) because Creditor failed to file a financing statement for the painting.
- The court however held that it did have jurisdiction to determine the Creditor's relief from stay motion and the Trustee's attempt to avoid the Creditor's interest per § 544(a) because these determinations are "inextricably bound up with the resolution of the . . . [creditor's] proof of claim."
- The Court noted that "*Stern* is replete with language emphasizing that the ruling should be limited to the unique circumstances of that case, and the ruling does not remove from the bankruptcy court its jurisdiction over matters directly

related to the estate that can be finally decided in connection with restructuring debtor and creditor relations.”

- While *Marathon*, *Granfinanciera*, and *Stern* all require caution when a bankruptcy court is rendering a judgment on a claim based in state law, “[n]owhere in *Marathon*, *Granfinanciera*, or *Stern* does the Supreme Court rule that the bankruptcy court may not rule with respect to state law when determining a proof of claim in the bankruptcy, or when deciding a matter directly and conclusively related to the bankruptcy.
- Therefore, “[i]t is clear from the foregoing that the Bankruptcy Court is empowered to apply state law when so doing would finally resolve a claim.”

***In re Bearing Point, Inc.*, 453 B.R. 486 (Bankr. S.D.N.Y. 2011) (Judge Gerber)**

- The trustee sought to be relieved from the requirement of the confirmation order that the trustee could only litigate against the debtor’s former officers and directors in bankruptcy court.
- The bankruptcy court granted trustee’s motion which would allow the trustee to litigate against the former officers and directors in a court other than the Bankruptcy Court.
- The reason Judge Gerber granted the trustee’s motion is that *Stern v. Marshall* would preclude him from being able to render a final judgment on any future claims that the Trustee would bring against the former officers and directors.
- “If I require this action to be litigated here in the bankruptcy court—or, more precisely, initially in the bankruptcy court—there is a material risk, in my mind, that especially with the inspiration of *Stern v. Marshall*, and the [debtor’s former directors’] pointed reminder that I wouldn’t be authorized to enter final judgment, this action will be tied in procedural knots by motion practice, here and in the district court, exploiting asserted or actual inabilities on my part, as an Article I bankruptcy judge, to issue findings and orders.”
- Therefore, because the Supreme Court decided *Stern v. Marshall* after this court entered the confirmation order, the trustee is now entitled to relief from the portions of the confirmation order that would have required future actions by the trustees against the debtor’s former officers and directors to be litigated exclusively in this bankruptcy court.
- The court noted that the reasoning behind the requirement in the confirmation order was that Judge Gerber thought both sides would consent to the jurisdiction of the Bankruptcy Court in these future matters for the sake of efficiency.

However, Judge Gerber observed that *Stern v. Marshall* eliminated jurisdiction by parties' consent.

- Judge Gerber's conclusion on the effect *Stern* had on jurisdiction by consent: "[I]n *Stern v. Marshall*, the majority, while repeatedly stating that Pierce had consented to the bankruptcy court's determination, nevertheless found his consent, under the facts there, inadequate. . . . But it may now be, and it's fair to assume that it will now be argued, that consent, no matter how uncoerced and unequivocal, will never again be sufficient for bankruptcy judges ever to issue final judgments on non-core matters. That huge uncertainty presages litigation over that issue with the potential to tie up this case, and countless others, in knots. It also would at least seemingly invite litigants to consent, see how they like the outcome, and then, if they lose, say their consents were invalid."

***In re Bigler*, 2011 WL 3665007 (Bankr. S.D. Tex. Aug. 19, 2011) (Judge Bohm)**

- Creditor, Amegy, filed an adversary proceeding seeking a declaratory judgment to determine the lien priority against two other creditors, Shaw and Halgo, over property that was in the debtor's bankruptcy estate.
- Judge Bohm, in noting the importance and scope of *Stern*, noted that "[t]he broader applicability of the Supreme Court's decision remains unclear. Other types of disputes frequently decided by bankruptcy courts may now also require final adjudication by Article III courts. A bankruptcy court's authority over matters involving state law causes of action is particularly questionable. Indeed, just as the debtor's counterclaim in *Stern* was based entirely upon state law, the law governing the dispute in this adversary proceeding is based entirely upon state law. Accordingly, at first blush, it would appear that the undersigned Article I judge does not have the constitutional authority to enter a final judgment in this adversary proceeding."
- However, in ruling that this Bankruptcy Court does have jurisdiction over this adversary proceeding, Judge Bohm reasoned that "[t]his Court may exercise authority over matters integral to the bankruptcy scheme under the "public rights" exception articulated in *Stern*."
- Further, the Bankruptcy Code "is a public scheme for restructuring debtor-creditor relations" that determines "the equitable distribution of that property among the debtor's creditors."
- Therefore, the lien priority dispute that is at issue in this adversary proceeding is a public right because it determines "the appropriate distribution among the Debtors' creditors."

***In re Hudson*, 2011 WL 3583278 (Bankr. W.D. Mich. Aug. 16, 2011) (Judge Gregg)**

- Chapter 7 trustee moved under 11 U.S.C. § 544(a) to avoid bank's lien on real property in the bankruptcy estate because the mortgage contained the wrong legal description of the property.
- In ruling that *Stern* did not restrict a bankruptcy court's jurisdiction for adversary proceedings such as this, the court held "[t]his adversary proceeding, even though it requires reviewing, discussing and deciding state law issues, pertains to the determination of the validity, extent, or priority of the Bank's asserted mortgage lien in Lot 5. Regardless of the state law issues, this adversary proceeding 'arises under' § 544(a)(3) of the Bankruptcy Code."
- Therefore, despite the fact that state law considerations did shape the court's decision of whether the trustee could avoid this action, the proceeding is undoubtedly "core" because the court could not "envision a core proceeding that is more 'core' than lien avoidance."
- However, after such authoritative language exerting its jurisdiction, the court mentioned at the end of the opinion that if the District Court were to determine on appeal that this Bankruptcy Court did not have constitutional authority to hear this claim, this opinion should be considered a report and recommendation.

***Gecker v. Flynn (In re Emerald Casino)*, 2011 WL 3799643 (Bankr. N.D. Ill. Aug. 26, 2011) (Judge Wedoff)**

- Chapter 7 trustee brought two state law counterclaims against defendants, former members of management for the debtor.
- The first complaint arose under this bankruptcy proceeding. However, the second complaint was initially raised in Illinois state court by individual investors. This complaint was dismissed in state court. Defendants now seek to obtain summary judgment over this claim on grounds of *res judicata* from the state court's dismissal.
- The court held that *res judicata* did not apply and denied the motion for summary judgment because the defendants could not show that the claims were identical to those adjudicated in state court.
- In reasoning that these counterclaims were probably "non-core" and should be decided by an Article III judge, the court held that "even if the trustee's bankruptcy complaint were wholly within the scope of the *Stern* decision, and so removed from core jurisdiction, it would still affect the extent of the estate available to pay Emerald's creditors. Therefore, the trustee's complaint would at

least be within the “related-to” jurisdiction of the bankruptcy court and, as set forth in 28 U.S.C. § 157(c)(1), a bankruptcy judge may propose findings and conclusions to the district court for that court's entry of judgment pursuant to such jurisdiction.”

- Therefore, the court determined that, under *Stern*, it should still be allowed to hear and submit proposed conclusions and findings of fact but would not be able to render a final judgment on the counterclaims.

***Stoebner v. PNY Techs., Inc. (In re Polaroid Corp.)*, 451 B.R. 493 (Bankr. D. Minn. July 7, 2011) (Judge Kishel)**

- Trustee brought adversary proceeding against defendant for breach of contract and disallowance of defendant's claims until the defendant satisfied the liability he owed the estate.
- In applying *Stern*, the court held “the holding in *Stern v. Marshall* directly applies to this adversary proceeding, given the posture of claims against the bankruptcy estate and the claims and counterclaims in the present litigation.”
- The court noted that without consent, the Trustee's state law breach of contract counterclaim could not be finally adjudicated by the bankruptcy court.
- Because consent could not be clearly determined by the court, the court ordered that the parties “file express written statements as to whether [they] consent to entry of a final judgment on [the breach of contract claim].”

***Schmidt v. Klein Bank (In re Schmidt)*, 453 B.R. 346 (B.A.P. 8th Cir. 2011) (Judge Federman, Venters, and Saladino)**

- The Bankruptcy Appellate Panel reversed the decision of the bankruptcy court and held that Klein Bank's replevin actions (which included actions for breach of promissory note, breach of personal guaranties, breach of security agreement, breach of contract, breach of personal guaranty, breach of security agreement, and replevin) were “non-core” and remanded the action to the bankruptcy court “for further findings on the question of whether the Court is required to abstain.”
- Previously, the bankruptcy court found that the actions were “core” under § 157(b)(2)(A) because the actions were “matters concerning the administration of the estate.”
- However, the Appellate Panel disagreed and stated that “core proceedings are those that arise in a bankruptcy case or under title 11. That is so regardless of

whether the matter can be fitted into one of the enumerated examples in § 157(b)(2).”

- Therefore, “[s]ince the [r]eplevin [a]ctions do not arise under or arise in the Debtors' bankruptcy cases, they are, simply, not core.” The actions do not arise under or arise in the bankruptcy cases because they are state law causes of action.
- The other element to determine whether a bankruptcy must abstain from hearing a claim is “whether the claims could be timely adjudicated in state court.” Because the bankruptcy court did not reach this question because it believed that the claims were “core,” this action must be remanded for the bankruptcy court to determine if it must abstain from hearing this action.

***Adams Nat'l Bank v. GB Herndon & Assocs., Inc. (In re GB Herndon & Assocs., Inc.), 2011 WL 4628805 (Bankr. D.D.C. Oct. 4, 2011) (Judge Teel)***

- Prior to debtor's filing of Chapter 11, Adams Bank brought action in D.C. Superior Court against debtor and two other defendants for breach of forbearance agreement between the bank and the defendants.
- Defendants filed counterclaims for breach of contract, tortious interference with contract, and breach of duty of good faith and fair dealing arising from Adams Bank's failure to disburse funds in the original loan contract.
- Shortly thereafter, debtor filed petition for Chapter 11. After filing, debtor's counterclaims were removed to the bankruptcy court. The bankruptcy court granted summary judgment for Adams Bank on debtor's counterclaims.
- Debtor and the other two defendants sought relief from the prior order granting Adams Bank summary judgment because the bankruptcy court's lack of jurisdiction per *Stern*.
- The bankruptcy court granted the debtor and other defendants relief from the prior judgment because “[i]n light of the Supreme Court's decision in *Stern v. Marshall*, this court did not have the constitutional authority to resolve the defendants' counterclaims.”
- The court reasoned that “[a]s with the counterclaims in *Stern*, the Defendants' Counterclaims are governed by state law, and may be resolved independently from the Adversary Proceeding. They do not ‘flow from a federal statutory scheme,’ nor are they ‘completely dependent upon’ adjudication of a claim created by federal law.”
- Therefore, because the counterclaims could have been adjudicated separately from the bank's proof of claim, and in fact were being separately adjudicated in

state court before the debtor filed for bankruptcy, this court had no constitutional authority to hear the counterclaims.

***In re Washington Mut., Inc.*, 2011 WL 4090757 (Bankr. D. Del. Sept. 13, 2011) (Judge Walrath)**

- Washington Mutual sought confirmation of the sixth modified plan of the debtors.
- Those opposing confirmation of the plan argued that the bankruptcy court did not have jurisdiction to confirm the plan because of *Stern*.
- Specifically those opposing confirmation argued that “that the Bankruptcy Court lack[ed] jurisdiction to confirm the Modified Plan because to do so the Court must decide the estate's claims against JP [Morgan] and the FDIC, over which only an Article III court has jurisdiction.”
- Those opposing confirmation argued that because the estate’s claims against JP Morgan and the FDIC “involved state corporate law, tort law, fraudulent conveyance law, as well as federal intellectual property and tort claims,” the bankruptcy court should not have jurisdiction to confirm the plan.
- The court disagreed and ruled that *Stern* did not take jurisdiction from the bankruptcy court for these types of proceedings because:
  - Historical Context: “Approval of settlements by bankruptcy courts is ‘a firmly established historical practice’ that stretches back before the enactment of the Bankruptcy Code to the Bankruptcy Act and, therefore, the bankruptcy court may continue to exercise that jurisdiction.” Further, Rule 9019 expressly grants bankruptcy courts the jurisdiction to “approve a compromise or settlement.
  - (2) Nature of Settlement Approval: “[T]here is a fundamental difference between approval of a settlement of claims (which the Court is being asked to do here) and a ruling on the merits of the claims. . . . [A] court does not have to have jurisdiction over the underlying claims in order to approve a compromise of them.”
  - (3) Nature of Claims Compromised: “[T]he approval of the [confirmation plan] in this case is particularly within the core jurisdiction of the Bankruptcy Court because it deals with a determination of what is property of the estate. . . . [T]he approval of the [plan] in this case is particularly within the core jurisdiction of the Bankruptcy Court because it deals with a determination of what is property of the estate.”

- For the above reasons, the bankruptcy court retained jurisdiction to enter orders of plan confirmation.

***Musich v. Graham (In re Graham)*, 2011 WL 2694146 (Bankr. D. Colo. July 11, 2011) (Judge Brooks)**

- Musich filed an adversary proceeding to prevent the discharge of a criminal and tort claim of assault and battery against the debtor.
- In ruling on the dischargeability of this claim, the court referenced, in a footnote, the potential impact of *Stern* noting that “[*Stern*] may put into doubt this Court’s ability and authority to rule on this issue because it emanates from an interpretation of Colorado civil tort law and criminal law. The alleged tortious conduct—the assault and wrongful acts under state law—have been fully adjudicated by the state court. This Bankruptcy Court is dealing only with the question of dischargeability. Moreover, the matter at hand is agreed to by the parties to be a ‘core’ proceeding under 28 U.S.C. § 157(b)(2)(A) and (I) and this matter indeed appears to be a ‘core’ proceeding,—statutorily and constitutionally—thus, this Court believes it can issue this ruling accordingly.”
- Therefore, a proceeding that determines dischargeability of a claim based on state law is still a core proceeding.

***In re Ambac Fin. Grp.*, 2011 WL 4436126 (Bankr. S.D.N.Y. Sept. 23, 2011) (Judge Chapman)**

- Plaintiffs in a derivative action against the debtor challenge the bankruptcy court’s ability to rule upon a settlement stipulation entered into by the debtor.
- In ruling that the derivative plaintiffs have “misread *Stern*,” the court ruled that “[*Stern* had] nothing to do with the Court’s *in rem* jurisdiction to administer property of the estate. The ‘narrow’ issue in *Stern* was whether a bankruptcy court had subject matter jurisdiction to hear and finally resolve a debtor’s counterclaim against a third party. Here, the Debtor does not seek to try the Derivative Actions in the bankruptcy court. Instead, the Debtor seeks this Court’s approval of its disposition of the claims at issue in the Derivative Actions, assets which are property of the Debtor’s estate.”
- In discussing the unfortunate uses that litigants have used *Stern* for, the court stated, “Unfortunately, *Stern v. Marshall* has become the mantra of every litigant who, for strategic or tactical reasons, would rather litigate somewhere other than the bankruptcy court. Whatever *Stern v. Marshall* may ultimately be held to mean, this Court is confident that, as a matter of law and practice, it most certainly does not stand for the proposition that the bankruptcy court cannot

approve the compromise and settlement of a claim which is indisputably property of a debtor's estate.”

***Liberty Mut. Ins. Co. v. Citron (In re Citron)*, 2011 WL 4711942 (Bankr. E.D.N.Y. Oct. 6, 2011) (Judge Rosenthal)**

- Plaintiff brought adversary proceeding seeking to set aside fraudulent conveyances to family member of the debtor. Defendant filed a counterclaim “seeking an offset under New York Debtor Creditor Law for payments allegedly made for the benefit of the Debtor.”
- Defendant argued that the bankruptcy court lacked subject matter jurisdiction under *Stern* because the claims all derive from state or common law and “these claims will not be resolved in the claims allowance process because [defendant] never filed a proof of claim in the case.”
- In analyzing the breadth of decisions after *Stern*, the court noted, “[I]n the ‘noise’ after the Supreme Court decision, one can find decisions supporting broad, narrow, and middle-of-the-road interpretations of the *Stern* ruling. This Court chooses to accept the Supreme Court at its word and read the decision narrowly.” The court reasoned that *Stern* only applied to “‘a state . . . action that exist[ed] without regard to any bankruptcy proceeding.’”
- Here, *Stern* does not apply because “[u]nlike the counterclaim in *Stern*, Defendant's counterclaim here is not independent of the Bankruptcy Code and it relies upon a finding of Defendant's liability pursuant to Plaintiff's claims brought under several provisions of the Bankruptcy Code.”
- Moreover, the Defendant already “agreed Plaintiff's claims were core and consented ‘to the entry by [this] Court of a final judgment in the action pursuant to Federal Rule of Bankruptcy 7008(a).’”

***Oxford Expositions, L.L.C. v. Questex Media Grp., L.L.C. (In re Oxford Expositions, L.L.C.)*, 2011 WL 4074028 (Bankr. N.D. Miss. Sept. 13, 2011) (Judge Houston)**

- Questex sent debtor cease and desist letters to keep them from violating non-compete agreements. Shortly thereafter, debtor filed suit in Mississippi state court seeking an injunction and declaratory judgment against Questex. Questex then removed the case to district court and filed a counterclaim against debtor. Following removal, debtor filed for Chapter 11 and the district court transferred the proceeding to the bankruptcy court. Questex filed a proof of claim against debtor in the bankruptcy proceeding similar to its counterclaim.

- The court gave an in-depth summarization of the facts and holding of *Stern* followed by an analysis of *Stern's* effect on future determinations of what is “core” and what is “non-core.” The court stated, “There are some students of bankruptcy lore who are concerned that *Stern* impacts the subject matter jurisdiction of the bankruptcy courts. This court does not believe that is the case at all.”
- Further, the court ruled that *Stern* did not adversely impact the bankruptcy court’s subject matter jurisdiction because even in “non-core” matters, the bankruptcy court may enter proposed findings of fact and conclusions. Therefore, because they can still hear the case, they still have subject matter jurisdiction.
- The court emphasized the limited nature of *Stern* noting language from *Stern* itself that it should be interpreted “narrowly” and should not “meaningfully change” the bankruptcy jurisdiction landscape.
- In fact, *Stern* does not even remove counterclaims based on state law that “by necessity must be resolved in the process of ruling on the creditor's proof of claim” from the bankruptcy court’s “core” jurisdiction.
- Because Questex’s counterclaims “against Oxford Expo are for pre-petition and post-petition damages in addition to the remedial claim for injunctive relief which would effectively terminate Oxford Expo's ability to operate as a going concern. As such, they are core proceeding claims as defined in § 157(b)(2)(A), (B), and (O).”

***Szilagyi v. Chi. Am. Mfg., L.L.C. (In re Lakewood Eng’g & Mfg. Inc.), 2011 WL 4600564 (Bankr. N.D. Ill. Sept. 29, 2011) (Judge Hollis)***

- Szilagyi, as trustee for Lakewood Engineering, brought claims against Chicago American Manufacturing under the Lanham Act and Illinois Deceptive Business Practices Act for patent infringement, trademark infringement, and unfair competition.
- After the district court referred the action to the bankruptcy court, Chicago American moved for withdrawal of the reference because twelve of the seventeen counts involved patent and trademark law, which is not related to bankruptcy. The district court denied the motion because “it was possible that resolution of the issue of the effect of rejection of the Supply Agreement could ‘resolve, or at least simplify, some or all of the non-bankruptcy issues in the case.’”
- In applying *Stern*, the court stated that “[t]he instant adversary proceeding presents an entirely different procedural posture from *Stern v. Marshall*” because the claims here in question are not counterclaims.

- The bankruptcy court agreed with the district court's denial of the motion to withdraw the reference and stated, "[T]he principal issues in the adversary proceeding are whether CAM has a valid license to use certain Lakewood marks and patents under Illinois law and whether any such license was terminated when the Bankruptcy Court approved the rejection of CAM's purported license under 11 U.S.C. § 365.' In the end, the district court's prediction was fulfilled; this court is ruling only on claims 'derived from or dependent upon bankruptcy law,' unlike the state law tort action at issue in *Stern v. Marshall*."
- Therefore, because the claims of Szilagyi and Lakewood were ultimately determined by the question of whether the supply agreement between the parties should be rejected, an issue that did involve claims derived from or dependent on Title 11, it retained core jurisdiction over the proceeding.

***Samson v. Blixseth (In re Blixseth)*, 2011 WL 3274042 (Bankr. D. Mont. Aug. 1, 2011) (Judge Kirscher)**

- The court considered *sua sponte* whether it had subject matter jurisdiction over the "equitable subordination and fraudulent and preferential transfer claims" raised in this proceeding.
- "Fraudulent conveyance claims in bankruptcy do not fall within the public rights exception. Although codified by the Bankruptcy Reform Act of 1978, fraudulent conveyance claims are 'quintessentially suits at common law that more nearly resemble state law contract claims brought by a bankrupt corporation to augment the bankruptcy estate than they do creditors' hierarchically ordered claims to a pro rata share of the bankruptcy res.'"
- In denying constitutional jurisdiction over the Trustee's fraudulent conveyance claim, the court reasoned, "Since Trustee's fraudulent conveyance claim is essentially a common law claim attempting to augment the estate, does not stem from the bankruptcy itself and would not be resolved in the claims allowance process, it is a private right that must be adjudicated by an Article III court. This Court's jurisdiction over that claim as a core proceeding is therefore unconstitutional. However, the equitable subordination and preferential transfer claims arise from the Bankruptcy Code and the claims allowance process, therefore, this Court's jurisdiction over those claims is constitutionally acceptable."
- Moreover, the court determined that it could not even render proposed findings for the core claim that it did not have constitutional jurisdiction to hear. "While 28 U.S.C. § 157(c)(1) allows a bankruptcy judge to render findings and conclusions in 'a proceeding that is not a core proceeding but that is otherwise related to a case under title 11,' no other code provision allows bankruptcy judges to do the same in core proceedings. . . . Since this Court may not constitutionally hear the fraudulent conveyance claim as a core proceeding, and this Court does

not have statutory authority to hear it as a non-core proceeding, it may in no case hear the claim.”

- Therefore, *In re Blixseth* appears to be one of the broadest interpretations of *Stern*.

***Meoli v. Huntington Nat'l Bank (In re Teleservices Grp., Inc.)*, 2011 WL 3610050 (Bankr. W.D. Mich. Aug. 17, 2011) (Judge Hughes)**

- Huntington Bank moved to amend a pre-trial order of this bankruptcy court because the court lacked “the constitutional authority to enter what in this instance could be a multi-million dollar judgment against it arising from fraudulent transfers.”
- The court agreed that because of *Stern* it did not have the constitutional authority to hear the fraudulent transfer proceeding.
- “For over twenty-five years, my colleagues and I have operated with the understanding that we were properly constituted judges capable of rendering final judgments in many, but not all, matters arising in connection with a bankruptcy proceeding. That understanding derives from 28 U.S.C. § 157 and its identification of so-called “core proceedings. . . . However, *Stern v. Marshall* reveals how misplaced my confidence has been.”
- “For what it is worth, I believe that *Stern's* reasoning is sound. I may take umbrage at the suggestion that my independence as a decision-maker would ever be compromised by the threat of not being reappointed or having my compensation reduced. But there remains the appearance that I could be so influenced and that alone is enough. Moreover, the historical argument that the Court makes is compelling, as is its argument that constitutional principles cannot be overlooked simply because the issue raised is mundane or the potential infringement is innocuous.”
- “[B]ombshell does fairly describe *Stern's* impact upon the more practical issue of how bankruptcy judges are to perform what the Code still calls us to do. *Stern* is careful to limit its holding to only the specific issue that was before the Court. Unfortunately, this is not a situation where those who labor in the fields can wait until the next fistfight between an expectant heir and his stepmom finds its way to the Court. Every day I am presented with numerous orders that Congress expects me to either sign 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 that standard is unreliable when tested against the Constitution itself.

- In offering a comprehensive assessment of how *Stern* applies to numerous bankruptcy proceedings, the court concluded that in the fraudulent transfer context, “any judgment that will enter against Huntington in this adversary proceeding must be entered by an Article III judge. *Stern*, coupled with the Court's earlier decision in *Murray's Lessee*, is all that is needed to realize that the taking that Trustee has in mind in this adversary proceeding requires the oversight of a judicial officer with the independence that is only guaranteed by life tenure and salary protection.”

***Paloian v. Am. Express Co. (In re Canopy Fin., Inc.)*, 2011 WL 3911082 (N.D. Ill. Sept. 1, 2011) (Judge Hibbler)**

- “Paloian seeks to recover payments made by Canopy to American Express that were allegedly the result of fraud perpetrated by Canopy's former officers. The complaint sets forth six counts. Counts One and Three are for the avoidance and recovery of fraudulent transfers pursuant to Sections 548 and 550 of the Bankruptcy Code. Counts Two, Four, and Five are for avoidance and recovery of fraudulent transfers pursuant to Illinois law and Sections 544 and 550 of the Bankruptcy Code. Count Six is a claim for unjust enrichment under Illinois law.”
- American Express moved for the district court to withdraw the reference. The district court denied the motion for the following reasons:
  - “*Stern* did not directly address the constitutionality of bankruptcy courts ruling on fraudulent conveyance claims, and explicitly intended its decision to be read narrowly. . . . However, the language of *Stern* makes clear that the decision, while narrow, is at least broad enough to reach this case.”
  - *Stern* “held specifically that only Article III courts could enter final judgment on actions like those described in *Granfinanciera* that ‘are quintessentially suits at common law.’”
  - However, while the court agreed that it does not appear that the bankruptcy court can render a final judgment in a fraudulent conveyance claim, it denies American Express’s motion to withdraw the reference because “*Stern* did not strip the Bankruptcy Court of the authority to hear Paloian's claims against American Express and to propose findings of fact and conclusions of law on those claims to this court.”

## **VIII. QUICK SUMMARY OF DECISIONS**

<b>Court</b>	<b>Decision Date</b>	<b>Case/Holding</b>
M.D. Fla	July 27, 2011	<i>Colony Beach &amp; Tennis Club, Ltd. v. Colony Beach &amp; Tennis Club Ass'n (In re Colony Beach &amp; Tennis Club Ass'n, Inc.)</i> —held the state law claims, not counterclaims, to be non-core and, therefore, the bankruptcy court's ruling could only be viewed as proposed findings
Bankr. N.D. Ill.	August 25, 2011	<i>In re Old Prairie Block Owner, LLC</i> —held that two of the five counterclaims were “core” because they were necessary to resolve the creditor's proof of claim, and that the bankruptcy court could render final judgment on the other counterclaims as well because parties consented to their jurisdiction
Bankr. S.D. Tex.	July 11, 2011	<i>Turner v. First Cmty. Credit Union (In re Turner)</i> —held that the court had jurisdiction over this adversary proceedings because these counterclaims were to be decided by Title 11 and also because it was a “public rights” dispute
Bankr. S.D.N.Y.	July 18, 2011	<i>In re Salander O'Reilly Galleries</i> —held that bankruptcy court had jurisdiction to finally adjudicate a trustee's avoidance action based on state law because these determinations are necessary to resolve the creditor's proof of claim
Bankr. S.D.N.Y.	July 11, 2011	<i>In re Bearing Point, Inc.</i> —held that trustee should be relieved from portion of pre- <i>Stern</i> confirmation order that required future litigation against debtor's officers in bankruptcy court because there is a material risk that <i>Stern</i> would preclude jurisdiction of the bankruptcy court in this type of litigation and because <i>Stern</i> also eliminated jurisdiction by consent of the parties, so the parties could not consent for the bankruptcy court to hear such matters
Bankr. S.D. Tex.	August 19, 2011	<i>In re Bigler, L.P.</i> —held that while this lien priority dispute is based on state law, the bankruptcy court still has jurisdiction over the dispute because it fell under the “public rights” exception
Bankr. W.D. Mich.	August 16, 2011	<i>In re Hudson</i> —held that the bankruptcy court had jurisdiction to hear the avoidance action even though state law considerations would shape the outcome because the court could not envision a proceeding “more ‘core’ than lien avoidance”
Bankr. N.D. Ill.	August 26, 2011	<i>Gecker v. Flynn (In re Emerald Casino, Inc.)</i> —held that because of <i>Stern</i> , the bankruptcy court could only enter proposed conclusions and findings of fact on trustee's state law counterclaims
Bankr. D. Minn	July 7, 2011	<i>Soebner v. PNY Techs., Inc. (In re Polaroid Corp.)</i> —held the trustee's state law counterclaims could only be finally adjudicated by the bankruptcy court if the parties consented, which did not appear to be the case here
8th Cir. Bankruptcy Appellate	August 3, 2011	<i>Schmidt v. Klein Bank (In re Schmidt)</i> —held that state law actions against the debtor were “non-core” because claims did not arise in or arise under Title 11, and ruled that <i>Stern</i> rendered the fact that the

Panel		claims might fall under 157(b)(2)(A) useless
Bankr. D.D.C.	October 4, 2011	<i>Adams Nat'l Bank v. GB Herndon &amp; Assocs., Inc. (In re GB Herndon &amp; Assocs., Inc.)</i> —held that the bankruptcy court had not constitutional jurisdiction to hear the counterclaims because they were governed by state law and could be separately adjudicated outside of the bankruptcy proceeding
Bankr. D. Del	September 13, 2011	<i>In re Washington Mutual, Inc.</i> —held that the bankruptcy court retained jurisdiction to confirm plans because: 1) approval of settlements is a firmly established historical practice for bankruptcy courts; 2) courts do not have to have jurisdiction over the claims to approve a settlement of them; and 3) the claims in the plan dealt with property of the estate
Bankr. D. Colo.	July 11, 2011	<i>Musich v. Graham (In re Graham)</i> —held that the bankruptcy court has jurisdiction to finally adjudicate a proceeding determining the dischargeability of state law claims against the debtor
Bankr. S.D.N.Y.	September 23, 2011	<i>In re Ambac Fin. Grp.</i> —held that the bankruptcy court has jurisdiction to rule on the compromise and settlement of a claim, which is indisputably property of the estate
Bankr. E.D.N.Y.	October 6, 2011	<i>Liberty Mut. Ins. Co. v. Citron (In re Citron)</i> —held that the court had jurisdiction and that <i>Stern</i> was inapplicable because the counterclaims here were integrally related to Title 11 and, further, because the parties consented to the bankruptcy court's jurisdiction
Bankr. N.D. Miss.	September 13, 2011	<i>Oxford Expositions, L.L.C. v. Questex Media Grp., L.L.C. (In re Oxford Expositions, L.L.C.)</i> —held that <i>Stern</i> should be narrowly interpreted and that the counterclaims at issue were under the jurisdiction of the bankruptcy court because they were core proceedings under § 157(b)(2)(A)(B) and (O)
Bankr. N.D. Ill.	September 29, 2011	<i>Szilagyi v. Chi. Am. Mfg., L.L.C. (In re Lakewood Eng'g &amp; Mfg. Inc.)</i> —held that the bankruptcy court had jurisdiction over the non-bankruptcy claims because a bankruptcy issue, whether the supply agreement between the parties should be accepted or rejected, ultimately determined those non-bankruptcy claims
Bankr. D. Mont.	August 1, 2011	<i>Samson v. Blixseth (In re Blixseth)</i> —held that while fraudulent conveyance actions are statutorily “core” proceedings, the court did not have constitutional jurisdiction to hear them because of <i>Stern</i> and also that since it was a “core” claim rather than a “related to” claim, the court also could not issue proposed findings for the district court
Bankr. W.D. Mich.	August 17, 2011	<i>Meoli v. Huntington Nat'l Bank (In re Teleservices Grp., Inc.)</i> —held that post- <i>Stern</i> fraudulent transfer actions are not within the scope of the bankruptcy court's jurisdiction because these actions require the oversight and independence of an Article III judge
N.D. Ill.	September 1, 2011	<i>Paloian v. Am. Express Co. (In re Canopy Fin., Inc.)</i> —held that while <i>Stern</i> prevented bankruptcy courts from rendering final judgments for fraudulent conveyance claims, the motion to withdraw the reference should be denied because the bankruptcy court can still hear the action and issue proposed findings and conclusions

## **IX. COMMENTS CONCERNING IMPLICATIONS**

*Adam Lewis et al., Stern v. Marshall: A Jurisdictional Game Changer?*, PRATT'S J. BANKR. L (2011)<sup>1</sup>

- At least in the near future, greater amounts of time and money will be expended in litigation to determine whether the bankruptcy court or district court is entitled to render a final judgment on the issue.
- This could result in more 9019 settlements and compromises of counterclaims.
- Suggests that even in matters that are “non-core,” the bankruptcy court could very easily still be the final arbiter considering that most district court judges are overburdened and will likely “rubber-stamp” the bankruptcy judge’s findings and conclusions.
- Could shift the power of forum shopping from the debtor to the defendant in the adversary proceeding by giving the defendant the option to refuse consent and challenge the “core” status of the counterclaim.
- Suggests that jurisdiction by consent will now be a thing of the past. The Supreme Court’s ruling that *Stern’s* filing of a proof of claim in the bankruptcy court was not enough to establish his consent over the bankruptcy court’s jurisdiction of the counterclaim was a rejection of *Granfinanciera* and *Langenkamp*.
- 4 Strategies to Consider
  - Perform a cost/benefit analysis before filing a proof of claim to consider whether a counterclaim that is arguably not linked to the underlying bankruptcy action could be asserted which could cause greater delays and costs.
  - Considering the greater time and costs that will now go into litigating counterclaims, the practitioner should place greater weight on settling the claim.
  - Develop a strategy for playing “jurisdictional ping-pong” between the bankruptcy and district courts.
  - As to any pending litigation, think seriously about objecting to the subject matter jurisdiction of any claim in bankruptcy court because these objections can be considered stale if not timely asserted.

---

<sup>1</sup> Found via Westlaw citing references to *Stern v. Marshall*. This is the 104th citing reference in the list.

Stephen Sather, Lexis Nexis Bankruptcy Law Blog,  
<http://www.lexisnexis.com/community/bankruptcylaw/blogs/bankruptcylawblog/archive/2011/06/29/thoughts-about-the-impact-of-Stern-v-marshall.aspx>

- Undoubtedly, this decision will increase the number of motions to withdraw reference and motions to abstain.
- Greater delay in the resolution of the adversary proceeding. Gives an example of the average adversary proceeding in the Bankruptcy Court for the *Western* District of Texas taking approximately six months as opposed to two years in the District Court for the *Western* District of Texas.
- 3 Important Questions to Ask to Determine whether the counterclaim is a “core” claim:
  - Does the counterclaim involve a Code-created right?
  - Does the counterclaim exist outside of bankruptcy?
  - Does the counterclaim have a collective aspect to it?
  - If the answer is yes to two out of three of these questions, it is likely a “core” claim.

#### Dallas Bankruptcy Bar Presentation

- *Stern* undermines § 157(b)(3) which states that “a determination that proceeding is not a core proceeding shall not be made solely on the basis that its resolution may be affected by State law.” *Stern* explicitly stated that the fact that Marshall’s counterclaim arose out of state law and must be interpreted using state substantive law is a large factor in determining that Marshall’s claim is “non-core.”
- *Stern* could result in more Bankruptcy Courts certifying state issues for state supreme courts to decide in advisory opinions. This would only be for issues that are novel or unsettled in state common law, which would limit the amount of state issues that could be certified.

Cadwalader, Wickersham, & Taft: Clients & Friends Memo,  
[http://www.cadwalader.com/assets/client\\_friend/071411SternvMarshallHowBigIsIt.pdf](http://www.cadwalader.com/assets/client_friend/071411SternvMarshallHowBigIsIt.pdf)

- *Stern* may be limited only to counterclaims that have little or nothing to do with the underlying bankruptcy proceeding. Most counterclaims, especially compulsory counterclaims, will have a much greater relationship with the underlying bankruptcy claim than the counterclaim in *Stern*.

- Because of the overburdening size of most district courts' dockets, the district court will likely defer to the bankruptcy court's proposed findings of fact and conclusions for these claims.
- This process of the district court's review of the bankruptcy court's findings will not cost as much in time or money as would the normal appeals process from the bankruptcy court to the district court.
- It is very likely that *Stern* is an example of unusual facts creating unusual law.
- Despite these considerations that *Stern* may not have changed very much, non-debtors will likely use *Stern* to create delay and leverage when counterclaims are asserted against them.
- This could lead to greater frustration in efforts to confirm plans and lead to debtors asserting fewer counterclaims.