LOS ANGELES
Daily Journal
www.dailyjournal.com

VOL. 126 NO. 013 FRIDAY, JANUARY 18, 2013

Jurisdiction Questions To Plague Bankruptcy Courts

By David M. Reeder

You've heard of the 100-year flood and the 20-year cicada cycle. The bankruptcy world is now experiencing the most recent onset of the 30-year bankruptcy jurisdiction crisis.

This crisis affects the nation's busiest court system. Questions over its jurisdiction and power go to the very ability of the bankruptcy courts to carry out the business of the bankruptcy system.

The cycle started back in 1978 with the passage of the bankruptcy code. The code included very broad powers for the newly revamped bankruptcy courts. The federal judiciary was, however, hostile to the expanded powers of the bankruptcy courts.

At the heart of the controversy is the fact that the bankruptcy court system is presided over by judges appointed under Article I of the Constitution (executive functions), and not Article III (judicial functions). Article III judges, mainly federal district court judges, U.S. Court of Appeals judges, and of course, Supreme Court justices enjoy 1) lifetime appointment; and 2) constitutionally mandated salary protection. Bankruptcy judges, appointed under Article I, serve under 14-year appointments, and enjoy no salary protection. The federal judiciary had "issues" with a competing court system populated by Article I judges.

The first crisis over bankruptcy court jurisdiction and power erupted in 1982 with the Supreme Court's decision in *Northern Pipeline Construction Co. v. Marathon Pipe Line Co.*, 458 U.S. 50 (1982). The Supreme Court basically declared the bankruptcy courts to be without the power to enter final orders, obviously putting the viability of the bankruptcy system in jeopardy.

In the wake of *Marathon Pipeline*, the response of the proponents of effective bankruptcy court powers to the federal judiciary opposing broad bankruptcy court jurisdiction was: "So you want to deal with all of these bankruptcy cases? Where would you like them delivered?"

The system was salvaged by a set of interim "emergency rules", and a subsequent revamping of the bankruptcy jurisdiction scheme by Congress. After passage of the remedial legislation in 1984, the system went back to work on an almost business-as-usual basis, having dodged the *Marathon Pipeline* bullet.

In early 2011, almost 30 years after *Marathon Pipeline*, the Supreme Court again shattered the relative calm of the bankruptcy jurisdiction world with the case of *Stern v. Marshall*, 131 S. Ct. 2594 (2011) aka the Anna Nicole Smith case. Unlike *Marathon Pipeline*, which was very clear in its message, the opinion in *Stern zigs* and *zags* through over 50 pages, and comes out somewhere between holding that the bankruptcy courts lack jurisdiction over any matter determined by state law or lacks jurisdiction only in the narrow area of "certain counter claims". There are universes between these two extremes. As can be seen, *Stern*, creates major unanswered questions for the bankruptcy system.

In the period since *Stern*, the responses of the lower courts have

> [N]o single decision, except a decision of the U.S. Supreme Court, can fix the ambiguities and far-reaching questions created by *Stern*.

been as varied as the opinion in *Stern* itself. Responsive opinions of lower courts have varied from a "you can't touch us" approach, narrowing Stern down to the proverbial eye of the needle, to a due process based analysis taking a very hard stance on the Article III versus Article I issue. As the U.S. Bankruptcy Court for the Western District of Michigan stated in *Meoli v. Huntington Nat'l Bank (In re Teleservices Group, Inc.)*, 2011 WL 3610050 (Aug. 17, 2011): "the taking that Trustee has in mind in this adversary proceeding requires the oversight of a judicial officer with the independence that is only guaranteed by life tenure and salary protection.". Take *that* you 14-year appointment bankruptcy judges.

The direction that bankruptcy court power and jurisdiction jurisprudence is now taking, due to the wide ranging problems caused by *Stern*, is that no single decision, except a decision of the United States Supreme Court, can fix the ambiguities and far-reaching questions created by *Stern*.

A Supreme Court decision most likely will not be coming any time soon. Until then, lower courts will have to deal with bankruptcy court power and jurisdiction on an issue-by-issue basis. For example the 9th Circuit Court of Appeals in *In re Bellingham Insurance Agency, Inc.*

661 F.3d 476 (9th Cir. 2012) recently held that, although the current statutory scheme empowers bankruptcy judges to enter a final judgment in a fraudulent conveyance action against a party "nonclaimant" (someone who has not filed a proof of claim and submitted to bankruptcy court jurisdiction), the Constitution forbids entry of such a final order by the bankruptcy court. At the same time the influential U.S. Bankruptcy Court for the Northern District of Illinois in *KHI Liquidation Trust v. Wisenbaker Builder Servs., Inc. (In re Kimball Hill, Inc.)*, 2012 WL 4867409 (Oct. 12, 2012) has held that no such Constitutional limitation exists. Although the 9th Circuit decision in *Bellingham Insurance Agency, Inc.* certainly resolves the *Stern* issues as to the significant issue of fraudulent transfer actions against non-claimants, still unresolved are a plethora of other issues as to the bankruptcy courts' jurisdiction and power raised by *Stern*.

The battle is far from over. Due to the far-reaching issues implicated by *Stern*, "satellite litigation" regarding the bankruptcy courts' power and jurisdiction will plague the bankruptcy system for the foreseeable future.

There is much to argue and spill ink over in the wake of *Stern.* Stay tuned.

David M. Reeder *is an attorney with 24 years of experience focused on bankruptcy cases, business reorganizations, bankruptcy and commercial litigation, loan workouts, bankruptcy trustee representation, and the representation of purchasers of distressed assets. He can be contacted at david@reederlaw.com.*

David Reeder
Bankruptcy Attorney