

Implications Of In Re Marshall

Law360, New York (November 15, 2010) -- As Professor Ken Klee has written, "no other topic demanded as much attention of the Supreme Court over the last 111 years as did bankruptcy court jurisdiction." Klee, *Bankruptcy and the Supreme Court* (2009). Once again the U.S. Supreme Court will deal with bankruptcy court jurisdiction in its certiorari review of the Ninth Circuit decision, *In re Marshall*, 600 F.3d 1037 (9th Cir. 2010), which it granted on Sept. 28, 2010.

The Marshall decision arises from the bankruptcy case of Vickie Lynn Marshall, aka Anna Nicole Smith. Marshall filed a Chapter 11 petition in the Central District of California on Jan. 25, 1996. The case, exhausting and complex, has already been to the Supreme Court once before and also on a jurisdictional question.

In that first visit, the Supreme Court reversed the Ninth Circuit's interpretation of the "probate exception" to its subject matter jurisdiction, *Marshall v. Marshall*, 547 U.S. 293 (2006), and remanded the matter back to the Ninth Circuit to deal with the remaining question: Does the bankruptcy court have jurisdiction to hear and determine a debtor's compulsory counterclaim to a filed proof of claim.

The procedural background is somewhat complicated. The bankruptcy court had exercised jurisdiction over Marshall's compulsory counterclaim for tortious interference with expectation of a gift from her late husband which she filed as a counterclaim to her late husband's son, Pierce Marshall's, proof of claim for defamation. The bankruptcy court dismissed the defamation claim and ruled in favor of Vickie Marshall's counterclaim, awarding her \$449 million.

On appeal from the bankruptcy court's decision, the district court ruled that the compulsory counterclaim was not a core proceeding and therefore was at most a proposed judgment. The district court then proceeded to take some evidence and enter its own judgment in favor of Vickie Marshall but for a far smaller amount, \$88 million, than had been awarded by the bankruptcy court.

Both sides appealed to the Ninth Circuit. The Ninth Circuit initially dismissed the appeal on the basis of the "probate exception." The Supreme Court reversed and remanded to the Ninth Circuit to rule on the compulsory counterclaim question.

On remand, the Ninth Circuit ruled that the compulsory counterclaim was not a core proceeding and that the Texas probate court's findings and conclusions adverse to Vickie, entered before the district court's decision, were entitled preclusive effect by the district court. The Ninth Circuit reversed the district court and ordered that judgment be entered in favor of Pierce Marshall in accordance with the Texas probate court ruling. It is that decision which the Supreme Court has accepted to review.

The Ninth Circuit held that not all compulsory counterclaims to a filed proof of claim are core proceedings notwithstanding the language of 28 U.S.C. 157(b)(2)(C). The Ninth Circuit concluded that the constitutional limits imposed on non-Article III court jurisdiction by *Northern Pipeline Construction Co. v. Marathon Pipeline Co.*, 458 U.S. 50 (1982), would be exceeded by a rule that all compulsory counterclaims were core proceedings.

It is worth noting that Sec. 157(b)(2)(C) does not refer to "compulsory counterclaims." It simply refers to "counterclaims" as core proceedings if they also "arise under" the Bankruptcy Code or "arise in" a case under the Bankruptcy Code.

Recognizing that arguing from the statutory language that all mere counterclaims are core proceedings would run afoul of *Marathon*, Vickie Marshall argued that her counterclaim of tortious interference to Pierce Marshall's defamation claim was a core proceeding because it was compulsory under F.R.Civ. P. Rule 13(a)(1).

The Ninth Circuit disagreed. It agreed that Vickie's claim was a compulsory counterclaim but then said "the test for compulsory counterclaims is generous and designed to promote judicial efficiency by avoiding multiplicity of lawsuits ... On the other hand, the standard delimiting what is a core proceeding is much narrower because it is designed to comply with the constitutional limitation on the bankruptcy court's jurisdiction as set forth in *Marathon*." *In re Marshall*, 600 F.3d at 1058.

The Ninth Circuit took note of *Katchen v. Landy*, 382 U.S. 323 (1966) (counterclaim for preference) and *Lagenkamp v. Culp*, 498 U.S. 42 (1990) (counterclaim for avoidance action). But, it observed that in the case of counterclaims which are avoidance claims, whether preference or fraudulent transfer, the determination of such counterclaim is necessary for the performance of the duty of allowing or disallowing claims against the estate.

Thus, the Ninth Circuit defined as a counterclaim over which a bankruptcy court would have core proceeding jurisdiction as a counterclaim "so closely related to the proof of claim that the resolution of the counterclaim is necessary to resolve the allowance or disallowance of the claim itself." Such definition by the court was consistent with the definition advanced in an amicus brief filed by various law professors.

In analyzing Pierce Marshall's defamation proof of claim and comparing it with Vickie Marshall's counterclaim for tortious interference the Ninth Circuit concluded that resolution of Vickie's counterclaim was not a necessary predicate to the allowance or disallowance of Pierce Marshall's defamation claim.

While Vickie Marshall's attorneys argued that all other circuits to have considered the question had concluded that any compulsory counterclaim was a core proceeding, the Ninth Circuit's review of those decisions by the other circuits led it to conclude that the facts in those other cases were consistent with its restrictive view of jurisdiction and did not stand for the proposition that all compulsory counterclaims were core proceedings.

For now, at least in the Ninth Circuit, filing a proof of claim will not submit the creditor to the bankruptcy court's jurisdiction over all compulsory counterclaims which do not meet the test set forth in *Marshall* for constitutional adjudication by such a court.

If the Supreme Court reverses, and the Ninth Circuit gets reversed about 85 percent of the time, then filing a proof of claim will have far greater consequences for the creditor, expand what has in the past been referred to as "jurisdiction by ambush," and put in jeopardy the creditor's right to a jury trial regarding the counterclaim. The Ninth Circuit is due for an affirmance.

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