Concurrent Session

Consumer Track:
Impact of Recent Supreme Court Decisions

Christopher P. Burke
Burke & Associates; Las Vegas

Richardo I. Kilpatrick
Kilpatrick & Associates, PC
Auburn Hills, Mich.

Hon. Dennis Montali
U.S. Bankruptcy Court (N.D. Cal.)
San Francisco

Prof. Mark S. Scarberry
Pepperdine University School of Law
Malibu, Calif.

Recent Supreme Court Consumer Bankruptcy Cases and Their Implications

By: Lynne F. Riley and David Koha*

Introduction

Since March 2010, the Supreme Court has issued five consumer bankruptcy decisions. Following these decisions, several courts of appeals and bankruptcy appellate panels have rendered opinions covering related issues – including their interpretations of the Supreme Court's decisions and applying the Court's reasoning to the related issues at hand. Three of the Supreme Court's decisions arise from disputes over Bankruptcy Code[1] provisions enacted in the Bankruptcy Abuse Prevention and Consumer Protection Act or 2005 ("BAPCPA" or "2005 Act"). It is widely observed that enactment of BAPCPA and its many ambiguous and otherwise confusing provisions obfuscated the consumer bankruptcy landscape.[2] The 2010 Supreme Court cases discussed in this article represent just the first of many BAPCPA issues that have been percolating up through the federal courts as a result of the textual ambiguities and conflicting policies that besiege the 2005 Act.[3]

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*Lynne F. Riley is principal of Riley Law Group LLC in Boston, MA (www.rileylawgroup.com). Ms. Riley is a fellow of the American College of Bankruptcy, and serves on its pro bono committee. Ms. Riley has been a chapter 7 panel trustee for the District of Massachusetts since 1995. She is on the executive board (treasurer) of the National Association of Bankruptcy Trustees, serving on its amicus and financial literacy committees. David Koha is an associate with Riley Law Group; joining the firm in 2010 upon graduating from Boston College Law School. Mr. Koha was on the Boston College Law Review as a staff writer and note editor. In 2010, Mr. Koha received the American Bankruptcy Institute's Medal of Excellence for outstanding performance in bankruptcy coursework.

[1] 11 U.S.C. § 101 et. seq. (sometimes referred to as "Code")

[2] See Lynne F. Riley and Maria C. Furlong, BAPCPA and the Plain Meaning Paradox, 2009 Norton Annual Survey of Bankruptcy Law, Part II § 1, Section I. 1 [hereafter Riley Furlong].

[3] See Riley Furlong at Section I.1. Some of the many confusing BAPCPA provisions that courts have needed to decipher include:

(i) the meaning of "goods" for purposes of § 503(b)(9), which grants administrative priority for goods received within 20 days of filing;
(ii) whether the 4-year prohibition against receiving a discharge in a subsequent chapter 13 case as set forth in § 1328(f) begins from the filing date of a previous chapter 7 or the date the chapter 7 discharge is granted;
(iii) whether § 330(a)(7) removes the bankruptcy court's discretion in awarding compensation to a chapter 7 trustee and mandates allowance in accordance with a fixed statutory commission;
(iv) whether Congress intended that a chapter 11 debtor's conduct must meet all 10 elements of "cause" justifying conversion under § 1112(b) due to BAPCPA's substitution of "and" for "or" when listing the elements;
(v) the effect of the "hanging paragraph" contained within § 1325 upon a debtor's surrender of a motor vehicle to the secured creditor for cramdown purposes;
(vi) whether a loan is a PMSI within the meaning of that same "hanging paragraph" contained in § 1325 for cramdown purposes when the loan in question includes negative equity;
(vii) interpretation of the means test contained in § 707(b) to determine whether a debtor can utilize a standard deduction allowed for property that the debtor intends to surrender;
(viii) interpretation of the same means test to determine whether a debtor can utilize a standard deduction allowed for ownership expenses where the debtor owns the property free of liens;

In this article, we address each of these Supreme Court cases in chronological order by decision date, followed by discussion of the related lower appellate court cases and the implications of these decisions for consumer debtors, creditors, and practitioners.

I. *Milavetz, Gallop & Milavetz, P.A. v. United States*, --- U.S. ---, 130 S.Ct. 1324 (2010)

Milavetz, Gallop & Milavetz[4] was decided March 8, 2010 and is the first BAPCPA opinion issued by the Supreme Court. *Milavetz* was a unanimous decision, authored by Justice Sotomayor in her first term on the Court.[5] In *Milavetz*, the Supreme Court was presented with the issues of whether law firms are "debt relief agencies" and whether the restrictions on debt relief agencies in Code § 526 and § 528 violate the First Amendment rights of attorneys.[6]

The plaintiffs, a bankruptcy law firm and others, sought declaratory relief, arguing that they were not bound by the requirements for debt relief agencies enacted under BAPCPA.[7] Under Code § 526(a)(4) and § 528, debt relief agencies must make certain disclosures in their advertisements[8] and are prohibited from advising clients to incur additional debt in contemplation of filing bankruptcy.[9] The plaintiffs argued that attorneys were not included in the term "debt relief agency" as defined by Code § 101(12A) and in the alternative, that the restrictions imposed on debt relief agencies were unconstitutionally overbroad violations of the First Amendment.[10]

(ix) the meaning of "projected disposable income" in calculating a debtor's plan payments in accordance with § 1325(b)(1)(B);
(x) whether the cap on a state homestead exemption for homesteads acquired within 1,215 days of filing is applicable to all debtors or only debtors in states that have not opted out of the federal exemptions; and
(xi) whether the termination of the automatic stay provided by § 362(c)(3)(A) with respect to repeat filers applies only to the debtor and property of the debtor or if it also includes property of the estate.
(citations omitted)

[4] 130 S.Ct. 1324 (2010)
[5] Id. at 1329
[6] Id.
[7] Id. at 1330
[8] See 11 U.S.C. § 528
[9] See 11 U.S.C. § 526(a)(4)
[10] Id. at 1331

The district court held that attorneys were not debt relief agencies, and that the restrictions of § 526 and § 528 were unconstitutionally overbroad.[11] The Eighth Circuit affirmed in part and reversed in part, determining that attorneys were debt relief agencies and that the disclosure requirements of § 528 were constitutional, but agreeing that the restriction imposed by § 526(a)(4) was overbroad in prohibiting advice to incur any additional debt, even when the advice comprised prudent pre-bankruptcy planning.[12]

The Supreme Court affirmed in part and reversed in part, deciding that attorneys are debt relief agencies and that both § 526 and § 528 are constitutional.[13] The Court determined that the definition of debt relief agency is unambiguous and that attorneys are included as debt relief agencies under the Bankruptcy Code.[14] Nonetheless, in footnote 3 of its opinion, the Court stated that although reference to the legislative history was unnecessary because the text was clear, the legislative history, as discussed therein, supported the holding.[15]

The Supreme Court upheld the Eighth Circuit's ruling on the constitutionality of the disclosure requirements of Code § 528.[16] The Court reasoned that the prohibition is directed at misleading commercial speech; and inasmuch as it is not an affirmative limitation on speech but merely requires certain disclosures, less exacting scrutiny applies,[17] citing *Zauderer v. Office of Disciplinary Counsel of Supreme Court of Ohio*.[18] Accordingly, the Court further determined that the § 528 disclosures are reasonably related to the government's interest in preventing consumer deception.[19]

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[11] Id.
[12] Id.
[13] Id. at 1333
[14] Id.
[15] Id. at 1332, n. 3
[16] Id. at 1340-1341
[17] Id. at 1339-1340.
[18] 471 U.S. 626, 105 S.Ct. 2265 (1985).
[19] Milavetz, 130 S.Ct. at 1340

The Supreme Court reversed the Eighth Circuit regarding the constitutionality of Code § 526(a)(4)'s prohibition against giving advice to incur debt in contemplation of filing for bankruptcy.[20] Applying a narrow reading of the provision, the Court determined that it only prohibits the type of situation where a debtor is advised to "load up" on debt, with the expectation that it will be discharged.[21] Read in this way, the Supreme Court held that the provision is not overbroad because it is only intended to prohibit specific abusive conduct.[22]

Justice Scalia concurred with the decision, but disagreed with the Court's use of the legislative history included in footnote 3 of its opinion.[23] Justice Scalia observed that the Supreme Court's jurisprudence has routinely advised that "legislative history is irrelevant when the statutory text is clear."[24] Justice Scalia chastised that "[t]he footnote advises conscientious attorneys that this is not true, and that they must spend time and their clients' treasure combing the annuls of legislative history in all cases: To buttress their case where the statutory text is unambiguously in their favor; and to attack an unambiguous text that is against them."[25] Justice Thomas also wrote a concurring opinion, agreeing in the outcome but disputing the Court's application of *Zauderer*'s relaxed scrutiny standard.[26]

a. *Adams v. Zelotes*, 606 F.3d 34 (2nd Cir. 2010)

Adams v. Zelotes[27] was decided in May 2010. In this case, the Second Circuit held that Code § 526(a)(4) was not unconstitutionally overbroad, overturning the district court's ruling that this BAPCPA provision was unconstitutional as applied to attorneys.[28] The Second Circuit determined that

[20] Id. at 1337
[21] Id at 1336-1337
[22] Id.
[23] Id. at 1341-1342
[24] Id. at 1342
[25] Id.
[26] Id. at 1342-1345
[27] 606 F.3d 34 (2nd Cir. 2010)
[28] Id. at 38

Milavetz, in narrowly construing the limitations of the provision regarding counsel's pre-filing advice to incur new debt, foreclosed any challenge to § 526(a)(4) as it applies to attorneys.[29]

b. *Connecticut Bar Association v. US*, 620 F.3d 81 (2nd Cir. 2010)

Connecticut Bar Association v. U.S.,[30] another Second Circuit case, was decided in September 2010. Here, the Second Circuit rejected constitutional challenges to portions of Code §§ 526, 527, and 528.[31] The Court relied on *Milavetz* to deny the challenges to § 526(a)(4) regarding advice about incurring new debt[32] and § 528(a)(3)-(4) regarding advertisements for "bankruptcy relief" by a "debt relief agency."[33] Although some of the plaintiff's arguments involved provisions not at issue in *Milavetz*, the Second Circuit relied on *Milavetz* to reject those claims, holding that the contract requirements of § 528(a)(1)-(2) and the disclosure requirements of § 527(a)-(b) were not unconstitutional.[34]

Like the provisions at issue in *Milavetz*, the Second Circuit held that the requirements set forth in § 528(a)(1)-(2) and § 527(a)-(b) constituted commercial speech that also fell under *Zauderer*'s relaxed scrutiny standard.[35] The court opined that the requirement to disclose the services to be rendered, the amount of the fees for the services, and the terms of payment, could all be "reasonably viewed as the debt relief agency's 'propos[al] of a commercial transaction'" with the debtor.[36] The disclosure requirements of § 527(a)(1)-(2) were similarly commercial speech because they relate to the commercial transaction between a debtor and his attorney, and they are required in context of the "federal bankruptcy system, a creature of law pervaded by commerce… [which] allows debtors to

[29] Id.
[30] 629 F.3d 81 (2nd Cir. 2010)
[31] Id. at 93-103
[32] Id. at 101
[33] Id.
[34] Id. at 96-101
[35] Id. at 93
[36] Id. at 94, quoting Bolger v. Youngs Drug Prods. Corp, 463 U.S. 60. 66, 103 S.Ct. 2875,77 (1983)

refashion commercial transactions in order to discharge debt obligations."[37] Having determined that the provisions were commercial speech, the Court followed *Milavetz* in concluding there was a rational basis for the contract and disclosure requirements.[38]

c. Implications of *Milavetz*

The *Milavetz* Court observed that: "In order to improve bankruptcy law and practice, Congress enacted through BAPCPA a number of provisions directed at the conduct of bankruptcy professionals."[39] One commentator, Hon. Thomas Waldron, argues that these provisions, codified in 11 U.S.C. §§ 526, 527 and 528, effectively legislate "federal standards of professional conduct" for attorneys practicing before the bankruptcy courts."[40] Judge Waldron condemns the *Milavetz* Court's comparison of § 526(a)(4)'s proscription to advise debtors to incur debts in contemplation of bankruptcy with ABA Model Rule of Professional Conduct 1.2(d)(2009),[41] stating that *Milavetz* "conflates the concept of abuse into the concepts of fraud and crime."[42] He concludes that "the

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[37] Id. at 94-95
[38] Id. at 103
[39] Milavetz, 130 S. Ct. at 1330
[40]See Hon. Thomas Waldron, Didn't See That Coming: Recent Supreme Court Decisions and Ethics, 2011 Norton Bankruptcy Law Adviser No. 1 (January 2011)[hereafter Waldron]. Judge Waldron is a retired bankruptcy judge from the Southern District of Ohio. Judge Waldron argues that it is unfortunate that lawyers' professional responsibility is being defined by lobbyists representing creditors' interests. He summarizes the Supreme Court's "trifecta of admonitions" to counsel for debtors as follows:

> It is also appropriate to recognize this decision [referring to Hamilton v. Lanning, ___ U.S. ___, 130 S. Ct. 2464 (2010) discussed infra] completes the Supreme Court's trifecta of admonitions to debtor's counsel: Milavetz--advice which could be construed as approving "loading up" on debt potentially violates the "Federal Bankruptcy Code of Professional Conduct"; Espinosa--advice which could be construed as presenting plans with illegal provisions potentially violates the "Federal Bankruptcy Code of Professional Conduct," and, Lanning--advice which could be construed as manipulation of projected disposable income potentially violates the "Federal Bankruptcy Code of Professional Conduct."

[41] ABA Model Rule of Professional Conduct 1.2(d) states: "A lawyer shall not counsel a client to engage, or assist a client, in conduct that the lawyer knows is criminal or fraudulent, but a lawyer may discuss the legal consequences of any proposed course of conduct with a client and may counsel or assist a client to make a good faith effort to determine the validity, scope, meaning or application of the law."
[42] Waldron at 2

Milavetz decision confuses, rather than clarifies, the newly enacted Federal Bankruptcy Code of Professional Conduct provisions intended to regulate counsel who represent[] debtors."[43]

In practice, the most vexing issue for practitioners under these BAPCPA provisions and the *Milavetz* Court's interpretations of them is what constitutes prohibited advice to incur new debt in contemplation of filing for bankruptcy.[44] In *Milavetz*, the Supreme Court spent considerable time dissecting the statutory construct of the phrase "in contemplation of bankruptcy.[45] The Court, in discussing the Government's argument, refers to Black's Law Dictionary's definition of this phrase, which reads: "[t]he thought of declaring bankruptcy because of the inability to continue current financial operations, *often coupled with action designed to thwart the distribution of assets in a bankruptcy proceeding*."[46] Further citing the Government's position, the Court discussed both legislative history and the overall context in which § 526(a)(4) was enacted.[47] Looking at this section as it relates to the other § 526(a) provisions, the Government posited that the phrase "in contemplation of bankruptcy" only proscribes counsel's advancement of abusive debtor conduct.[48]

Adopting the Government's view, the Court observed that "advice to incur more debt because of bankruptcy, as proscribed by Code § 526(a)(4), will generally consist of advice to 'load up' on debt with the expectation of obtaining its discharge – i.e., conduct that is abusive *per se*."[49] The pre-BAPCPA non-dischargeability provision in § 523(a)(2) similarly provides redress for the unlawful

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[43] Id. at 3.
[44] 11 U.S.C. § 526 (a)(4) provides, in relevant part::
> (a) A debt relief agency shall not –
> ....
> (4) advise an assisted person or prospective assisted person to incur more debt in contemplation of such person filing a case under this title...

[45] See Milavetz, 130 S. Ct. at 1334-1337
[46] Id. at 1334, citing Black's Law Dictionary 336 (8th ed. 2004)(emphasis added)
[47] Id.
[48] Id. at 1335
[49] Id. at 1336

"practice of loading up on debt prior to filing."[50] The Court also referred to BAPCPA's means test set forth in § 707(b)(2)(D), and its proclivity to invite debtor manipulation by "enhanc[ing] incentives to incur additional debt prior to filing, as payment on secured debts offset a debtor's monthly income under the [means test] formula."[51] Thus, the Court cautions counsel that advising debtors to take action that harms debtors or creditors may not only implicate counsel's violation of § 526(a)(4), but may also result in judgment against a debtor in a § 523(a)(2) non-dischargeability action, or dismissal of a debtor's case for abuse under § 707(b).[52]

Indeed, in *In re Hornung*,[53] the North Carolina bankruptcy court cites to *Milavetz* in its decision dismissing the joint debtors' case for abuse under Code § 707(b). Here, the debtors traded their leased vehicles for purchased vehicles shortly before filing their petition, decreasing their total monthly payments by $320; nonetheless, this action reduced the debtors' monthly disposable income on the means test by $130.84.[54] Based on this, the court determined that the debtors conduct "rais[ed] the specter of impermissible manipulation" and dismissed the case for abuse under § 707(b), with citation to *Milavetz* and § 526(a)(4).[55]

Case law has yet to develop better defining where the line is drawn for attorneys providing advice about incurring new debts in contemplation of filing bankruptcy, as proscribed under Code § 526(a)(4). Therefore, bankruptcy counsel must tread carefully in this area of pre-filing representation inasmuch as correctly assessing this line is important not only for § 526(a)(4) implications; but also

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[50] Id.
[51] Id.
[52] Id. at 1337
[53] 425 B.R. 242 (Bankr. M.D.N.C. 2010)
[54] The debtors secured car loan payments would be "scheduled as contractually due to secured creditors" and deducted as a monthly expense in their chapter 7 means test under 11 U.S.C. § 707(b)(2)(A)(iii)(I). On the other hand, the lease payments would be capped. Id. See discussion infra, section V, regarding vehicle "Ownership Costs" under the IRS National Standards.
[55] Hornung, 425 B.R. at 249

because counsel could face claims by debtor clients asserting that these proscribed debts were incurred on advice of counsel, leading to non-dischargeable debts or denial of their discharge.

II. *United Student Aid Funds v. Espinosa*, --- U.S.---, 130 S.Ct. 1367 (2010)

United Student Aid Funds v. Espinosa[56] was issued on March 23, 2010. In *Espinosa*, the Supreme Court decided whether an order confirming a chapter 13 plan that discharged a portion of the debtor's student loans, without a finding of undue hardship, was void.[57] The debtor's plan, as confirmed, provided for discharge of interest on his student loan debt and repayment of principal only.[58] The student loan creditor received notice of the proposed plan and did not object.[59] The bankruptcy court confirmed the plan, and the debtor received a discharge after completing the plan.[60]

The student loan creditor subsequently sought to collect the unpaid portion of the loan, and the debtor filed a motion in the bankruptcy court to enforce the discharge.[61] The creditor argued that the order confirming the plan was void, seeking relief from judgment under Fed. R. Civ. P. 60(b)(4).[62] According to the creditor, the plan was void because it was contrary to the Bankruptcy Code and Rules, which make student loan debts nondischargeable unless a finding of undue hardship is made through an adversary proceeding.[63] The creditor also argued that it was denied due process because it was not served with a summons and complaint.[64]

The Supreme Court affirmed the ruling of the Ninth Circuit that the order confirming the plan was not void.[65] Justice Thomas, writing for the unanimous Court, determined that for a judgment or order to be void, it must be "so affected by a fundamental infirmity that the infirmity may be raised

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[56] --- U.S.---,130 S.Ct. 1367 (2010)
[57] Id. at 1373
[58] Id. at 1374
[59] Id.
[60] Id.
[61] Id.
[62] Id.
[63] Id. at 1374-75; see 11 U.S.C. § 523(a)(8), §1328(a); Fed. R. Bankr. P. 7001(6)
[64] Espinosa, 130 S.Ct. at 1375
[65] Id. at 1380

even after the judgment becomes final."[66] The Court observed that this type of infirmity occurs only in rare instances such as a jurisdictional error or a violation of due process.[67] Here, the Court determined that had not occurred.[68]

The Supreme Court further held that there was no due process violation because the right to be served with a summons and complaint in an adversary proceeding was not a constitutional right but rather was granted by a procedural rule.[69] Indeed, the Court observed that the creditor had received actual notice of the contents of the plan prior to confirmation.[70] The Court determined that even though the bankruptcy court's ruling was clear error, it only provided grounds for a timely appeal.[71] The Court relied on *Mullane v. Central Hanover Bank & Trust Co.,*[72] which held that the requirements of due process are satisfied where a party receives notice "reasonably calculated, under all the circumstances, to apprise interested parties of the pendency of the action and afford them an opportunity to present their objections."[73]

The Supreme Court warned that bankruptcy courts should conduct an independent determination of undue hardship even if a creditor fails to object, rejecting the Ninth Circuit's holding that a bankruptcy court must confirm a plan absent an objection.[74] The Court also suggested that sanctions under Rule 9011 might be appropriate against debtors and their attorneys who file plans in derogation of the Code and in bad faith.[75]

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[66] Id. at 1377
[67] Id.
[68] Id.
[69] Id. at 1378
[70] Id.
[71] Id.
[72] 339 U.S. 306, 70 S.Ct. 652 (1950)
[73] 130 S.Ct. at 1378
[74] Id. at 1380-81
[75] Id. at 1382; see Fed. R. Bankr. P. 9011

a. *In re Kleibrink*, 621 F.3d 370 (5th Cir. 2010)

In re Kleibrink[76] was decided in September 2010. Here, the Fifth Circuit applied *Espinosa* in voiding a discharge order's abrogation of a secured creditor's lien, where the creditor did not receive notice satisfying due process.[77] The debtor received a discharge in an earlier bankruptcy case and a creditor subsequently attempted foreclosure of the debtor's property.[78] The debtor challenged the foreclosure, arguing that his claim objection filed in the earlier proceeding had extinguished the lien.[79]

The bankruptcy court held that the creditor had not been afforded due process because the claim objection did not provide clear notice that the debtor was challenging the validity, priority, or extent of the lien; and because the debtor did not file an adversary proceeding as required by the bankruptcy rules.[80] The district court affirmed on substantially the same grounds.[81]

On appeal, the Fifth Circuit noted that in the time since the lower courts ruled, the Supreme Court had decided *Espinosa*, which dealt with the same dispositive issue: whether a creditor in a bankruptcy case received notice that satisfied due process requirements.[82] The Fifth Circuit affirmed the lower courts, determining that under *Espinosa,* where a creditor did not receive notice satisfying due process, a judgment extinguishing the creditor's interest in a bankruptcy proceeding was void under Fed. R. Civ. P. 60(b)(4).[83] The factual findings of the lower courts established that the debtor's "confusing claim objection filings" did not provide notice that was "reasonably calculated, under all the circumstances, to apprise [the creditor] of the pendency of the action and afford [it] an opportunity to [object]."[84] Therefore, the discharge of the creditor's security interest was void.[85]

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[76] 621 F.3d 370 (5th Cir. 2010)
[77] Id. at 371
[78] Id. at 370
[79] Id.
[80] Id. at 370-71
[81] Id at 371
[82] Id.
[83] Id.
[84] Id.

b. *Holsinger v. Hanrahan (In re Miell)*, 439 B.R. 704 (8th Cir. BAP 2010)

In re Miell[86] was decided in December 2010. In this case the Eighth Circuit Bankruptcy Appellate Panel (BAP) relied on *Espinosa* to uphold an order authorizing the sale of several parcels of real estate free and clear of all liens where the junior lienholders complained that they had received insufficient notice of the sale.[87] The BAP affirmed the bankruptcy court's order granting the buyer's motion to dismiss for failure to state a claim, determining that the junior lienholders received actual notice of the proposed sale, which stated that it was "free and clear of *all* liens and encumbrances."[88]

Even though the trustee's notice did not specifically identify the junior lienholders or their claims, and despite the trustee's procedurally erroneous failure to serve them with a copy of her motion for the proposed sale, the court held that the notice was constitutionally sufficient because "all liens and encumbrances" necessarily included junior liens.[89] The court opined that under *Espinosa* and *Mullane*, constitutionally sufficient notice involves notice "reasonably calculated, under all the circumstances, to apprise interested parties of the pendency of the action and afford them an opportunity to present their objections."[90] Wherever these conditions are met, "with due regard to the practicalities and peculiarities of the case," an order will not be held void under Fed. R. Civ. P 60(b)(4).[91] The trustee's failure to serve the junior lienholders with a copy of the motion for proposed sale merely deprived the junior lienholders of a right granted by a procedural rule; but under *Espinosa*, such failure did not amount to a constitutional deprivation voiding the subsequent court order.[92]

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[85] Id.
[86] 439 B.R. 704 (8th Cir. BAP 2010)
[87] Id. at 709-10
[88] Id.
[89] Id. at 709
[90] Id. at 708-09
[91] Id. at 709
[92] Id. at 709-10

c. Implications of *Espinosa*

After *Espinosa*, creditors will undoubtedly take a more active role in plan confirmation and claims issues. Creditors should compare the plan to their proofs of claim, since a chapter 13 plan's unambiguous, properly noticed treatment of a creditor's claim will likely be *res judicata* as to the filed proof of claim.[93] Two aspects of the Court's opinion do, however, temper *Espinosa's* impact. First, the Court reversed the Ninth Circuit's holding that bankruptcy courts must confirm a plan absent an objection.[94] The Court held that bankruptcy courts not only have the authority, but also the obligation to ensure that a plan conforms to the requirements of the Bankruptcy Code, such as the undue hardship requirement for the discharge of student loans.[95] The second limiting aspect of the decision is the Court's reference to Rule 9011 sanctions against attorneys and debtors who attempt to avoid the undue hardship requirement, or other Code requirements, by filing a plan in bad faith that does not conform with the Bankruptcy Code.[96]

Thus, the Court did establish lines of defense against plans that deprive creditors of their rights under the Bankruptcy Code: i.e. creditors must receive notice reasonably calculated to apprise them of their rights; the bankruptcy court must take an active role in ensuring that the plan complies with the Bankruptcy Code; and sanctions may be imposed on debtors' attorneys intentionally filing non-compliant plans in the hopes that the court and creditors will not notice the errors.

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[93] Both before and since Espinosa, discrepancies between chapter 13 plans and proofs of claim have produced "a mixed bag of jurisprudence on the res judicata effect of confirmed Chapter 13 plans, deemed allowance of proof of claim, conflicts between plans and proof of claim, and parties' failure to timely raise pertinent issues and protect their rights." In re Euliano, 442 B.R. 177 (Bankr. D.Mass. 2010)(citing long list of cases representing "sampling" of such variations; ordering dismissal for debtor's failure to file modified plan conforming to "cure and maintain" plan requirements); but see In re McLemore, 426 B.R. 728 (Bankr. S.D.Ohio 2010) (following Espinosa; confirmed plan given res judicata impact); In re Ryan, 431 B.R. 1 (Bankr. D.Mass. 2010)(same). On reconsideration, the Ryan court clarified that secured prepetition arrears not paid through plan must be paid outside the plan. In re Ryan, No. 08–40601, 2010 WL 2889107 (Bankr.D.Mass. 2010)

[94] United Student Aid Funds, Inc. v Espinosa, 130 S.Ct. at 1380

[95] Id. at 1381. The Court noted that bankruptcy courts "appear to be well aware of this statutory obligation." Id. n.15.

[96] Id. at 1382

III. *Schwab v. Reilly (In re Reilly)*, --- U.S. ---, 130 S.Ct. 2652 (2010)

Schwab v. Reilly (In re Reilly)[97] was issued on June 17, 2010. In this case, the Court determined whether the bankruptcy estate forfeited its claim to the portion of a debtor's property in excess of its scheduled value, where the trustee failed to object to a claimed exemption that was within the statutory limits, and equaled the scheduled value of the property.[98]

In *Reilly*, the debtor listed cooking and other kitchen equipment as an asset on Schedule B, claiming an estimated market value of $10,718; on Schedule C she claimed an exemption of $10,718 in the property.[99] The trustee did not object to the exemption even though an appraisal indicated the property was worth up to $17,200, and then moved to sell the equipment and realize for the estate the value in excess of the claimed exemption.[100] The debtor objected, arguing that by equating the claimed exemption with the equipment's market value, she put the trustee on notice of her intent to exempt the equipment's full value.[101] She asserted that even though the property turned out to be worth more than the amount she scheduled, resulting in an exemption exceeding the amount allowed under the Code, the trustee's failure to object resulted in a forfeiture of any rights in the excess value.[102]

The bankruptcy court denied the trustee's motion to sell; the district court affirmed, as did the Third Circuit.[103] The Third Circuit relied on *Taylor v. Freeland & Kronz*[104] in holding that Schwab was put on notice that the debtor intended to exempt the full market value of the property.[105] In *Taylor*, the Supreme Court held that where a debtor claimed an estimated market value of property as "unknown" and a corresponding exemption amount of "unknown," the trustee was required to object

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[97] --- U.S. ---, 130 S.Ct. 2652 (2010)
[98] Id.
[99] Id. at 2657-1258
[100] Id. at 1258
[101] Id.
[102] Id.
[103] Id. at 2659
[104] 503 U.S. 638, 112 S.Ct. 1644 (1992)
[105] See In re Reilly, 534 F. 3d 173, 178-179 (3d Cir. 2008)

to the exemption because it was not within the Code's statutory limits.[106] The Third Circuit determined that an "unstated premise" of *Taylor* was that a claimed exemption that equals the reported value is a claimed exemption in "the full amount, whatever it turns out to be."[107]

The Supreme Court reversed, with Justice Thomas writing for the 6-3 majority, holding that the trustee was not required to object because the claimed exemption was within the statutory amounts allowed by the Code.[108] The Court reasoned that exemptions under § 522(d) apply to the debtor's *interest* in the property up to a specified value – they are not exemptions in the property itself.[109] Thus, the debtor was not claiming an exemption in the property irrespective of its full market value, but only an interest in the property up to the claimed amount of the exemption, and the remaining value was an estate asset.[110] The Court distinguished *Taylor*, observing that in *Taylor* a claimed exemption of "unknown" was not within the limits prescribed by the Code, and therefore the trustee was required to object.[111] Here, the exemption of $10,718 was within the proper statutory limits.

Justice Ginsburg authored the dissent, joined by Chief Justice Roberts and Justice Breyer.[112] The dissent reasoned that inasmuch as the market value of an asset is integral to determining the character of the interest the debtor claims in that asset, objectors should be required to comply with Rule 4004(b)'s 30-day limitation period in objecting to valuation.[113] The dissent posits:

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[106] 112 S.Ct. at 1646-1648
[107] 534 F. 3d at 178-179
[108] 130 S.Ct. at 2659-2660
[109] Id. at 2661-2663
[110] Id. at 2662
[111] Justice Thomas also authored Taylor, wherein the Court recognized that even though the debtor had no colorable basis for her exemption claim, the trustee nonetheless was required to object within the 30-day period provided under Fed. R. Bankr. P. 4003(b). Taylor v Freeland & Kronz, 112 S.Ct. at 1647-1648. The Taylor Court noted, however, that "[d]ebtors and their attorneys face penalties under various provisions for engaging in improper conduct in bankruptcy proceedings." Id. at 644 citing 11 U.S.C. § 727(a)(4)(B); Fed R. Bankr. P. 1008, 9011; 18 U.S.C. § 152. The Court cautioned that [t]hese provisions may limit bad-faith claims of exemptions by debtors." Id. Justice Stevens dissented, contesting the majority's conclusion that it lacked authority to limit the application of 11 U.S.C. § 522(*l*), and opining that "strong equitable considerations" supported equitable tolling of the 30-day limitation period. Id. at 646
[112] 130 S.Ct. at 2669-2678 (Ginsburg, J. dissenting)
[113] Id. at 2673-2674

> By permitting trustees to challenge a debtor's valuation of exempted property anytime before discharge, the Court casts a cloud of uncertainty over the debtor's use of assets reclaimed in full. If the trustee gains a different opinion of an item's value months, even years, after the debtor has filed her bankruptcy petition, later he may seek to repossess the asset, auction if off, and hand the debtor a check for the dollar amount of her claimed exemption. With this threat looming until discharge, how can debtors reasonably be expected to restructure their affairs.[114]

The concerns expressed by the dissent regarding subsequent asset appreciation and the prospect of later sale by the trustee are represented by the facts in the following Ninth Circuit case.

a. *Gebhart v. Gaughan (In re Gebhart)*, 621 F.3d 1206 (9th Cir. 2010)

In re Gebhart[115] was decided in September 2010. Here, the Ninth Circuit considered two companion cases in which the debtors owned real property and claimed their equity in the properties as exempt for the full amounts allowed under the relevant exemption statutes: one claiming the federal exemptions and the other the Arizona state exemptions.[116] The properties increased in value after the filings such that there was value in excess of the applicable homestead exemptions as of the time the trustees sought to sell the properties – in both instances more than two years after the debtors' petitions were filed.

The Ninth Circuit relied on *Reilly* in holding that the increased value over and above the claimed exemptions and secured claims was property of the estate. The Court determined that under *Reilly*, an exemption is frozen as of the time of filing, while the value of the property is not. The Court stated, "what is removed from the estate is an 'interest' in the property equal to the value of the exemption claimed at filing."

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[114] Id. at 2677 (internal footnotes and citations omitted). The dissent's reference to discharge as establishing the deadline to object to valuation under the majority's view is unclear.
[115] 621 F.3d 1206 (9th Cir. 2011)
[116]

b. *Messina v. Neuner (In re Messina)*, 386 Fed. Appx. 152 (3rd Cir. 2010) (unpublished)

In re Messina[117] was decided in July 2010. In *Messina*, the Third Circuit had suspended a district court appeal awaiting the *Reilly* decision. Citing *Reilly* for the proposition that the scope of Rule 4003's objection limitations period was expressly limited to the three categories listed in Schedule C, the *Messina* court opined that the 30-day limitation period only applies to objections based on '''three, and only three' elements of a claimed Schedule C exemption: (1) the description of the exempted property; (2) 'the Code provisions governing the claimed exemptions;' and (3) the amount 'listed in the column titled value of claimed exemption.'"[118] Thus, a "trustee's duty to object under § 522(l) within the 30 days of Rule 4003(b) does not extend to objections over the estimated total market value of the asset."[119]

c. Implications of Reilly

An issue arising post-*Reilly*, in addition and related to the *Gebhart* concerns, is utilization of what appears to some as the Supreme Court's express invitation to list the value of capped exemptions as 100% of fair market value. The relevant language of the Supreme Court's opinion is as follows:

> Where, as here, it is important to the debtor to exempt the full market value of the asset or the asset itself, our decision will encourage the debtor to declare the value of her claimed exemption in a manner that makes the scope of the exemption clear, for example, by listing the exempt value as "full fair market value (FMV)" or "100% of FMV." Such a declaration will encourage the trustee to object promptly to the exemption if he wishes to challenge it and preserve for the estate any value in the asset beyond relevant statutory limits.[120]

This statement, made at the conclusion of the Court's opinion, appears to somewhat contravene its earlier recognition that only specific subsections of § 522(d) allow debtors to exempt certain assets

[117] 386 Fed. Appx. 152 (3d Cir. 2010)2011 WL 322018 (D.N.J. 2011)
[118] Id. at 154, citing Reilly, 130 S.Ct. at 2663-2664
[119] Id.
[120] Reilly, 130 S.Ct. at 2668

"in kind or in full regardless of value."[121] Indeed, the Court specifies these subsections, which include: § 522(d)(9) for professional prescribed health aids; § 522(d)(10)(C) for disability benefits, and § 522(d)(7) for unmatured life insurance contracts.[122]

Depicting this recent impasse, the Texas bankruptcy court recently issued an opinion addressing objections to exemptions brought by trustees in nine consolidated chapter 7 and chapter 13 cases where debtors had scheduled the value of their claimed exemptions as "100% of FMV."[123] In *Salazar*, the trustees argued that the exemption claims were improperly taken, while the debtors submitted that they were "indeed proper as they were made in accordance with the perceived directive from the Supreme Court in *Schwab v. Riley*."[124] The *Salazar* court recognized that "[t]he angst expressed by both the debtors and trustees ... concerns what they perceive the Supreme Court to have recommended in *Schwab* when addressing Reilly's desire to retain the asset..."[125]

In its discussion, the *Salazar* court cited another recent Texas bankruptcy court decision with similar facts, where that court determined an evidentiary hearing was appropriate, at which the joint debtors would have the burden of establishing a "plausible basis for the claim that '100% of FMV' of an asset falls within the statutory limit."[126] The *Moore* court had held that once a plausible basis for the exemption claim was established, the trustee had the burden of proving that the claim exceeded the statutory limit; if she did so, then the objection was overruled, and if she did not, then the asset was no longer property of the estate.[127]

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[121] Id. at 2663
[122] Id. Note that most of the exemptions in subsection (d) of § 522, including those at issue in *Reilly*, refer to the "debtor's aggregate interest" not exceeding a certain amount in the applicable asset. See 11 U.S.C. § 522(d).
[123] In re Salazar et. al., 2011 WL 1104109 (Bankr. N.D. Tex. 2011)
[124] Id. at *1
[125] Id. at *4, citing Reilly, 130 S.Ct at 2668
[126] In re Moore, 2010 WL 5397193 at *2 (Bankr. N.D. Tex. 2010)
[127] Id. at *2

The *Salazar* court declined to follow *Moore*, instead adopting an approach which it believed "best recognize[d] the reasoning of *Schwab*..."[128] The *Salazar* court disagreed with *Moore*'s conclusion that once a "100% FMV" objection is overruled, the asset is no longer property of the estate.[129] Rather, the *Salazar* court held that an objection to a "100% FMV value" exemption claim regarding an asset with a capped exemption limit was facially valid; and that in response to such an objection the debtors were entitled to amend their exemptions to bring them within the allowable statutory amounts.[130] Citing *Gebhart* with approval, the court held that even if the debtors were attempting to make an "in-kind" exemption claim, "such goal may still be thwarted if, for example, the property appreciates in value."[131]

The *Salazar* court acknowledged the perceived harshness of *Gebhart,* but reiterated the *Gebhart* court's "solution to this clouded-title issue and the practical desires of debtors who... want to keep certain property in-kind."[132] Thus, both the *Salazar* and *Gebhart* courts directed debtors seeking to reclaim their property in-kind, despite a capped exemption limit, to utilize Code § 554(b) – which permits any party in interest to move to compel a trustee to abandon estate property that is burdensome or of inconsequential value.[133] Indeed, the Code provides, and trustees on their own or upon request regularly file abandonments without the need of a motion to compel them to do so.[134]

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[128] Salazar, 2011 WL 1104109 at *5
[129] Id.
[130] Id. at *7
[131] Id. at *5 citing Gebhart, 621 F.3d 1206
[132] Id. at *7
[133] Id.
[134] See 11 U.S.C. § 554, Abandonment of property of the estate, which reads in relevant part:
(a) After notice and a hearing, the trustee may abandon any property of the estate that is burdensome to the estate or that is of inconsequential value and benefit to the estate.
(b) On request of a party in interest and after notice and a hearing, the court may order the trustee to abandon any property of the estate that is burdensome to the estate or that is of inconsequential value and benefit to the estate.

IV. *Hamilton v. Lanning*, --- U.S. ---, 130 S.Ct. 2464 (2010)

Hamilton v. Lanning[135] was decided June 7, 2010. In *Lanning*, the Supreme Court interpreted the phrase "projected disposable income" in Code § 1325(b)(1).[136] This provision requires that an above-median-income chapter 13 debtor commit all "projected disposable income" to repay creditors, unless creditors are being repaid in full.[137]

The debtor in *Lanning* received a one-time buyout from her employer prior to filing her chapter 13 petition, resulting in an inflation of her current monthly income during the six month look-back period.[138] Incorporating this income number into the means test calculation resulted in disposable income of $1,114.98 on her Form B22C.[139] However, the debtor proposed a chapter 13 plan with a monthly payment of $144, contending that the term "projected disposable income" was forward-looking and should not include the one-time buyout.[140]

The chapter 13 trustee objected to confirmation of the plan, asserting that the debtor was required to use the mechanical calculation to determine her plan payment, because although "projected" was not defined, "disposable income" was defined and was based on a calculation of "current monthly income," averaging all income earned over the six months before filing.[141] Since a monthly payment of $756 would repay her creditors in full, the trustee argued that this was the required plan payment.[142] There was no dispute that the debtor was unable to make payments in that amount.[143]

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[135] --- U.S. ---, 130 S.Ct. 2464 (2010)
[136] Id. at 2469
[137] 11 U.S.C. §1325(b)(1)
[138] Lanning, 130 S.Ct. at 2470
[139] Id.
[140] Id.
[141] Id.
[142] Id.
[143] Id.

The bankruptcy court overruled the trustee's objection, holding that the word "projected" required that a debtor's actual income on Schedule I be considered in order to avoid the absurd result of denying chapter 13 relief to individuals whose finances worsened during the six-month look-back period.[144] The Tenth Circuit BAP affirmed, alluding to pre-BAPCPA practice in which courts considered Schedules I and J in arriving at "projected disposable income" – a phrase left unchanged by BAPCPA.[145] The Tenth Circuit affirmed, holding that a court should start with the presumption that the mechanical means test calculation represents the debtor's disposable income, but this presumption could be rebutted by showing a substantial change in circumstances.[146]

The Supreme Court affirmed the lower courts in an 8-1 decision.[147] Justice Alito, writing for the majority, identified the split of authority – with some courts taking the "mechanical approach" favored by the trustee, and others taking the "forward-looking approach" followed by the debtor.[148] The Court adopted the forward-looking approach applied by most lower courts.[149] The Court discussed the ordinary meaning of the word "projected," determining that it is generally understood to take into account future changes.[150] The Court discussed examples from ordinary usage and other federal statutes, and observed that when Congress wanted to mandate simple multiplication, it did so explicitly.[151] The Court also referred to pre-BAPCPA case law, under which courts had discretion to account for "known or virtually certain changes in the debtor's income."[152] The Court held that pre-BAPCPA practice was relevant where it had not been clearly altered by Congress; and here, the term

[144] Id. at 2470-2471
[145] Id. at 2471
[146] Id.
[147] Id. at 2468
[148] Id. at 2469
[149] Id.
[150] Id. at 2471
[151] Id. at 2471-2472
[152] Id. at 2472-2473

"projected disposable income" was not changed.[153] The Court also looked at the context of the provision and found that a mechanical approach would clash with the terms of Code § 1325, which speak of (1) projected disposable income "to be received" (a phrase that would be read out of the statute if the mechanical approach was followed), (2) income "as of the effective date of the plan" (suggesting an emphasis on post-filing circumstances), and (3) a requirement that projected disposable income "will be applied to make payments" (which would be a "hollow command" if the debtor lacks the means to do so).[154]

The *Lanning* Court also discussed the main argument advanced on behalf of the mechanical approach: that because BAPCPA had redefined "disposable income," "projected disposable income" should be interpreted in accordance with the new meaning.[155] The Court determined that the forward-looking approach did incorporate the new meaning, because disposable income calculated under the means test would always be the starting point for arriving at a plan payment – and only in unusual circumstances should a court "go further and take into account other known or virtually certain information about the debtor's future income or expenses."[156] The Court also noted that in cases where the debtor's income over the six-month look-back period was substantially different from the actual income, the mechanical approach would lead to "senseless results that we do not think Congress intended."[157]

Justice Scalia dissented, arguing that the mechanical approach was the only approach that was true to the statutory text.[158] He contended that BAPCPA's definition of "disposable income" was controlling and courts have no discretion to change the debtor's plan payment based on changed

[153] Id. at 2473-2474
[154] Id. at 2474
[155] Id. at 2474-2475
[156] Id. at 2475
[157] Id. at 2475-2476
[158] Lanning, 130 S.Ct. at 2478-2479 (Scalia, J. dissenting)

circumstances.[159] Justice Scalia agreed with the majority's definition of the word "projected" as a prediction or calculation of future events, but he contended that Congress had already determined the basis for the projection – the six months of prior income of the debtor.[160] Justice Scalia criticized that the Court had "utterly abandon[ed] the text" and inserted its own conception of how a plan payment should be calculated.[161] He found no basis in the text for court-authorized changes where the change to the debtor's disposable income was both "significant" and "known or virtually certain"; instead arguing that if the statute allows for changes, then it must allow them in all instances.[162]

Justice Scalia observed that the mechanical approach was not "senseless" and suggested policy rationales that could have motivated Congress.[163] He theorized that Congress could have determined that debtors whose finances had deteriorated after or near the end of the six-month period "do not yet need a reprieve from repaying their debts; perhaps they will recover."[164] Likewise, he suggested that "perhaps the debtor who has received a one-time bonus will thereby be enabled to stay afloat."[165] This reasoning reflects Justice Scalia's approach to the doctrine of absurdity – which is that an unambiguous statute should be followed unless the court can arrive at no possible, reasonable explanation for the supposedly absurd result.[166] Thus, a court should use its imagination in conjecturing why Congress could have written a seemingly senseless provision.[167] This argument is premised on the principle that it is not for a court to determine the wisdom of a statutory provision.[168]

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[159] Id. at 2479
[160] Id. at 2479-2480
[161] Id. at 2479
[162] Id.
[163] Id. at 2482-2483
[164] Id. at 2483
[165] Id.
[166] See id; Holloway v. United States, 526 U.S. 1, 19 n.2 (1999)(Scalia, J., dissenting); United States v. X-Citement Video, Inc., 513 U.S. 64, 82, 115 (1994)(Scalia, J., dissenting); Green v. Bock Laundry Mach. Co., 490 U.S. 504, 527 (1989)(Scalia, J., concurring).
[167] Lanning, 130 S.Ct. at 2483
[168] See id. at 2482

a. *Whaley v. Tennyson (In re Tennyson),* 611 F.3d 873 (11th Cir. 2010)

In re Tennyson[169] was decided in July 2010. In *Tennyson*, the Eleventh Circuit interpreted the term "applicable commitment period" in 11 U.S.C. §1325.[170] The debtor argued that the term "applicable commitment period" exists only for the purposes of the calculation in § 1325(b)(1)(B), wherein a debtor must pay projected disposable income to be received in the applicable commitment period.[171] The Eleventh Circuit held that under a plain reading, § 1325(b)(4) has independent meaning, imposing a minimum duration of five years on chapter 13 plans for above-median debtors.[172]

The court found support in *Lanning,* reasoning that since "projected disposable income" was not a strict mechanical formula, "applicable commitment period" must have an independent significance.[173] To leave "applicable commitment period" dependent on "projected disposable income" would make the term dependent on the various factors set forth in *Lanning*.[174] In order to give "applicable commitment period" a definite meaning, the term must be understood as a temporal term determined in § 1325(b)(4).[175] The court also cited legislative history in support of its conclusion, quoting a House of Representatives report: "The heart of [BAPCPA] consumer bankruptcy reforms… is intended to ensure that debtors repay creditors the maximum they can afford."[176] The court also referred to statements indicating that § 1325(b) was intended to require a five year plan for above-median income debtors.[177]

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[169] 611 F.3d 873 (11th Cir. 2010)
[170] Id. at 874
[171] Id. at 878
[172] Id.
[173] Id.
[174] Id. at 878-879
[175] Id. at 879
[176] Id.
[177] Id.

b. *Darrohn v. Hildebrand (In re Darrohn),* 615 F.3d 470 (6th Cir. 2010)

In *In re Darrohn*[178] also decided in July 2010, the Sixth Circuit was faced with the reverse of the situation in *Lanning* – the chapter 13 debtor's six-month look back period included a 90-day period of unemployment, after which the debtor found a new job.[179] The debtor used the mechanical approach to his advantage; proposing a chapter 13 plan with an artificially low payment, which the bankruptcy court confirmed.[180] The Sixth Circuit reversed and remanded, holding that under *Lanning*, the significant, known change in circumstances required an adjustment to the debtor's projected disposable income.[181]

The Sixth Circuit also applied *Lanning* to changes to the expense side of the disposable income calculation.[182] Acknowledging that this "was not directly at issue in *Lanning*," the court nevertheless found that the question "fall[s] squarely within the Court's decision in *Lanning*."[183] The debtors claimed expense deductions for mortgage debts on two properties that they intended to surrender.[184] The language at issue provides a deduction for "amounts scheduled as contractually due to secured creditors in each of the 60 months following the date of the petition."[185] The bankruptcy court, following a mechanical approach, had held that the relevant question was simple: whether the mortgages were contractually scheduled as due at the time of filing.[186] Answering the question in the affirmative, the court allowed the deductions.[187] The Sixth Circuit reversed, applying *Lanning* and holding that the surrender of the properties was a "known or virtually certain" change at the time of

[178] 615 F.3d 470 (6th Cir. 2010)
[179] Id. at 472-473
[180] Id. at 473
[181] Id. at 475-746
[182] Id. at 476
[183] Id.
[184] Id.
[185] 11 U.S.C. §707(b)(2)(A)(iii)
[186] Darrohn, 615 F.3d at 476
[187] Id.

confirmation of the plan, and therefore the debtor could not claim an expense deduction for the mortgage debts.[188]

c. *In re Liehr*, 439 B.R. 179 (10th Cir. BAP 2010)

In re Liehr[189] was decided in November 2010. This chapter 13 case follows *Lanning* and *Darrohn* in determining that debtors who state an intention to surrender their property cannot claim the mortgage debt as a deduction, stating, "all of the Supreme Court's reasoning in *Lanning* with respect to the debtor's change in income is equally applicable to the expense side of the PDI equation."[190]

d. *In re Timothy*, 442 B.R. 28 (10th Cir. BAP 2010)

In re Timothy[191] was decided in December 2010. This case follows the Eighth and Eleventh Circuits' decisions in *Frederickson*[192] and *Tennyson*, concluding that the applicable commitment period for an above-median income debtor is a minimum of five years, unless all unsecured creditors are paid in full.[193]

e. Implications of Lanning

The first and most obvious outcome of *Lanning* is that the strictly mechanical approach to calculating "projected disposable income" is no longer viable. Although changes in the debtor's anticipated expenses were not directly at issue in *Lanning*, the Court extended its holding to changes in expenses that are known or virtually certain at the time of confirmation.[194] Two appellate courts interpreting *Lanning* have given it precedential value regarding the expense side of the means test formula, suggesting that *Lanning*'s discussion in this regard was not merely dicta.[195] Questions remain, however, regarding how courts will apply *Lanning* to the various expense categories – some of which

[188] Id. at 477
[189] 439 B.R. 179 (10th Cir. BAP 2010)
[190] Id. at 184-185
[191] 442 B.R. 28 (10th Cir. BAP 2010)
[192] 545 F.3d 652 (8th Cir. 2008) cert. denied, --- U.S. ---, 129 S.Ct. 1630 (2009)
[193] Id. at 33
[194] Lanning at 2478
[195] See In re Darrohn, 615 F.3d 470; In re Liehr, 439 B.R. 179 (10th Cir. BAP 2010)

are based on the standardized expense deductions set forth in the IRS guidelines, some that are based on actual expenses, and still others that are based on expenses "scheduled as contractually due to secured creditors in each of the 60 months following the date of the petition."[196]

Also, *Lanning* only applies to chapter 13 cases because the means test under chapter 7 does not involve "projected disposable income."[197] Thus, for the purposes of determining whether a presumption of abuse arises under Code § 707(b)(2), the mechanical approach may still be viable.[198] *In re Rudler*[199] is a chapter 7 case decided by the First Circuit Court of Appeals before *Lanning*. *Rudler* upheld a mechanical, plain text approach in determining that debtors who intended to surrender their residence but had mortgage payments that were "scheduled as contractually due to secured creditors" could deduct this monthly expense in their chapter 7 means test.[200] The United States Trustee (UST) had argued that "allowing debtors to deduct only payments they will actually make, rather than all payments scheduled at the time of the bankruptcy filing, better serves the purpose behind the means test."[201] While the First Circuit acknowledged the merits of the UST's argument, it nonetheless determined that the text of the statute was unambiguous and adhered to the strictly mechanical means test analysis.[202]

As indicated, although *Lanning* does not abrogate *Rudler* because the modifier "projected" appears only in § 1325(b),[203] *Ransom v. FIA Card Services*, the next consumer bankruptcy case decided by the Supreme Court and discussed *infra*, does call into serious doubt *Rudler*'s continuing

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[196] 11 U.S.C. §707(b)(2)(A)(ii)-(iv); see discussion infra, Darrohn v. Hildebrand, 615 F.3d 470 (6th Cir. 2010), and In re Liehr, 439 B.R. 179 (10th Cir. BAP 2010)
[197] See 11 U.S.C. §707(b)(2)
[198] See id.; see also discussion infra, In re Rudler, 576 F.3d 37 (1st Cir. 2009).
[199] 576 F.3d 37 (1st Cir. 2009)
[200] Id. at 40; 11 U.S.C. §707(b)(2)(A)(iii)(I).
[201] Rudler, 576 F.3d. at 50
[202] Id.
[203] See 11 U.S.C. § 1325(b)

viability.[204] As discussed *supra* in *Darrohn* and *Lier*, two circuits have opined on this issue in the chapter 13 context, determining that *Lanning* does preclude the inclusion of such mortgage expenses for property that is being surrendered.[205]

A second implication of *Lanning* derives from the Court's emphasis on the importance of pre-BAPCPA case law. The Court stated: "Pre-BAPCPA case law is telling because 'we will not read the Bankruptcy Code to erode past bankruptcy practice absent a clear indication that Congress intended such a departure.'"[206] Despite the substantial changes wrought by the means test, the Court determined that BAPCPA had not changed the term "projected disposable income" and therefore pre-BAPCPA case law was still relevant to an interpretation of that phrase.[207] Justice Scalia disagreed with the majority on this issue, noting that the definition of "disposable income" had been changed.[208] Nevertheless, the Court's reasoning is instructive, and may provide a principled basis for deciding cases where the text of the statute is susceptible to more than one reasonable interpretation, as is the case with many BAPCPA provisions.[209]

Lanning also provided a further interpretive guideline that may aid courts in deciding BAPCPA cases: statutes should only be read to require simple multiplication where they do so unambiguously. Otherwise, as with the term "projected," courts have more leeway. The Sixth Circuit in *Baud*, as discussed *infra*, used this reasoning in determining that § 1325(b) establishes a temporal requirement for chapter 13 plans, based on the "lack of explicit multiplier language in § 1325(b)… or some other clear indication that mere multiplication was intended."[210]

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[204] See Ransom, 131 S.Ct. at 721, 725, 727, 729
[205] See also infra., Baud v. Carroll, 634 F.3d 327 (6th Cir. 2011)
[206] Lanning, 130 S.Ct. at 2473 (quoting Traveler's Casualty & Surety Co. of America v. Pacific Gas & Elec. Co., 549 U.S. 443, 454 (2007)
[207] Id. at 2473-2474
[208] Id. at 2482 (Scalia, J., dissenting)
[209] See, e.g., Baud v. Carroll, 634 F.3d at 341
[210] Id. at 340-341

Thus, as noted by *Baud,* the *Lanning* Court established various "guideposts" for interpretation that can be applied where a statute is capable of more than one reasonable meaning: (1) the purpose of the statute, (2) pre-BAPCPA caselaw (unless Congress clearly indicated a departure from such practice), and (3) whether or not the statue includes explicit multiplier language.[211] The Supreme Court's statement that it would avoid "senseless results that we do not think Congress intended," clearly signaled its purposive analysis;[212] and *Ransom*, issued 7 months later, reinforced and expanded further upon this purpose-driven approach.

V. *Ransom v. FIA Card Services, N.A., fka MBNA America Bank, N.A.*, --- U.S. ---, 131 S.Ct. 716 (2011)

Ransom v. FIA Card Services[213] was decided January 11, 2011. In *Ransom,* the Supreme Court resolved a circuit split regarding whether a debtor can deduct the "ownership" expense for a vehicle he owns free and clear of liens for the purposes of calculating "projected disposable income" under Code § 1325(b).[214] In this case, the debtor proposed a chapter 13 plan payment of $210.55, reflecting his projected disposable income as calculated under the statutory means test formula.[215] As required by the statute, he arrived at this amount by deducting from his current monthly income the expenses allowed under the statute, including the "applicable" monthly expenses specified by the National and Local Standards issued by the IRS.[216] The National Standards allow a vehicle "Ownership Cost" of $471 for the first car owned.[217] The debtor took the position that the Ownership Cost was applicable because he

[211] Id. at 339-341
[212] Lanning, 130 S.Ct. at 2475-76
[213] 131 S.Ct. 716 (2011)
[214] Id. at 723
[215] Id.; 11 U.S.C. §§707(b)(2), 1325(b)(2).
[216] Ransom, 131 S.Ct. at 723
[217] Id. at 722

owned a car.[218] FIA objected to confirmation, arguing that the monthly expense was not applicable because the debtor did not have a car payment.[219]

The bankruptcy court denied confirmation of the debtor's plan, holding that he could only use the "Ownership Expense" deduction if he was making loan or lease payments.[220] The Ninth Circuit BAP and Court of Appeals both affirmed;[221] The Supreme Court granted certiorari to resolve the circuit split on this issue.[222] Justice Kagan, writing the 8-1 majority opinion, affirmed the lower court holdings, determining that a deduction for "Ownership Costs" only applies when the debtor actually has a monthly loan or lease payment.[223] Interpreting the term "applicable," the Court determined that an expense is applicable when "the debtor has costs corresponding to the category covered by the [IRS] table."[224] Otherwise, the word "applicable" would be mere surplusage.[225] The Court also referenced two IRS publications, the Internal Revenue Manual and the IRS Collection Financial Standards, to support its determination.[226] The Collection Financial Standards explicitly provide that an individual with no car payment may not claim the "Ownership Costs" deduction.[227] The Court noted that "although the statute does not incorporate the IRS's guidelines, courts may consult this material in interpreting the National and Local Standards."[228]

The Court rejected the notion that a debtor could utilize a "wholly fictional" expense.[229] To demonstrate the anomalies of the debtor's interpretation, the Court presented a hypothetical situation where a debtor "purchase[s] for a song a junkyard car – an old, rusted pile of scrap metal that would sit

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[218] Id. at 726
[219] Id. at 723
[220] Id.
[221] Id.
[222] Id.
[223] Id. at 720, 721, 726
[224] Id. at 724
[225] Id.
[226] Id. at 725-726
[227] Id. at 726
[228] Id.
[229] Id. at 727

on cinder blocks in his backyard… in order to deduct the $471…"[230] The Court acknowledged the central purpose of BAPCPA and the means test – ensuring that debtors who can pay, do pay.[231] It reasoned that mere ownership of a car, with no associated car payment, should not permit a debtor to withhold substantial distributions from creditors, especially when a separate expense deduction exists for the costs of operating the car.[232]

Justice Scalia, again the lone dissenter, agreed with the position of the three circuits that had resolved the question differently (Fifth, Seventh, and Eighth).[233] Justice Scalia disagreed with the majority's use of the Internal Revenue Manual and the Collection Financial Standards, arguing that no reference should be made to these sources because they were not incorporated into the statute, and that a plain text interpretation was possible within the confines of the statute and the IRS tables.[234] Using only these authorities, a vehicle "Ownership Expense" would simply apply to anyone who owned a car.[235] Justice Scalia also disagreed with the majority's emphasis on the word "applicable," making the point that "the canon against superfluity is not a canon against verbosity," and that courts should not "cast about for some additional meaning to [a] word or phrase that could have been dispensed with."[236] Finally, Justice Scalia criticized the "imagined horrible" of the majority, positing the equally offensive scenario in which a debtor "might purchase a junkyard car for a song plus a $10 promissory note payable over several years."[237]

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[230] Id. at 729
[231] Id. at 727
[232] Id.
[233] Id. at 730 (Scalia, J. dissenting)
[234] Id. at 730-731
[235] Id. at 731
[236] Id.
[237] Id. at 732

a. *Baud v. Carroll*, 634 F.3d 327 (6th Cir. 2011)

Baud v. Carroll[238] was decided in February 2011. In this case, the Sixth Circuit relied heavily on *Ransom* and *Lanning* in deciding three issues in the chapter 13 context.[239] The court first decided whether § 1325 requires, upon objection by the trustee or a creditor, that a plan have a certain duration, or whether it simply establishes a minimum amount that must be paid to unsecured creditors.[240] Noting a split of authority, the court discerned "tenable arguments" on both sides of the issue.[241] The court began with the language of the statute and noted that the phrase "applicable commitment period" has a temporal connotation, quoting at length from *Tennyson*, supra.[242] However, the Sixth Circuit observed that the textual arguments for the opposing position were also compelling.[243] To resolve this impasse, the Court relied on the puposivist reasoning in *Lanning* and *Ransom* to determine that a set duration was required.[244]

The Sixth Circuit noted that in *Lanning*, the Supreme Court observed the lack of explicit multiplier language in the phrase "projected disposable income" and determined that Congress generally uses terms like "multiply" when simple multiplication is intended.[245] Thus, the Supreme Court had concluded that the absence of any such term was revealing.[246] The *Baud* court applied this reasoning to the phrase "applicable commitment period," observing that if Congress had intended this phrase to serve simply as a monetary multiplier in arriving at the total to be paid out through the plan, it would have stated so.[247] The court also relied on pre-BAPCPA precedent, quoting *Lanning*: "[Such precedent] is telling because we will not read the Bankruptcy Code to erode past bankruptcy practice

[238] 634 F.3d 327 (6th Cir. 2011)
[239] Id. at 330, 339, 342-343
[240] Id. at 336-344
[241] Id. at 338
[242] Id.
[243] Id. at 338-339
[244] Id. at 339
[245] Id. at 339-340
[246] Id. at 339
[247] Id.

absent a clear indication that Congress intended such a departure."[248] The *Baud* court noted that prior to BAPCPA, there was a specific plan length requirement.[249]

Finally, the Sixth Circuit emphasized the Supreme Court's purposivist analyses in *Lanning* and, especially, in *Ransom*.[250] The Court quoted four separate portions of the *Ransom* opinion that clearly demonstrate the Supreme Court's heavy reliance on the statute's purpose in arriving at its decision in that case.[251] Since *Ransom* instructs that BAPCPA's purpose was to ensure that debtors repay creditors to the greatest extent that they can, the Sixth Circuit determined that a durational requirement was most aligned with that purpose of the 2005 Act.[252]

The second issue resolved by the *Baud* court involved the calculation of projected disposable income.[253] The two underlying issues presented were: (1) whether *Darrohn* and *Lanning* require that "projected disposable income" include Social Security benefits even though the definition of "disposable income" excludes them, and (2) whether above-median debtors can deduct the full amount of their mortgage payment by right, or whether courts should inquire whether the payments are "reasonably necessary."[254]

The *Baud* court held that Social Security benefits should not be included in "projected disposable income" because they were not included in "disposable income."[255] *Darrohn* and *Lanning* provide that "known or virtually certain information about the debtor's future income or expenses" should be taken into account in "unusual cases," but courts are not empowered to simply disregard the Code's definition of "disposable income."[256] The court cited the Seventh Circuit's post-*Lanning*

[248] Id. at 341
[249] Id.
[250] Id. at 342-343
[251] Id. at 343
[252] Id.
[253] Id. at 344
[254] Id.
[255] Id. at 345
[256] Id.

decision, *In re Johnson,*[257] which held that the projected disposable income calculation "employs the inclusions and exclusions from 'current monthly income' set forth in section 101(10A), but applies them not in the retrospective manner specified by that provision but rather in the forward-looking manner envisioned by section 1325(b)."[258]

The *Baud* court noted that most courts to decide the issue post-*Lanning* had reached the same result, although one bankruptcy court did arrive at the opposite conclusion.[259] The court determined that the language of the statute unambiguously excluded Social Security benefits, even in chapter 13.[260] The statute demonstrated a clear intention on the part of Congress to depart from pre-BAPCPA practice of including Social Security benefits.[261] The court reached its conclusion despite the fact that this result seemingly contradicts BAPCPA's purpose of maximizing creditor recoveries.[262]

Turning to the question of whether the debtors could deduct the full amount of their mortgage payments regardless of the reasonableness of the expense (the debtors had a $1,699.93 mortgage payment, compared with an IRS Local Standard for housing of $791), the court determined that the text of the statute clearly permitted the deduction of the full amount.[263] The court summed up its holdings regarding calculation of projected disposable income, perhaps illuminating how *Lanning* will be applied to the expense side of the means test calculation, as follows: "it is appropriate to calculate a debtor's projected disposable income using the inclusions and exclusions from disposable income set forth in the Code and the deductions permitted by the Code, supplemented as of the date of

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[257] 382 Fed. App'x 503 (7th Cir. June 21, 2010)
[258] Id. at 346 (citing In re Johnson, 382 Fed.Appx. 503, 506 (7th Cir. 2010))
[259] Baud, 634 F.3d at 346, citing In re Cranmer, 433 B.R. 391 (Bankr. D. Utah 2010) (applying Lanning in a much broader sense; holding that a debtor with Social Security benefits was "the unusual case the Supreme Court meant in Lanning where there are other known sources of income that should be included in the calculation of projected disposable income").
[260] Baud, 634 F.3d at 347
[261] Id.
[262] Id.
[263] Id. at 347-49. The Court refused to the consider whether an above-median debtor's decision to continue making payments on secured debt could be factored into the good-faith analysis of §1325(a)(3), noting a split of authority on that matter. Id. at 349 n.16.

confirmation and adjusted to take into account changes during the applicable commitment period that are known or virtually certain at the time of confirmation."[264]

The final issue decided in *Baud* was whether there is an exception to the temporal requirement for chapter 13 plans where debtors have zero or negative disposable income.[265] The court noted that the two circuit courts to have decided the issue, the Eleventh (in *Tennyson*) and the Ninth (in *Kagenveama*[266]), both applied a plain-meaning approach, but nonetheless came to opposite conclusions.[267] The *Baud* court began with a plain meaning analysis and found the *Tennyson* approach slightly more compelling.[268] However, the court noted that the "plain language arguments supporting each approach are nearly in equipoise, and... the circuit-level decisions on the issue are entirely so."[269]

Thus confused, the *Baud* court turned to *Ransom* and *Lanning* for guidance.[270] The Sixth Circuit considered the only relevant guidepost in *Lanning* to be the Supreme Court's desire to avoid a "senseless result that we do not think Congress intended… [which] would deny creditors payments that the debtor could easily make."[271] The court stated that *Ransom*, consistent with *Lanning*, established the same guidepost: courts should implement "BAPCPA's purpose of ensuring that debtors repay creditors using their full disposable income."[272] With these principles in place, the Court engaged in an extended analysis showing why a minimum plan length requirement, even for debtors with no disposable income, maximizes creditor recoveries.[273]

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[264] Id. at 349
[265] Id. at 350
[266] 541 F.3d 868 (9th Cir. 2008)
[267] Baud, 634 F.3d at 350. See also Riley Furlong, n. 1 supra (discussing paradox of numerous "plain meaning" BAPCPA case analyses arriving at divergent conclusions)
[268] Id. at 350-351
[269] Id. at 351
[270] Id.
[271] Id. at 351-352
[272] Id. at 352-353
[273] Id. at 353-356

The *Baud* court concluded its analysis, stating: "We believe it is now clear that, where each competing interpretation of a Code provision amended by BAPCPA is consistent with the plain language of the statute, we must, as the Supreme Court did in *Lanning* and *Ransom*, apply the interpretation that has the best chance of fulfilling BAPCPA's purpose of maximizing creditor recoveries."[274]

b. Implications of Ransom

One implication of *Ransom* is that courts will now freely use the Internal Revenue Manual and Collection Financial Standards published by the IRS in making the means test calculation. Previously, there was some debate about whether or not these publications could be consulted in relation to the standardized expense deductions based on the National and Local Standards. But in *Ransom*, the Court plainly stated: "courts may consult this material in interpreting the National and Local Standards."[275] An important issue left unresolved by the *Ransom* Court, however, is whether the National and Local Standards merely set caps on the expense deductions, or whether a debtor may claim the full deduction even if it exceeds his actual expense for that particular category.[276]

The broader implication of *Ransom* is the Supreme Court's newly articulated interpretive approach – to analyze the "text, context and purpose" of BAPCPA and its various provisions.[277] Thus, the *Ransom* opinion relied heavily on the purposes of BAPCPA and its means test; the primary purpose of which the Court viewed as "ensur[ing] that debtors who can pay creditors do pay them."[278] After

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[274] Id. at 356
[275] Ransom, 131 S.Ct. at 726
[276] Id. at 728 n.8
[277] Id. at 721, 726, 730
[278] See Ransom, 131 S.Ct. at 721. Considering the central role played by the purposes of BAPCPA in the Ransom Court's analysis, the Court does not spend much time discussing those purposes. The Court posits that BAPCPA's main purpose, as a whole, is to ensure that debtors pay the maximum they can afford. The House of Representatives Report cited by the Court introduces discussion of the 2005 Act's purpose as follows: "The purpose of the bill is to improve bankruptcy law and practice by restoring personal responsibility and integrity in the bankruptcy system and ensure that the system is fair for both debtors and creditors. H.R. Rep. No. 109-31, pt. 1, p. 2 (2005). Reading the House Report as a whole, it is apparent that BAPCPA is largely aimed at ensuring maximal repayment to creditors; but it is also apparent that there were other

Ransom, it is thus anticipated that lower courts will employ this purposive analysis when interpreting BAPCPA and its provisions, and perhaps to decipher meaning when interpreting other unresolved Bankruptcy Code provisions.

While it appears that the Court's purpose-driven approach will, in most instances, tip the balance toward the interpretation that maximizes creditor recovery, this approach does, however, also give bankruptcy courts discretion to look at a debtor's actual circumstances and what a debtor can realistically pay. Thus, although the implications of *Ransom* as a whole would appear to enhance creditor recoveries, there will also be situations – like that seen in *Lanning* – where debtors will benefit from a realistic discretionary approach. And although both *Lanning* and *Ransom* were decided in a chapter 13 means test context, these cases will have wide-ranging implications beyond the realm of chapter 13.

Conclusion

These recent Supreme Court cases, decided over less than a one-year period, demonstrate the Supreme Court's interest in addressing consumer bankruptcy issues, especially those arising from ambiguous BAPCPA provisions. These decisions establish guideposts for debtors, creditors and bankruptcy professionals as they work through these difficult interpretive issues. Further appellate developments will likewise assist in illuminating this post-BAPCPA landscape.

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motivating factors relating to consumer protection. Thus, even if the House Report is clear in stating BAPCPA's main purposes, it is difficult to boil down such a large and complex bill that involved various special interests and legislative compromises into one overarching purpose.

The Supreme Court's Decision in Stern v. Marshall: Analysis & Implications*

(working paper – comments welcome)

Professor Mark S. Scarberry
Pepperdine University School of Law
Malibu, California
mark.scarberry@pepperdine.edu

Abstract: This paper discusses the Supreme Court's June 23, 2011 decision in Stern v. Marshall, which held:

– that all core proceedings, including all counterclaims filed against creditors who have filed claims, arise under title 11 or arise in the case under title 11, with none being merely "related to" proceedings;
– that 28 U.S.C. § 157 must be interpreted to grant jurisdiction to bankruptcy judges to enter final judgments on all counterclaims filed against creditors who have filed claims, with all such counterclaims being core proceedings; and
– that Article III of the Constitution prohibits bankruptcy judges from entering final judgments on some counterclaims, even where the creditors have filed claims in the bankruptcy case.

The paper explains that the Court's decision, though perhaps modest in direct effect, fails to lay to rest continued questions about the possible vulnerability of the entire system of bankruptcy court jurisdiction. The paper also explains the circumstances under which bankruptcy courts have jurisdiction to enter final judgments on counterclaims. It discusses the rationales for the distinctions made by the Court, including issues of public rights, res judicata, and consent to jurisdiction.

I. Stern v. Marshall: Introduction

The Supreme Court's recent 5-4 decision in Stern v. Marshall[1] held that, "in one isolated respect," Congress's 1984 grant of jurisdiction to bankruptcy courts exceeds the constitutional limits set by Article III.[2] The Court split in a typical way. The opinion for the Court by Chief Justice Roberts was joined by Justices Scalia, Kennedy, Thomas, and Alito. (Justice Scalia also wrote a concurring opinion.) The dissenting opinion by Justice Breyer was joined by Justices

[1] 564 U.S. __, No. 10-179, slip op. (June 23, 2011).
[2] *Id.* at 38.

Ginsburg, Sotomayor, and Kagan. However, this was a kind of role reversal. The majority took an approach quite similar to Justice Brennan's plurality opinion – joined by Justices Marshall, Blackmun, and Stevens – in the Supreme Court's 1982 *Northern Pipeline* decision.[3] The dissent in Stern v. Marshall rejected Justice Brennan's approach.

Initially the Court's decision would seem to be an endorsement of the constitutionality of the bankruptcy courts' statutory jurisdiction, except for the "one isolated respect." That initial reaction would be incorrect. The decision does **not** hold that in other respects the jurisdiction currently granted to bankruptcy judges by statute is consistent with Article III.

A. The Constitutional Setting: *Northern Pipeline*, and Congress's Response

Congress restructured the bankruptcy courts and bankruptcy jurisdiction in 1984[4] in response to the Supreme Court's 1982 *Northern Pipeline* decision.[5] In *Northern Pipeline* the Court held that the system set up by the Bankruptcy Reform Act of 1978[6] violated the Constitution.[7] The 1978 Act gave bankruptcy judges authority that, under Article III of the

[3] Northern Pipeline Constr. Co. v. Marathon Pipe Line Co., 458 U.S. 50 (1982).
[4] *See* Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, 98 Stat. 333 (1984).
[5] 458 U.S. 50 (1982).
[6] Pub. L. 95-598, 92 Stat. 2590.
[7] Chapter 11 debtor Northern Pipeline sued Marathon in bankruptcy court, seeking "damages for alleged breaches of contract and warranty, as well as for alleged misrepresentation, coercion, and duress." *Id.* at 56. Justice Brennan's plurality opinion (which was joined by Justices Marshall, Blackmun, and Stevens) argued that the 1978 Bankruptcy Reform Act "ha[d] impermissibly removed most, if not all, of the 'essential attributes of the judicial power' from the Art. III district court, and ha[d] vested those attributes in a non-Art. III adjunct." *Northern Pipeline*, 458 U.S. at 87. The plurality opinion concluded that "[s]uch a grant of jurisdiction cannot be sustained as an exercise of Congress' power to create adjuncts to Art. III courts." *Id.*

The jurisdictional scheme was not severable and thus had to be invalidated in its entirety (though only prospectively, and with the Court's judgment stayed for a period that the Court thought would be sufficient for Congress to restructure the bankruptcy court system). *Id.* at 87-88. Chief Justice Rehnquist (in an opinion joined by Justice O'Connor) concurred only in the judgment. The Chief Justice argued that the Court need not reach (and thus should not reach) the broad question of the constitutionality of the bankruptcy court system, but should only hold that the exercise of jurisdiction over Northern Pipeline's claim against Marathon violated the requirements of Article III. *Id.* at 89-91. Though the Chief Justice thus disagreed with the breadth of the plurality's holding, he agreed that the jurisdictional scheme was not severable. *Id.* at 91-92. Thus the entire jurisdictional scheme had to be invalidated, according to the Chief Justice. *Id.*

Constitution, could only be exercised by judges who enjoyed the protections provided by Article III,[8] but it did not give them those protections.

The 1984 restructuring also failed to give bankruptcy judges the Article III protections, but it did restrict bankruptcy judges' jurisdiction, permitting them to enter judgments only in "core proceedings," including those listed in 28 U.S.C. § 157(b)(2). Such judgments would be reviewed on appeal, not on a de novo basis, but using the same standards of review used for other appeals.[9] Otherwise, absent consent of the parties,[10] the 1984 restructuring permits bankruptcy judges only to submit proposed findings of fact and conclusions of law to the district courts, subject to de novo review of "those matters to which any party has timely and specifically objected."[11] The nonexclusive list of "core proceedings" in § 157(b)(2) includes "counterclaims by the estate against persons filing claims against the estate."[12]

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[8] As noted below, Article III requires that judges hold lifetime appointments subject only to removal by impeachment, and that they receive salaries that cannot be reduced while they are in office.

[9] Stern v. Marshall, slip op. at 21.

[10] *See* 28 U.S.C § 157(c)(2). Consent normally cannot confer subject matter jurisdiction on a federal court. (It is true that a court has jurisdiction to determine its jurisdiction, Stoll v. Gottlieb, 305 U.S. 165 (1938), and as a practical matter the nonopposition of a party may affect a court's decision whether it has jurisdiction.) The question whether Article III concerns may be resolved by consent or waiver is more complex than generally thought. *See* infra note 83 and text accompanying notes 23-28, 38, 92 & 96.

[11] 28 U.S.C. § 157(c). Under 28 U.S.C. § 1334(a)-(b), bankruptcy jurisdiction is given to the district courts. Under 28 U.S.C. § 157(a), district courts then may refer (and uniformly have referred) bankruptcy matters to the bankruptcy courts, subject to the right of district courts to withdraw the reference under § 157(d).

Section 157(b)(1) then allows bankruptcy judges (with respect to such referred matters) to enter judgments in "all cases under title 11 [the Bankruptcy Code] and all core proceedings arising under title 11, or arising in a case under title 11." Section 157(b)(2) provides a nonexclusive list of "core proceedings," including, per § 157(b)(2)(C), "counterclaims by the estate against persons filing claims against the estate." (Note that, under § 157(b)(5), "personal injury tort and wrongful death claims" must be tried in the district court unless the district court chooses to abstain in favor of state court adjudication under the discretionary abstention provision in 28 U.S.C. § 1334(c)(1), and that bankruptcy courts have only limited power to estimate such claims. See 28 U.S.C. § 157(b)(2)(B).)

If the proceeding is not a core proceeding but instead merely is related to the bankruptcy case, then the bankruptcy judge may not enter judgment (absent consent of all the parties) but may hear the proceeding and submit proposed findings of fact and conclusions of law to the district court, which then will enter judgment "after reviewing de novo those matters to which any party has timely and specifically objected." See 28 U.S.C. § 157(c).

[12] 28 U.S.C. § 157(b)(2)(C).

B. An Initial Look at Article III and "Public Rights"

To the extent that "core proceedings" involve adjudication of "public rights," Congress's grant of jurisdiction over them to bankruptcy judges is valid. Such a grant is a permissible exercise of Congress's power under the Bankruptcy Clause[13] and is consistent with Article III.[14] That is not particularly comforting for the bankruptcy bench and bar: the Supreme Court has consistently refused to decide whether there are any bankruptcy proceedings at all that adjudicate "public rights."[15] In particular, the Court has explicitly refused to find that even "the restructuring of debtor-creditor relations, which is at the core of the federal bankruptcy power"[16] is a matter of public rights.[17]

It seems likely, though, that the Court eventually will so hold, or will hold that such central bankruptcy matters fit within a broader category of matters that can be given to non-Article III judges under a multi-factor analysis (as suggested at length by the dissent in Stern v. Marshall[18]). A shift of position by one Justice would lead to that result.

C. An Initial Look at Expansion of Jurisdiction By Way of Res Judicata Principles

On the positive side for bankruptcy court jurisdiction, it is clear – at least in the analogous context of Seventh Amendment jury trial rights – that principles of res judicata may

[13] U.S. CONST. art. I, sec. 8, cl. 4.
[14] *See infra* text accompanying notes 51-59 & 86-95.
[15] *See infra* text accompanying notes 51-59.
[16] *Northern Pipeline*, 458 U.S. at 71 (plurality opinion) (stating that such restructuring "may well be a public right," though inconsistently insisting, 458 U.S. at 69-70, that nothing could be a matter of public right unless the government was involved in the dispute);*see* Granfinanciera, S.A. v. Nordberg, 492 U.S. 33, 54 (1989) (explaining expansion of "public rights" concept since decision in *Northern Pipeline*, so that government involvement in a dispute is no longer required); Katchen v. Landy, 382 U.S. 323, 329-30 (1966) (stressing that resolution of claims allowance disputes is "of basic importance in the administration of a bankruptcy" (internal quotes and citation omitted) such that use of summary proceedings to resolve such disputes is "essential"). *Granfinanciera* and *Katchen* both dealt with the analysis of "public rights" and the effects of res judicata in the context of Seventh Amendment jury trial rights.
[17] *Granfinanciera*, 492 U.S. at 56 n. 11.
[18] Dissent by Justice Breyer, slip op. *passim*.

supplement the "public rights" analysis.[19] (It is not completely clear that the analysis in Seventh Amendment cases should be taken straight over into the context of disputes over Article III, but the Supreme Court has done so repeatedly.) This approach may expand the authority that bankruptcy judges otherwise may constitutionally exercise. Such an expansion is particularly likely with respect to counterclaims against creditors who have filed claims against the estate. The issues that must be resolved to allow or disallow the claim may be dispositive of the counterclaim. If that is so, then the bankruptcy judge's jurisdiction over the claims allowance process may effectively give the bankruptcy judge authority to resolve the counterclaim.

For example, after a creditor files a claim, the trustee may object to it on the basis that the creditor received a prepetition payment that is an avoidable preference;[20] the trustee then may file a counterclaim (in this context by way of an adversary proceeding) to recover the preference. If the creditor received an avoidable preference, the bankruptcy court must disallow the creditor's claim, until and unless the creditor pays it back to the estate.[21] To determine allowability of the claim, the bankruptcy court must decide (1) whether the creditor received an avoidable preference, and (arguably) if so (2) the amount that the creditor has to pay back to the estate before the claim can be allowed. Once that is done there will be nothing left to decide on the preference counterclaim. As a result, the bankruptcy court may enter judgment on the preference counterclaim under res judicata (claim and issue preclusion) principles. Thus, if the bankruptcy court has authority to decide whether the claim should be allowed, the bankruptcy court effectively will have authority to decide the preference counterclaim.[22]

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[19] *See Granfinanciera* at 57-58 (relying on *Katchen*, which had relied on res judicata analysis).
[20] *See* 11 U.S.C. § 502(d).
[21] *Id.*
[22] *See* Katchen v. Landy, 382 U.S. 323, 333-38 (1966) (holding on such facts that res judicata principles allow the bankruptcy court to enter judgment without the necessity of a jury trial).

Note that the issue in *Katchen* was whether the creditor who had filed a claim had a Seventh Amendment right to jury trial on the counterclaim that was brought to recover a preference. It might be thought that under

D. An Initial Look at Expansion of Jurisdiction by Consent

Subject matter jurisdiction ordinarily cannot be conferred by waiver or consent (subject to the principle that a court has jurisdiction to determine its jurisdiction and that such a determination may not be collaterally attacked[23]). There an analogous limit to the extent that consent or waiver can cure violations of Article III. The requirement that the judicial power of the United States be exercised only by Article III courts is part of the structural support for the separation of powers, a feature of the Constitution that protects each branch of the federal government from the others:

> To the extent that this structural principle is implicated in a given case, the parties cannot by consent cure the constitutional difficulty for the same reason that the parties by consent cannot confer on federal courts subject-matter jurisdiction beyond the limitations imposed by Article III, § 2. When these Article III limitations are at issue, notions of consent and waiver cannot be dispositive because the limitations serve institutional interests that the parties cannot be expected to protect.[24]

In addition, the Supreme Court recently has questioned the voluntariness (and thus the effectiveness) of consent by creditors to bankruptcy procedures.[25]

Beacon Theatres, Inc. v. Westover, 359 U.S. 500 (1959), and Dairy Queen, Inc. v. Wood, 369 U.S. 469 (1962), the counterclaimant would be entitled to trial by jury of issues common both to the equitable claim for a share of the bankruptcy estate and to the legal claim of the trustee for a monetary recovery in the preference action. The Court in *Katchen* held that it was essential to permit claims allowance to be decided in equity without a jury, and thus that an exception had to be made to the *Beacon Theatres* and *Dairy Queen* doctrine. *Katchen* at 338-40.

The Supreme Court in Stern v. Marshall seems to have rejected an alternative reading of *Katchen* (and of Langenkamp v. Culp, 498 U.S. 42 (1990)), under which a creditor's filing of a claim is considered an invocation of the bankruptcy court's equity powers sufficient to allow the bankruptcy court to use those powers to handle any bankruptcy-related issue involving the creditor. *See* Stern v. Marshall, 564 U.S. __, No. 10-179, slip op. at 29-33 (June 23, 2011).

[23] Stoll v. Gottlieb, 305 U.S. 165 (1938).

[24] Commodities Futures Trading Comm'n v. Schor, 478 U.S. 833, 850-51 (concluding, however, that the CFTC counterclaim jurisdiction did not violate Article III – partly because of the truly free choice that the counterclaim defendant had in deciding whether to invoke the CFTC dispute resolution system – nor did it implicate separation of powers concerns).

[25] *Granfinanciera*, 492 U.S. at 59 n. 14. The Court in *Granfinanciera* noted that a waiver argument, applied in contexts like that in *Schor* – that a party who invokes the power of a nonjury forum waives the right to jury trial of counterclaims in that forum – "is unavailable in the context of bankruptcy proceedings, because creditors lack an alternative forum to the bankruptcy court in which to pursue their claims." The Court explained that such a waiver argument was not the basis for the holding in *Katchen* (the holding that a party who files a proof of claim is not

Section 157(c)(2)[26] provides jurisdiction to bankruptcy courts to enter final judgments in noncore proceedings if all the parties consent. In this context, it seems clear that any explicit consent would be truly voluntary. Such consensual jurisdiction probably does not threaten separation of powers sufficiently to preclude consent from being effective.[27] But it does not seem that consent to jurisdiction over counterclaims can be implied from the mere filing of a claim, even where the claim and counterclaim are closely related.[28]

II. Stern v. Marshall: The Basics

A. The Basic Facts, Including Prior Proceedings[29]

Vickie Marshall (J. Howard Marshall's widow) and Pierce Marshall (one of J. Howard's sons) were involved in litigation over J. Howard's massive fortune. J. Howard's estate plan gave Pierce the bulk of his assets and gave Vickie nothing (beyond the substantial gifts he had given her during their brief marriage). Even before J. Howard died, Vickie had sued in a Texas probate court, seeking to invalidate J. Howard's estate plan, because of alleged fraud and undue influence on the part of Pierce. Pierce then sued Vickie (and her attorneys) in a Texas court, claiming damages for defamation. When Vickie filed a chapter 11 bankruptcy petition in California, Pierce dismissed his Texas defamation suit, filed an adversary proceeding in Vickie's chapter 11 case seeking a declaration that any defamation liability was nondischargeable, and then filed a claim in the chapter 11 case for damages for defamation. Vickie then filed a

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entitled to a jury trial on a counterclaim, where the claims allowance process will resolve issues that are determinative on the counterclaim).

Citing *Granfinanciera*, the Supreme Court in Stern v. Marshall held that "Pierce did not truly consent to resolution of Vickie's claim in the bankruptcy court proceedings. He had nowhere else to go if he wished to recover from Vickie's estate." Slip op. at 27.

[26] 28 U.S.C. § 157(c)(2).

[27] *See Schor*, 478 U.S. at 850-51; Stern v. Marshall, slip op. at 14 (citing § 157(c)(2) approvingly). Note, however, the strong language near the very end of the Court's opinion. *See* slip op. at 37-38.

[28] *See supra* notes 22 (final paragraph) and 25.

[29] These facts (as well as the more detailed facts set out below) are taken from the Ninth Circuit's opinion, Marshall v. Stern (In re Marshall), 600 F.3d 1037 (2010), which was affirmed by the Supreme Court in Stern v. Marshall.

counterclaim in the Bankruptcy Court against Pierce, alleging he had tortiously interfered with her expectation of much larger gifts (or bequests) from J. Howard. Vickie also amended her Texas probate court complaint to add a similar tort cause of action.

The Bankruptcy Court entered a judgment awarding Vickie almost half a billion dollars. Vickie dismissed her Texas probate court claims against Pierce, but Pierce then sought declaratory relief in the Texas probate court case, asking it to determine that Vickie had no right to any of J. Howard's assets, and asking it to declare that J. Howard's estate planning documents "reflected his true intentions and were valid."[30] A jury in the Texas probate action found for Pierce, and the Texas probate court entered judgment for him. On Pierce's appeal from the Bankruptcy Court's judgment, the District Court held that the Bankruptcy Court lacked jurisdiction to enter a final judgment but then entered its own judgment against Pierce for almost a hundred million dollars (after holding that, under res judicata principles, the Texas probate court decision did not require judgment for Pierce).

The Ninth Circuit reversed, holding that the probate exception to federal jurisdiction applied, and that the federal courts thus lacked jurisdiction over Vickie's counterclaim. Marshall v. Marshall (In re Marshall), 392 F.3d 1118 (9th Cir. 2004). On the case's first trip to the Supreme Court, the Supreme Court reversed and remanded, holding that the probate exception did not apply. Marshall v. Marshall, 547 U.S. 293 (2006).

On remand, the Ninth Circuit held that the Bankruptcy Court lacked statutory jurisdiction to enter a final judgment, because, as the Ninth Circuit interpreted § 157(b)(2), Vickie's counterclaim, though a "core proceeding" under that term as used in the statute, did not arise under title 11 or arise in a title 11 case. As a result, the Texas probate court judgment was the first final judgment (because it preceded the District Court judgment). Under res judicata

[30] Marshall v. Stern, 600 F.3d at 1047.

principles,[31] the Texas probate court judgment controlled, requiring judgment for Pierce on Vickie's counterclaim in the Bankruptcy Court. Marshall v. Stern (In re Marshall), 600F.3d 1037 (2010). Thus Pierce prevailed over Vickie once again in the Ninth Circuit (or, more accurately – since both Pierce and Vickie had died – Pierce's executor, Elaine T. Marshall, prevailed over Vickie's executor, Howard K. Stern).

B. The Basics: Issues, Approaches, and Holdings

The Supreme Court granted certiorari, bringing the case to the Supreme Court for the second time. The main issues before the Supreme Court in Stern v. Marshall were (1) whether 28 U.S.C. § 157(b)(2)(C) should be interpreted to grant the bankruptcy court jurisdiction to enter a final judgment on Vickie's counterclaim, and (2) whether such a grant of jurisdiction would violate the Constitution.[32]

On the first issue, the Court held that the language and structure of § 157(b) required that it be interpreted to classify Vickie's counterclaim as a core proceeding over which the statute granted jurisdiction to the Bankruptcy Court. It was a counterclaim against a creditor who had filed a claim against the estate, and thus a core proceeding under § 157(b)(2)(C).[33] As a core proceeding, it necessarily arose under the Bankruptcy Code or arose in Vickie's bankruptcy

[31] Res judicata principles pervade the litigation between Pierce and Vickie. There is the question whether res judicata principles expanded the Bankruptcy Court's jurisdiction so that it could enter a final judgment on Vickie's counterclaim. If so, there would be a valid judgment in Vickie's favor that could not be precluded (under res judicata principles) by the Texas probate court's later judgment. But if the Bankruptcy Court did not have jurisdiction to enter a final judgment, so that the only final judgment *in the bankruptcy litigation* was the one entered by the District Court, then the Texas probate court's judgment would be the first final judgment. Then the question would be whether, under res judicata principles, the Texas probate court's judgment controlled, requiring judgment for Pierce on Vickie's bankruptcy court counterclaim.

[32] Stern v. Marshall, slip op. at 2, 11, 16.

[33] *Id.* at 8, 11.

case.[34] Thus, as a matter of statutory authority, the Bankruptcy Court could enter final judgment under § 157(b)(1).[35]

On the second issue, the Supreme Court considered all three ways in which an exercise of such jurisdiction might be constitutional: the public rights approach, the res judicata approach, and the consent approach. The Court held that Vickie's counterclaim against Pierce was not a matter of public rights.[36] It also held, in effect, that res judicata principles did not apply to allow the Bankruptcy Court to exercise jurisdiction.[37] And it held that Pierce's filing of a claim in Vickie's case did not constitute consent to bankruptcy court jurisdiction over her counterclaim.[38]

Because the Bankruptcy Court's judgment was invalid, the Texas probate court's judgment was the first final judgment. As a result, res judicata required that Pierce be granted judgment on Vickie's counterclaim.[39]

Thus the Court held that, "in one isolated respect," the 1984 restructuring still violates the Constitution.[40] As noted above, that would seem on first glance to be an endorsement of the restructuring's constitutionality, except for the "one isolated respect." However, the decision does **not** hold that in other respects the 1984 restructuring is consistent with Article III.[41]

II. Article III, Suits in Equity, and "Public Rights"

Under Article III, "[t]he judicial Power of the United States"[42] may be exercised only by judges who "enjoy life tenure, subject only to removal by impeachment,"[43] and whose salaries

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[34] *Id.* at 9-11.
[35] *Id.* at 11, 16.
[36] *Id.* at 19-29.
[37] *Id.* at 30-33.
[38] *Id.* at 27.
[39] *Id.* at 6, 38.
[40] *Id.* at 38.
[41] *See id.* at 27 n. 7.
[42] U.S. CONST. art. III.
[43] *Northern Pipeline*, 458 U.S. at 59 (explaining the Article III requirement that judges "hold their Offices during good Behaviour").

are protected against any reduction "during their Continuance in Office."[44] Bankruptcy judges did not enjoy those protections under the provisions of the 1978 Bankruptcy Reform Act. They were appointed by the President for fourteen-year terms, could be removed during their fourteen-year terms by circuit judicial council action rather than only by impeachment, and were given salaries that could be reduced by Congress.[45] Under the 1984 restructuring, bankruptcy judges still do not enjoy the Article III protections. They still are still appointed only for fourteen-year terms (though now by the circuit courts), still are subject to removal by circuit judicial council action, and still do not enjoy protection against salary reduction.[46] Thus they still may not exercise "[t]he judicial Power of the United States."

Bankruptcy courts are often described as courts of equity.[47] It is clear that the determination to allow or disallow a claim against the bankruptcy estate is equitable in nature.[48] However, it is important to understand that the judicial power of the United States includes cases in equity: "[W]e have long recognized that, in general, Congress may not 'withdraw from judicial cognizance any matter which, from its nature, is the subject of a suit at the common law, or in equity, or admiralty.' "[49] As a general matter there is no right to jury trial in equity, and it is true that there is overlap between the issue of whether there is a right to jury trial and the issue of whether a dispute may be assigned to a non-Article III tribunal.[50] But abuses by courts exercising equity powers – and thus acting without any check from a jury – were in the minds of the

[44] U.S. CONST. art. III; *Northern Pipeline*, 458 U.S. at 59.
[45] *Northern Pipeline*, 458 U.S. at 60-61.
[46] *See* 28 U.S.C. § 152(a), (e); Stern v. Marshall, slip op. at 2, 19.
[47] *See, e.g.*, Katchen v. Landy, 382 U.S. 323, 326-27 (1966). *But see* Granfinanciera, S.A. v. Nordberg, 492 U.S. 33, 57-58 (1989) (noting that bankruptcy courts acted as courts of equity when they exercised summary jurisdiction but that they also had jurisdiction at law).
[48] *See, e.g.*, Langenkamp v. Culp, 498 U.S. 42, 44 (1990); *Granfinanciera*, 492 U.S. at 58-59.
[49] Stern v. Marshall, 564 U.S. __, slip op. at 18 (quoting from Murray's Lessee v. Hoboken Land & Improvement Co., 59 U.S. (18 How.) 272, 284 (1856)).
[50] *See, e.g.*, *Granfinanciera*, 492 U.S. at 53-54 (applying Article III public rights cases to determination of whether there was Seventh Amendment right to jury trial.)

Founders when they insisted that the independence of federal judges be protected by life tenure and by a guarantee that the judges' salaries could not be reduced. Thus assignment of judicial matters to non-Article III judges cannot be justified on the basis that the matters are in equity.

The Supreme Court has recognized that Congress may assign adjudication of some disputes to non-Article III judges, namely disputes involving "public rights."[51] However, in at least three cases the Court has held that particular proceedings in bankruptcy cases did not involve public rights,[52] and the Court has not yet held that a particular proceeding in any bankruptcy case did involve public rights.[53] The Court's analysis at times has seemed to assume that "the restructuring of debtor-creditor relations, which is at the core of the federal bankruptcy power"[54] involves public rights, but in each case the Court has made clear that it is making no decision to that effect.

The plurality in *Northern Pipeline* noted that "restructuring of debtor-creditor relations … *may well be* a public right" – a less than ringing endorsement of that proposition – but that the "state-created" claim for contract damages at issue in that case "obviously is not."[55] In *Granfinanciera*, the Court contrasted the fraudulent conveyance actions at issue in the case (which the Court held not to involve public rights) with "creditors' hierarchically organized claims to a pro rata share of the bankruptcy res." Relying on *Northern Pipeline*, the Court concluded that the fraudulent conveyance actions "therefore appear matters of private rather than public right."[56] But the Court pulled back, stating in a footnote:

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[51] *See id.* at 52-56; *Northern Pipeline*, 458 U.S. at 67-72 (plurality opinion). The nature of "public rights" is discussed above in the text accompanying notes 13-18, and below in the text accompanying notes 52-59 and 86-95.
[52] *See* Stern v. Marshall, slip op. at 22-29; *Granfinanciera*, 492 U.S. at 55-62; *Northern Pipeline*, 458 U.S. at 63-76 & 91 (plurality and Chief Justice Rehnquist's opinion concurring in judgment, respectively).
[53] *See* Marshall v. Stern (In re Marshall), 600 F.3d 1037, 1053 n. 23 (9th Cir. 2010), *aff'd*, 564 U.S. __, No. 10-179, slip op. (June 23, 2011).
[54] *Northern Pipeline*, 458 U.S. at 71.
[55] *Id.* (emphasis added).
[56] *Granfinanciera*, 492 U.S. at 56 and 56 n. 12.

> We do not suggest that the restructuring of debtor-creditor relations is in fact a public right. This thesis has met with substantial scholarly criticism … and we need not and do not seek to defend it here. Our point is that even if one accepts this thesis, the Seventh Amendment entitles petitioners to a jury trial.[57]

And then, in Stern v. Marshall, the Court held that Vickie Marshall's counterclaim did not involve a public right.[58] The Court recounted its analysis from *Granfinanciera* and then once again refused to endorse the idea that the restructuring of the debtor-creditor relationship in bankruptcy was a matter of public right:

> We noted [in *Granfinanciera*] that we did not mean to "suggest that the restructuring of debtor-creditor relations is in fact a public right." Our conclusion was that, "even if one accepts this thesis," Congress could not constitutionally assign resolution of the fraudulent conveyance action to a non-Article III court. Because neither party asks us to reconsider the public rights framework for bankruptcy, we follow the same approach here.[59]

III. Stern v. Marshall: A More Detailed Look

A. Events Leading up to Vickie Marshall's Chapter 11 Filing[60]

Vickie Marshall (then Vickie Lynn Smith, aka Anna Nicole Smith) met J. Howard Marshall II, a much older self-made Texas oil tycoon, in October 1991. Nine years earlier, J. Howard had transferred most of his property into a revocable trust. J. Howard was the income beneficiary under the trust instruments, and he was entitled to use the trust assets as collateral for loans.[61] In December 1992, J. Howard executed estate planning documents, including a pour-over will (under which any property he might have outside the trust on his death would be poured over into the trust) and a directive asking that his younger son Pierce Marshall serve as J. Howard's guardian, should the need arise. Vickie and J. Howard married on June 27, 1994, and a

[57] *Id.* at 56 n. 11 (citations omitted).
[58] Stern v. Marshall, 564 U.S. __, slip op. at 21-29.
[59] *Id.* at 27 n.7 (citations omitted).
[60] These facts are taken from the Ninth Circuit's opinion, Marshall v. Stern (In re Marshall), 600 F.3d 1037 (2010), which was affirmed by the Supreme Court in Stern v. Marshall.
[61] Marshall v. Stern, 600 F.3d at 1041.

few days later J. Howard amended the trust to make it irrevocable. Under the will and the trust instruments, Pierce would receive most of the assets on J. Howard's death, and Vickie would receive nothing (beyond the substantial gifts J. Howard gave her during their short marriage).

J. Howard died in August, 1995, but, before he died, Vickie sued in Texas probate court, claiming J. Howard executed the will and made the trust irrevocable as a result of fraud and undue influence on the part of Pierce. Pierce then sued Vickie and her lawyers in Texas, claiming they had defamed him.[62]

B. Proceedings in the Bankruptcy Court and in the Texas Probate Court[63]

In January 1996, Vickie filed a chapter 11 petition in the Central District of California. Pierce then dismissed her from his Texas defamation suit without prejudice but commenced an adversary proceeding in her bankruptcy case by filing a complaint under § 523(a)(6) seeking a declaration that any liability she might have for defaming him was a willful and malicious injury and thus not be dischargeable. A month later he filed a proof of claim for damages for the alleged defamation. Vickie answered Pierce's nondischargeability complaint, pleading *inter alia* truth as a defense; she also filed a counterclaim against Pierce in the bankruptcy court, seeking damages for his alleged tortious interference with her expectation of a gift. Vickie also joined a will contest that Pierce's disinherited older brother had filed in 1995 after J. Howard's death.

The Bankruptcy Court denied Pierce's motions to dismiss the counterclaim for lack of jurisdiction and to abstain in favor of the Texas proceedings. Meanwhile, in March 1999, Vickie's chapter 11 plan was confirmed; it provided that any recovery on her counterclaim against Pierce would be used to pay creditors in full, with any remaining amounts going to

[62] *Id.* at 1043 n.10. As noted below, Pierce dismissed his Texas defamation suit after Vickie filed her chapter 11 petition. *Id.*

[63] The account of these proceedings is based on the Ninth Circuit's 2010 opinion, which was affirmed by the Supreme Court in Stern v. Marshall.

Vickie. In October 1999, the adversary proceeding went to trial in the Bankruptcy Court. The court quickly granted Vickie summary judgment on Pierce's defamation claim. In January 2000, Vickie amended her complaint in the Texas action to include her claim that Pierce had tortiously interfered with her expectation of receiving gifts from J. Howard. Then, in late 2000, the Bankruptcy Court awarded Vickie a judgment of almost half a billion dollars on her counterclaim. She then dismissed her claims against Pierce in the Texas probate action, despite the probate judge's warning that she would be giving up any chance of obtaining a probate court judgment against Pierce.

Pierce then filed counterclaims against Vickie in the Texas probate court, seeking a declaration that Vickie had no rights against J. Howard's trust and estate and that J. Howard's will and amended trust "reflected his true intentions and were valid."[64] Pierce's counterclaims were tried to a jury, which found for Pierce. In December 2001, the Texas probate court "entered judgment in favor of Pierce … and held that Pierce … was entitled to his inheritance, free from all claims by Vickie" or by J. Howard's other son.[65]

C. Pierce's Appeals, and the First Trip to the Supreme Court

Pierce had appealed the Bankruptcy Court's nearly half billion dollar judgment to the District Court. He sought dismissal of Vickie's claims on res judicata (claim and issue preclusion) grounds, based on the Texas judgment. Apparently he argued, as he had earlier, that the Bankruptcy Court lacked jurisdiction to enter a final judgment on Vickie's counterclaim;[66] thus the Texas judgment should have been given preclusive effect as the first (and in fact only) final judgment on her counterclaim. The District Court vacated the Bankruptcy Court's judgment, ruling that Vickie's counterclaim was not a core proceeding, and thus that the

[64] Marshall v. Stern, 600 F.3d at 1046-47.
[65] *Id.* at 1047.
[66] *Id.* at 1047-48

Bankruptcy Court did not have jurisdiction to enter a judgment.[67] But the District Court held that the Texas judgment did not decide issues that would preclude Vickie from pursuing her counterclaim. After taking new evidence, the District Court held for Vickie and, on March 7, 2002, entered a judgment against Pierce for about $90 million.[68]

The Ninth Circuit reversed, holding that the probate exception to federal jurisdiction required that the District Court's judgment be vacated.[69] The Supreme Court granted certiorari, reversed the Ninth Circuit on the probate exception issue, and remanded for consideration of other issues, including whether Vickie's counterclaim was a core proceeding and whether the Texas probate court judgment should be given res judicata effect .[70]

D. Ninth Circuit Opinion on Remand

On remand, the Ninth Circuit held that Vickie's counterclaim for tortious interference with her expectation of receiving a gift was not a core proceeding that arose under title 11 or that arose in a title 11 case, but rather a core proceeding that was only related to the title 11 case. Thus the Bankruptcy Court did not have jurisdiction to enter a judgment under 28 U.S.C. § 157(b)(1). According to the Ninth Circuit, constitutional limitations on bankruptcy court jurisdiction under the Supreme Court's *Northern Pipeline* decision required that the court use a two-step approach (to prevent the statute from being interpreted in a way that would create constitutional problems): a proceeding is a core proceeding on which a bankruptcy court may enter a judgment, only if (1) the claim falls within the statutory definition of a "core proceeding," and (2) the claim arises under title 11 or arises in the title 11 case.[71]

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[67] *Id.* at 1048.
[68] *Id.* at 1048-49.
[69] Marshall v. Marshall (In re Marshall), 392 F.3d 1118 (9th Cir. 2004).
[70] Marshall v. Stern, 600 F.3d at 1049; Marshall v. Marshall, 547 U.S. 293 (2006).
[71] Marshall v. Stern, 600 F.3d at 1055.

Thus the Ninth Circuit held that some "core proceedings" were only related to the bankruptcy case, and did not arise under title 11 or arise in the title 11 bankruptcy case. But § 157(b)(1) only grants bankruptcy judges authority to enter judgments in "core proceedings *arising under title 11, or arising in a case under title 11*." (Emphasis added.) It followed, according to the Ninth Circuit, that there were "core proceedings" – within the meaning of that term in § 157(b) – in which § 157(b)(1) did not grant bankruptcy judges the authority to enter judgments.

Thus, although Vickie's counterclaim was a core proceeding as defined in § 157(b), and even was a compulsory counterclaim, the statute did not grant the bankruptcy judge authority to enter a judgment on her counterclaim. Her counterclaim did not arise under title 11 or arise in a case under title 11; it was only related to the bankruptcy case, "because it was not so closely related to Pierce Marshall's defamation claim that it must be resolved in order to determine the allowance or disallowance of his claim against her bankruptcy estate."[72] There would be "differences in proof between the two claims" and "little overlap of the legal elements of the claims."[73] The Ninth Circuit's analysis thus focused on factors that seem most relevant to issues of res judicata (claim and issue preclusion). As discussed below, that was the correct focus, though the court erred as a matter of statutory interpretation in using its "two-step" approach.

Because, in the Ninth Circuit's view, the Bankruptcy Court did not have jurisdiction to enter a judgment, the Texas probate court's 2001 judgment was the first final judgment, coming before the District Court's 2002 judgment. The Ninth Circuit held that the issues decided by the Texas probate court precluded Vickie from succeeding on her counterclaim in the Bankruptcy

[72] *Id.* at 1059.
[73] *Id.* at 1060.

Court.[74] Thus it reversed the District Court and remanded for entry of judgment in favor of Pierce's estate (both Pierce and Vickie having died during the long litigation).[75] The Supreme Court then granted certiorari.[76]

E. The Supreme Court's Decision in Stern v. Marshall

1. Did the Bankruptcy Court Have Jurisdiction under the Terms of the Statute?

The Supreme Court rejected the Ninth Circuit's "two step" approach to determining whether the statute granted (or attempted to grant) bankruptcy judges authority to enter judgments on core proceedings.[77] Vickie's proceeding was a "core proceeding" within the plain meaning of 28 U.S.C. § 157(b)(2)(C).[78] And, under the only reasonable interpretation of § 157(b)(1), all core proceedings arise under title 11 or arise in the title 11 case.[79]

The statute provides for treatment of core proceedings arising under title 11 or arising in the title 11 case, and it provides for treatment of proceedings that are merely related to the title 11 case. It is silent on the treatment of any supposed core proceedings that might not arise under title 11 or arise in the title 11 case. The Court found it "hard to believe" that Congress would fail to provide for such supposed core proceedings.[80] Further, the Court argued that "[i]t does not make sense to describe a 'core' bankruptcy proceeding as merely 'related to' the bankruptcy case; oxymoron is not a typical feature of congressional drafting."[81] Section 157(b)(3) "instructs" bankruptcy judges to determine whether a proceeding is (1) a core proceeding arising under title 11 or arising in a title 11 case, or (2) a proceeding merely related to the title 11 case. Those are

[74] *Id.* at 1060-64.
[75] *Id.* at 1040, 1040 n.1, 1065.
[76] 561 U.S. __, 131 S. Ct. 63 (2010).
[77] Stern v. Marshall, 564 U.S. __, slip op. at 5, 8-11.
[78] *Id.* at 8.
[79] *Id.* at 9-11.
[80] *Id.* at 10.
[81] *Id.* at 9-10.

the only choices: "Two options. The statute does not suggest that any other distinctions need be made."[82]

Because Vickie's counterclaim was a "core proceeding" (and thus necessarily) "arising under title 11, or arising in a case under title 11," § 157(b)(1) granted the bankruptcy judge authority, as a statutory matter, to enter a judgment on the counterclaim.[83] But the question then was whether that grant of authority violated the Constitution.

2. Did the Statutory Grant of Jurisdiction Violate the Constitution?

a. The Purposes of the Limitations in Article III

The Court recognized that "the three branches are not hermetically sealed from one another."[84] But the Court stressed the importance of the limits in Article III on who could exercise the judicial power of the United States. They protect the principles of separation of powers, principles that not only protect each branch of government from the others but also protect individual rights. The limits in Article III also protect individual rights more directly by limiting the influence that could be brought to bear on federal judges and thus helping to "preserve the integrity of judicial decisionmaking."[85]

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[82] *Id.* at 10.
[83] *Id.* at 11. The Court rejected Pierce's argument that the bankruptcy court lacked jurisdiction because his defamation claim was a "personal injury tort" claim under § 157(b)(5). According to Pierce, the Court could decide the case "easily" and avoid deciding the constitutional issue by accepting his view of the § 157(b)(5) issue. The Court declined to decide that issue, because Pierce had consented to trial of his defamation claim in the bankruptcy court. The Court held that § 157(b)(5) was not jurisdictional, and thus that Pierce's consent was effective to give the bankruptcy court authority under the statute to decide his defamation claim, even if his claim was for a "personal injury tort." Slip op. at 12-16. The Court also noted that, if it addressed the issue of whether his claim was a "personal injury tort" claim, the Court would be "confronted with several questions on which there is little consensus or precedent." Slip op. at 13 n. 4.
[84] Slip op. at 17
[85] *Id.* at 17-18.

b. A Matter of Public Right?

The Court held that Vickie's counterclaim did not involve a matter of public right (just as the Court had held with respect to the contract-related suit in *Northern Pipeline*).[86] The Court gave a multitude of reasons for that conclusion (to the chagrin of Justice Scalia[87]), and stated several formulations of the test, none of which Vickie's counterclaim could satisfy. Though the Court had recognized that a matter could involve public rights even if the federal government were not a party, "what makes a right 'public' rather than private is that the right is integrally related to particular federal government action."[88] Or perhaps it must be "closely intertwined with a federal regulatory program."[89] Or perhaps, in the bankruptcy context, rights must be characterized as private if they "resemble state law … claims brought … to augment the estate" as opposed to "creditors' hierarchically ordered claims to a pro rata share of the bankruptcy res."[90] It was important to the Court that "Vickie's claimed right to relief d[id] not flow from a federal statutory scheme,"[91] and somehow important in the public rights analysis that "Pierce did not truly consent"[92] to the bankruptcy court's jurisdiction. Bankruptcy courts' statutory jurisdiction to decide counterclaims like Vickie's were not limited to a "particularized area of the law,"[93] nor did the case involve an agency deciding limited factual matters that it could resolve inexpensively with its expertise.[94] The Court concluded that

[86] *Id.* at 22.
[87] Stern v. Marshall, concurring opinion by Justice Scalia, slip. op. at 1-2.
[88] Stern v. Marshall, slip op. at 25 (majority opinion).
[89] *Id.* at 26 (quoting *Northern Pipeline*).
[90] *Id.* at 27.
[91] *Id.*
[92] *Id.*
[93] *Id.* at 28 (quoting *Northern Pipeline*).
[94] *Id.*

> [w]hat is plain here is that this case involves the most prototypical exercise of judicial power: the entry of a final, binding judgment *by a court* with broad substantive jurisdiction, on a common law cause of action, when the action neither derives from nor depends upon any agency regulatory regime.[95]

c. The Effect of Pierce's Filing of a Claim (including Issues of Consent and Res Judicata)

As noted above, the Court refused to treat Pierce's filing of a claim as consent to the bankruptcy court exercising jurisdiction over Vickie's counterclaim. "Pierce did not truly consent to resolution of Vickie's claim in the bankruptcy court proceedings. He had nowhere else to go if he wished to recover from Vickie's estate."[96]

The Court also refused to treat Pierce's filing of a claim as changing the nature of her counterclaim. It still was a common law action brought to "augment the bankruptcy estate," just the kind that *Northern Pipeline* and *Granfinanciera* require "be decided by an Article III court."[97]

The Court held that *Katchen* and Langenkamp v. Culp[98] did not permit a non-Article III court to decide Vickie's counterclaim just because Pierce had filed a claim. Those cases depended essentially on the res judicata analysis discussed above,[99] which did not apply here, because a decision on allowability of Pierce's claim would not resolve Vickie's counterclaim.[100] It was not sufficient that the claim and counterclaim were related, not even that they were sufficiently related that lower courts had treated Vickie's counterclaim as compulsory.[101] Even if the court disallowed Pierce's defamation claim by finding that Vickie's statements about his misconduct were true, the court would still have to decide whether Texas would allow a tort

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[95] *Id.* at 29 (emphasis in original).
[96] *Id.* at 27; *see id.* at 28 n. 8.
[97] *Id.* at 30.
[98] 498 U.S. 42 (1990).
[99] *Id.* at 30-33.This conclusion is undoubtedly true for *Katchen* but is less clearly the case for *Langenkamp*.
[100] Stern v. Marshall, slip op. at 30-33.
[101] *Id.* at 32.

action for interference with an expected gift and to decide what the elements of the tort would be.[102] Vickie would also still have to show, among other matters, "(1) the existence of an expectancy of a gift; (2) a reasonable certainty that the expectancy would have been realized but for the interference; and (3) damages."[103] She also would have to show facts justifying the requested punitive damages.[104]

The Court did depart somewhat from a normal res judicata analysis. The normal approach would be to wait until a final judgment is entered in one matter, and then to determine whether what was decided would justify claim or issue preclusion in another action that had not yet gone to final judgment. Here, though, the Court focused on what could have been expected at the time the bankruptcy court decided to take jurisdiction of the counterclaim. "[T]here was never any reason to believe that the process of adjudicating Pierce's proof of claim would necessarily resolve Vickie's counterclaim."[105] "From the outset it was clear that … the court could not enter judgment for Vickie [on her counterclaim] unless the court additionally ruled on" other questions. Perhaps the Supreme Court wants bankruptcy courts to know at the beginning of a combined claims-allowance and counterclaim hearing whether the bankruptcy court has jurisdiction over the counterclaim. That could justify a prospective approach in place of the usual retrospective approach to res judicata.

The Court also suggested that the result might have been different had Vickie's counterclaim asserted "a right of recovery created by bankruptcy law,"[106] or if it "stem[med] from the bankruptcy itself."[107] Perhaps this suggestion is a nod in the direction of Langenkamp v.

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[102] *Id.* at 32-33.
[103] *Id.* at 33.
[104] *Id.*
[105] *Id.* at 32.
[106] *Id.* at 33.
[107] *Id.* at 34.

Culp, which, from its text, is not obviously based on a res judicata analysis, even though the Court in Stern v. Marshall says that it is.[108] That suggestion does not seem to fit in the place the Court put it in the opinion, and in its reliance on *Granfinanciera* seems to be a non sequitur. Perhaps it will turn out to be a hidden jewel (or a time-bomb depending on your point of view), that was added at the last minute, in response to a Justice's concerns.

d. Bankruptcy Courts as True Adjuncts of the District Courts?

The Court gave short shrift to Vickie's argument that Article III concerns had been resolved by the 1984 restructuring because the restructuring somehow made the bankruptcy courts true adjuncts of the district courts. Under the 1984 restructuring, bankruptcy judges still would "exercise the essential attributes of judicial power over a matter such as Vickie's counterclaim," with the power to enter final judgments subject only to review by appeal.[109] Thus "a bankruptcy court can no more be deemed a mere 'adjunct' of the district court than a district court can be deemed such an 'adjunct' of the court of appeals."[110] Appointment by the circuit courts rather than by the President (as was the case under the 1978 scheme) does not allow bankruptcy judges to be treated as adjuncts that may exercise the district courts' power; bankruptcy judges still would not have the independence that Article III demands.[111]

e. Overriding Practical Concerns?

Finally, the Court noted that efficiency could not justify violation of the Constitution, and rejected predictions that its decision would "create significant delays and impose additional costs on the bankruptcy process."[112] The Court denied that its decision "meaningfully changes the

[108] *Id.* at 30-33.
[109] *Id.* at 35.
[110] *Id.*
[111] *Id.* at 36. The Court quotes from Federalist No. 78: "Periodical appointments, however regulated, or by whomsoever made, would, in some way or other, be fatal to [a judge's] necessary independence." *Id.* (insertion by the Court).
[112] *Id.* at 36.

division of labor in the current statute," because the question it decided was "narrow."[113] Other courts already handled some matters during a bankruptcy case, and district courts already were called on to perform de novo review in "related to" proceedings.[114] The practical import of the Court's decision might be small, thus remedying only a small "encroachment" on the Judicial Branch's authority. But the Court could not "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."[115]

IV. Conclusion

The Court describes its holding as "narrow," invalidating the 1984 restructuring of bankruptcy court jurisdiction only in "one isolated respect." It seems, though, that many counterclaims filed against creditors who themselves have filed proofs of claim will now be beyond the bankruptcy court's power to enter a final judgment. The bankruptcy judge would appear to have that power with respect to a counterclaim only when it could be expected that the counterclaim will be resolved in the course of the claims allowance process.

There is some possibility that bankruptcy courts may be able to exercise broader jurisdiction. There is the suggestion that the bankruptcy court might have jurisdiction if a counterclaim asserts "a right of recovery created by bankruptcy law,"[116] or if it "stems from the bankruptcy itself."[117]

The more important point is that Stern v. Marshall leaves us without a holding that basic matters of bankruptcy administration – claims allowance, automatic stay issues, etc. – are matters of public rights. Thus the entire bankruptcy court system remains somewhat vulnerable. It seems

[113] *Id.* at 37.
[114] *Id.*
[115] *Id.* at 38.
[116] *Id.* at 33; *see supra* text accompanying notes 106-08.
[117] *Id.* at 34; *see supra* text accompanying notes 106-08.

likely that in the appropriate case five Justices could be persuaded to end that vulnerability, but it is important to understand that the Court has not yet done so.

On the other hand, bankruptcy judges handle federal cases that are extremely important to our economy and to people in America. If Article III enshrines a strong principle of judicial independence, as the Court says it does, then perhaps bankruptcy judges should be given the protections of Article III, and thus the ability to exercise the full judicial power of the United States. As the Court notes, quoting the Federalist, to the extent a judge is subject to reappointment, the judge's "necessary independence" is threatened. That threat can come from Congress's power over salaries, and even from within the Judicial Branch through the reappointment process.

Alternatively, perhaps most forms of bankruptcy should be shifted to an administrative agency model. But these are subjects for another paper.