



Bankruptcy Advisory

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Supreme Court: Bankruptcy Courts Cannot Decide Debtors' State Law Counterclaims

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In a decision that may have significant practical implications to the practice of bankruptcy law, the U.S. Supreme Court recently declared, on constitutional grounds, that a bankruptcy court cannot exercise jurisdiction over a debtor's state law counterclaims, thus considerably limiting the ability of the bankruptcy court to fully and finally adjudicate claims in a bankruptcy case. *Stern v. Marshall*, No. 10-179 (June 23, 2011).

Stern is the latest chapter in the long-running saga over entitlement to nearly half a billion dollars from the estate of oilman J. Howard Marshall II. The key players are Vickie Lynn Marshall (aka Anna Nicole Smith) and her late husband's son, Pierce Marshall. After Vickie filed for bankruptcy, Pierce filed a proof of claim, asserting damages due to alleged defamation by Vickie. Vickie filed a counterclaim for tortious interference with the inheritance she expected to receive from her late husband. The bankruptcy court agreed with Vickie and ruled in her favor to the tune of over \$400 million. Pierce then argued that the bankruptcy court did not have jurisdiction to decide Vickie's counterclaim, and the district court agreed—but accepted the bankruptcy court's "proposed" ruling and upheld the verdict. After the court of appeals failed to resolve the issue to the satisfaction of the Supreme Court, the latter agreed to hear the case.

Surprising many observers, the Supreme Court found that although the bankruptcy court had statutory authority to hear Vickie's claim under 28 U.S.C. § 157, this authority is "one isolated respect" under the Bankruptcy Code in which Congress exceeded the limitation of Article III of the Constitution. Vickie's counterclaim against Pierce was indeed a "core proceeding" under the plain text of § 157(b)(2)(C), as the Court recognized. However, because resolution of the counterclaim was not necessary in order to adjudicate Pierce's bankruptcy proof of claim, the Court held that final resolution of the dissimilar counterclaim implicated the judicial power of the United States and therefore falls under the exclusive jurisdiction of Article III federal district court judges, rather than Article I bankruptcy judges, who do not wield the same judicial power as their district court colleagues.

This holding likely will have widespread ramifications in bankruptcy cases. As recognized in the dissent in *Stern*, bankruptcy proceedings in which a counterclaim will fall outside the jurisdiction of the bankruptcy court, given the majority decision, are quite common. Removing state law counterclaims from the scope of the bankruptcy court's review could cause confusion, inefficiency, waste, and a significant backlog in the dockets of the district courts, which normally adjudicate far fewer cases than the bankruptcy courts do, and are not equipped to handle the caseload, which will now be channeled in their direction. The Supreme Court answered such concerns by stating that "the fact that a given law or procedure is efficient, convenient, and useful in facilitation functions of government, standing alone, will not save it if it is contrary to the Constitution." Despite this rationale, the impact of *Stern* is likely to be felt deeply throughout the federal court system, and will negatively impact the

administration of bankruptcy cases.

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If you have any questions about bankruptcy litigation or the impact of ***Stern v. Marshall*** on such litigation, please call your principal Mintz Levin attorney or one of the attorneys noted on this alert.

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