No. _____

In The Supreme Court of the United States

HOWARD K. STERN, EXECUTOR OF THE ESTATE OF VICKIE LYNN MARSHALL,

Petitioner,

v.

ELAINE T. MARSHALL, EXECUTRIX OF THE ESTATE OF E. PIERCE MARSHALL,

Respondent.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

In the 1984 Bankruptcy Act, Congress divided bankruptcy court jurisdiction into "core" proceedings, in which bankruptcy judges can enter final orders, and "non-core" proceedings that are subject to district court de novo review. *See* 28 U.S.C. §157(b). Congress expressly identified certain core proceedings, including "counterclaims by the estate against persons filing claims against the estate." §157(b)(2)(C). Despite Article III challenges, lower courts across the country have uniformly held for decades that bankruptcy courts can enter final orders on debtors' compulsory counterclaims to proofs of claim.[1] Until now.

The Ninth Circuit opinion here holds that under *Northern Pipeline Construction Co. v. Marathon Pipe Line Co.*, 458 U.S. 50 (1982) (*Marathon*) and *Katchen v. Landy*, 382 U.S. 323 (1966), core jurisdiction constitutionally exists under §157(b)(2)(C) only for compulsory counterclaims entirely encompassed within the allowance or disallowance of the creditor's claim against the estate and that raise no issue beyond that claim. Even though here the debtor's compulsory counterclaim constituted an affirmative defense to

[1] A debtor's compulsory counterclaim to a proof of claim is any counterclaim that, at the time of pleading, arises out of the same transaction or occurrence as the creditor's claim against the estate and is not already pending in another action. Fed. R. Bankr. P. 7013; Fed. R. Civ. P. 13(a).

QUESTIONS PRESENTED – Continued

the proof of claim and, if decided first, would have defeated it entirely, the Court held the counterclaim was non-core because the debtor had to prove additional elements to prevail on it.

Accordingly, the questions presented are:

1. Whether the Ninth Circuit opinion, which renders §157(b)(2)(C) surplusage in light of §157(b)(2)(B), contravenes Congress' intent in enacting §157(b)(2)(C).

2. Whether Congress may, under Articles I and III, constitutionally authorize core jurisdiction over debtors' compulsory counterclaims to proofs of claim.

3. Whether the Ninth Circuit misapplied *Marathon* and *Katchen* and contravened this Court's post-*Marathon* precedent, creating a circuit split in the process, by holding that Congress cannot constitutionally authorize non-Article III bankruptcy judges to enter final judgment on all compulsory counterclaims to proofs of claim.

4. Where, as here, a creditor dismisses a state court claim against a debtor, files a proof of that claim in the bankruptcy and litigates the claim against the estate in that forum, has the creditor consented to core jurisdiction over the debtor's compulsory counterclaim that encompasses an affirmative defense?

PARTIES TO THE PROCEEDING

The original parties to this case, Vickie Lynn Marshall ("Vickie") and Pierce Marshall ("Pierce"), died during the pendency of this appeal. The current parties are Howard K. Stern, Executor of the Estate of Vickie Lynn Marshall, and Elaine T. Marshall, Executrix of the Estate of E. Pierce Marshall.

For the sake of readability, we adopt the Ninth Circuit's approach and refer to the parties as Vickie and Pierce.

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PETITION FOR WRIT OF CERTIORARI

OPINIONS BELOW

The Ninth Circuit's opinion is reported at 600 F.3d 1037 (9th Cir. 2010), Appendix to the Petition ("App.") 1-89.

Three opinions of the District Court for the Central District of California are reported at 275 B.R. 5 (C.D. Cal. 2002), App. 90-214; 271 B.R. 858 (C.D. Cal. 2001), App. 217-34; and 264 B.R. 609 (C.D. Cal. 2001), App. 239-86. A fourth is unpublished, App. 235-38.

Two opinions of the Bankruptcy Court for the Central District of California are reported at 257 B.R. 35 (Bankr. C.D. Cal. 2000), App. 286-99; and 253 B.R. 550 (Bankr. C.D. Cal. 2000), App. 313-36. A third is unpublished, App. 305-12.

JURISDICTION

The Ninth Circuit issued its opinion on March 19, 2010; it denied panel and *en banc* rehearing on May 5, 2010. App. 1, 337-38.

This Court has jurisdiction under 28 U.S.C. §1254(1). Jurisdiction was proper in the District Court under 28 U.S.C. §§1331 and 1334, and in the Ninth Circuit under 28 U.S.C. §1291.

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

Relevant portions of Article I, §8, and the entirety of Article III of the United States Constitution are reprinted at App. 339-41.

28 U.S.C. §§157 ("§157"), 1331 and 1334 are reprinted at App. 342-47.

STATEMENT OF THE CASE

Vickie's husband J. Howard Marshall, II ("Howard") attempted to provide for Vickie through an inter vivos trust. App. 25-26, 134-48, 198-202. However, his son Pierce suppressed or destroyed the trust instrument and stripped Howard of his assets before his death. App. 25-26, 143-202, 211-14. The bankruptcy and district courts found Pierce liable for tortious interference and awarded Vickie millions in compensatory and punitive damages. App. 3, 214.

The Bankruptcy Proceedings

In 1996, Vickie sought Chapter 11 bankruptcy protection following Howard's death. App. 91-93. Pierce dismissed a pending state-court defamation suit against Vickie and brought his defamation claims into the bankruptcy court via both a nondischargeability adversary complaint and a separate proof of claim for an unliquidated amount of damages. App. 14-16 nn.10 & 11, 77-87, 274-77; Supplemental

Excerpts of Record ("SER") 6101-02, 6801 (Pierce telling bankruptcy court that the amount of his creditor's claim "shall be determined by the adversary proceedings filed herein" and he's "happy" to litigate "[his] claim here" because "we did choose this forum").

Vickie objected to Pierce's proof of claim, answered his adversary complaint pleading truth as an affirmative defense, and filed a compulsory counterclaim for tortious interference with an inter vivos gift. App. 15-16, 48 n.29, 94, 378-81. This was the first time Vickie asserted that claim in any court. App. 48 n.29; *In re Marshall*, 273 B.R. 822, 825-26 (Bankr. C.D. Cal. 2002); SER 6757.

Shortly after Vickie filed her compulsory counterclaim, the bankruptcy court found it was core under subsections (B) and (C) of §157(b)(2). App. 294-96, 306-07. During trial in late 1999, the bankruptcy court summarily resolved Pierce's defamation claim against him on the grounds that Vickie did not publish or ratify the alleged defamatory statements. App. 18, 244-45. After trial, it found Pierce liable for tortious interference with a gift and awarded compensatory damages of $449 million (the amount of the intended trust) and $25 million in punitive damages, entering final judgment in December 2000. App. 18-20, 286-336. The court also found that Pierce engaged

in "massive discovery abuse," including destroying documents relevant to Vickie's claim. App. 320-26.[2]

The Texas Probate Proceedings

A Texas probate court began administering Howard's estate in August 1995. App. 11. Vickie first appeared in that proceeding in 1998, when she joined a pending will contest filed by Pierce's brother. App. 48 n.29. In January 2000, Vickie prophylactically filed her tortious interference with gift claim in the probate court after Pierce argued that the bankruptcy court lacked jurisdiction under the probate exception. App. 12, 48 n.29; *Marshall*, 273 B.R. at 825-26.

After the bankruptcy court entered judgment for Vickie in December 2000, Vickie immediately filed the bankruptcy judgment in the Texas probate court and voluntarily nonsuited her claims there without prejudice. App. 20, 232; *Marshall*, 273 B.R. at 826; SER 8426-27.

After nonsuiting her claims, Vickie remained in the probate proceedings only as a counterdefendant on a sanctions claim by Pierce. App. 21 & n.18, 223 n.4; SER 8427. Pierce then brought new claims against Vickie in an effort to re-litigate the issues the bankruptcy court had already decided. App. 21, 223

[2] The judgment was based, in part, on evidentiary sanctions. App. 19-20 n.17, 317 n.5.

n.4, 232; *Marshall*, 273 B.R. at 825-26; SER 8427-28, 8609-30.

Although the bankruptcy court directed Pierce to dismiss all his new probate claims, *Marshall*, 273 B.R. at 826, 831, Pierce's attorneys dismissed only a tortious interference claim, assuring the bankruptcy court that any risk of inconsistent judgments had been eliminated and that the "only" issue in the probate-court trial "directed at Ms. Marshall" was whether Howard and Vickie had an agreement for him to give her one-half his property, and that Pierce "only seek[s] to avoid any possibility of future litigation with Vickie Marshall over [Howard's estate] and to ensure that the Texas Probate Court can determine all claimants and efficiently administer that estate." SER 6624, 8470. The bankruptcy court found Pierce's claim "entirely consistent" with its judgment, which had "made no finding of an 'agreement' between [Vickie] and [Howard] to give her one-half of all his property." *Marshall*, 273 B.R. at 826-27, 831-32; SER 8585-86.

After her nonsuit, Vickie participated in the probate-court trial only as a counterdefendant. App. 21, 232. Pierce obtained a judgment against Vickie based on his "no agreement" theory, which became final in February 2002. App. 92; *Marshall*, 273 B.R. at 826-27, 831-32; SER 12260-61 & n.2.

The District Court Proceedings

Shortly after the bankruptcy court entered judgment and over a year before the Texas probate judgment became final, Pierce appealed the bankruptcy court judgment to the district court. App. 20, 96.

The district court concluded that Vickie's claim was a compulsory counterclaim to Pierce's defamation claim but was not a "core" proceeding because of post-pleading developments, *i.e.*, the amount that Vickie recovered on her counterclaim and the bankruptcy court's rationale in dismissing Pierce's claim. App. 236-38, 265-83. It treated the bankruptcy court's judgment as proposed and undertook a "comprehensive, complete and independent review of" the issues. App. 98, 284.

When Pierce subsequently moved for preclusion based on the Texas probate judgment, the district court denied preclusion because the requisite identity of issues was lacking and because Pierce's motion was untimely and inconsistent with fundamental fairness. App. 56 n.32, 223-33.

In March 2002, only one month after the Texas judgment became final, the district court affirmed the bankruptcy court's findings and entered judgment for Vickie. App. 91, 194-95, 215-16. It concluded Howard directed his lawyers to prepare an inter vivos trust for Vickie consisting of half the appreciation of his assets from the date of their marriage, App. 134-48, 198-202, but that Pierce conspired to suppress or

destroy the trust instrument and strip Howard of his assets, App. 145-202, 211-14.

It awarded compensatory damages of approximately $44.3 million and punitive damages of $44.3 million, finding "overwhelming" evidence of Pierce's "willfulness, maliciousness, and fraud." App. 26, 212, 214.

Ninth Circuit Appeal I

Pierce appealed and Vickie cross-appealed. App. 26-27. The Ninth Circuit reversed the judgment, concluding the probate exception to federal jurisdiction barred Vickie's counterclaim. *Id.*

In May 2006, this Court unanimously reversed and remanded to the Ninth Circuit for further proceedings to consider whether Vickie's claim was core and to address claim and issue preclusion. *Marshall v. Marshall*, 547 U.S. 293, 315 (2006).[3]

Ninth Circuit Appeal II

On March 19, 2010, nearly four years after remand, the Ninth Circuit again reversed the district court's judgment in favor of Vickie, holding her compulsory counterclaim was not a core proceeding

[3] Shortly after remand, Pierce died, and several months later, Vickie died; each were substituted on the appeal by their respective executors. App. 5-6 n.1.

under §157(b)(2)(C), and therefore the bankruptcy court's judgment was not "final," and the later Texas probate judgment should be given issue-preclusive effect. App. 55-57, 64-65.

In so concluding, the court made several key rulings:

- Vickie's counterclaim was a *compulsory* counterclaim to Pierce's proof of claim, "because the 'operative facts underlying [her] action' are the same as those underlying [Pierce's] defamation claim" and "[t]he defamation claim, [Vickie's] affirmative defense of truth, and her counterclaim for tortious interference all concern the alleged efforts by [Pierce] to obtain control of his father's estate" through improper means, App. 47-48 & n.29;
- Core jurisdiction can exist over counterclaims "based upon state law, not the Bankruptcy Code or something else that is unique to the bankruptcy context," and that "could have been brought in state court," App. 43-44 & nn.26, 27;
- The determination whether a counterclaim to a proof of claim is core under §157(b)(2)(C) "must focus largely on what is available to the court at the time of filing, that is, the parties' pleadings," App. 51-52;
- Vickie's success on her counterclaim would defeat Pierce's defamation claim

> by establishing the affirmative defense of truth, App. 47-48, 55.

Although these rulings supported the conclusion that Vickie's counterclaim was core, the court – relying solely on *Katchen v. Landy*, 382 U.S. 323 (1966) and *Northern Pipeline Construction Co. v. Marathon Pipe Line Co*., 458 U.S. 50 (1982) (*Marathon*) – narrowly construed §157(b)(2)(C) to mean that even a compulsory counterclaim to a proof of claim does not qualify as core *unless* it is "'so closely related to the proof of claim that the resolution of the counterclaim is necessary to resolve the allowance or disallowance of the claim itself.'" App. 50. It held Vickie's compulsory counterclaim was non-core because even if she proved through her counterclaim that the alleged defamatory statements were true, thus defeating Pierce's proof of claim, she would need to prove additional facts to prevail on her counterclaim, including damages; therefore, "its resolution was not a necessary precursor" to resolving Pierce's defamation claim against the estate and it "was not so closely related to his claim that they essentially merged, with her counterclaim becoming part and parcel of the bankruptcy court's claims determination and allowance process." App. 4, 49-50, 55.

To hold otherwise, the court concluded, would be "an expansive reading of § 157(b)(2)(C) [that] would certainly run afoul of the Court's holding in *Marathon*" and "arguably be inconsistent with the Congress' intent to revise the Bankruptcy Code in a

manner consistent with the principles of *Marathon* to make its jurisdictional grant constitutional." App. 46.

Because the conclusion that Vickie's counterclaim was non-core meant her bankruptcy judgment was not final, the court reversed the district court judgment on the basis of issue preclusion, finding the Texas probate court entered the earliest final judgment "on certain matters relevant to this proceeding." App. 4-5, 55-56, 64. It never addressed the district court's determination that binding her to the Texas court's findings would be fundamentally unfair. App. 56 n.32, 232.[4]

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[4] Concurring in the result, Judge Kleinfeld identified "alternative" grounds for reversal that actually rested on assertions the majority *rejected* and the record *refutes*, App. 66:

- The concurrence states Pierce only sought a non-dischargeability determination, not damages from the bankruptcy estate. *Id.* The majority rejected that contention, App. 15-16 n.11, and the record disproves it, SER 6101-02, 6801, 8409-16.
- The concurrence couches Vickie's counterclaim as an "evasion of Pierce's constitutional right to jury trial in Texas." App. 66. But the majority correctly notes that Pierce *dismissed* his Texas defamation claim against Vickie after the bankruptcy filing. App. 14 n.10, 274-76.
- The concurrence asserts there wasn't even "related to" jurisdiction, because Vickie "had already been discharged and her creditors would get none of the money she sought from Pierce in her counterclaim." App. 66. The majority correctly concluded that the bankruptcy plan specified that

(Continued on following page)

Vickie petitioned for rehearing en banc on the grounds that the opinion erred in determining her counterclaim was non-core. App. 348-77. She also sought panel rehearing based on the panel's failure to determine whether the district court properly exercised its discretion to deny issue preclusion on fundamental fairness grounds. *Id.* The petition was denied. App. 337-38.

REASONS TO GRANT THE PETITION

Purporting to follow *Marathon*, 458 U.S. 50, and *Katchen*, 382 U.S. 323, the Ninth Circuit has held that, even though §157(b)(2)(C) provides that bankruptcy courts may finally adjudicate "counterclaims by the estate against persons filing claims against the estate," Article III forecloses bankruptcy courts from finally adjudicating even a *compulsory*

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the counterclaim proceeds be applied first to creditor claims. App. 17.

- The concurrence characterizes Pierce's defamation claim as a "personal injury" claim that §157(b)(5) makes non-core. App. 66, 74-76. It is doubtful that §157(b)(5) encompasses defamation (*e.g.*, *Massey Energy Co. v. W. Va. Consumers for Justice*, 351 B.R. 348, 351 (E.D. Va. 2006)) but in any event, §157(b)(5) is waived where, as here, the creditor files a proof of claim, alleges core jurisdiction and does not timely object to bankruptcy court adjudication (*In re Smith*, 389 B.R. 902, 910-16 (Bankr. D. Nev. 2008); *see* App. 266-67 n.17; SER 6023, 6101-02, 6801).

counterclaim to claims against the estate – unless the counterclaim's resolution is a "necessary precursor" to resolving the creditor's claim and "so closely related to [the] claim that they essentially merge[ ], with [the] counterclaim becoming part and parcel of the bankruptcy court's claims determination and allowance process." App. 51. Certiorari should be granted because the Ninth Circuit's ruling:

- Creates a circuit split and contravenes the decades-long practice of bankruptcy courts everywhere.
- Nullifies Congress' intent in enacting §157(b)(2)(C) – indeed, renders the statute superfluous.
- Is compelled by neither *Marathon*, which did not involve a counterclaim, nor *Katchen*, a non-Article III case involving the 1898 Bankruptcy Act – nor by the two read together.
- Ignores this Court's relevant post-*Marathon* authority, including *Commodity Futures Trading Commission v. Schor*, 478 U.S. 833 (1986) (*Schor*), which upheld the constitutionality of a statutory scheme permitting non-Article III judges to decide compulsory counterclaims.
- Ignores that Congress rectified *Marathon*'s separation-of-powers concerns, including making bankruptcy courts units of the district courts with their judges appointed by Article III judges.

- Creates the absurd requirement that debtors *must* file compulsory counterclaims in bankruptcy courts that cannot finally decide them.
- Effects a sea change in bankruptcy practice that will confound efficient bankruptcy administration by saddling courts with jurisdictional battles and splintering inextricably-linked claims between bankruptcy and district courts.

This Court should resolve this issue immediately: It is in the nature of bankruptcy practice that only a tiny fraction of cases reaches the circuit court level; thus, decades could pass before this Court has another opportunity to review this important issue.

I. THE OPINION UNDERMINES CONGRESS' INTENT IN ENACTING 28 U.S.C. §157(b)(2)(C), CREATING STATUTORY AND CONSTITUTIONAL QUESTIONS THAT ONLY THIS COURT CAN RESOLVE.

A. Backdrop To §157(b)(2)(C).

1. Before *Marathon*, the filing of a proof of claim generally authorized bankruptcy judges to determine compulsory counterclaims.

Before Congress enacted the bankruptcy act invalidated by *Marathon*, bankruptcy proceedings were either summary or plenary; bankruptcy judges tried summary actions, but plenary actions were litigated

in state or federal court. *In re Los Angeles Trust Deed & Mortgage Exch.*, 464 F.2d 1136, 1138-39 (9th Cir. 1972).

The federal circuits uniformly held that any creditor who filed a proof of claim in the bankruptcy had impliedly consented to summary jurisdiction over any compulsory counterclaim by the debtor or trustee. 1 Alan N. Resnick & Henry J. Sommer, Collier on Bankruptcy 3-32, ¶ 3.02[3][d][i] (16th ed. 2010). But they were split as to whether filing a proof of claim permitted the bankruptcy court to determine unrelated or permissive counterclaims. *Id.*; *compare Peters v. Lines*, 275 F.2d 919, 924-25 (9th Cir. 1960) *with Inter-State Nat'l Bank v. Luther*, 221 F.2d 382, 389-90 (10th Cir. 1955).

In 1966, this Court held in *Katchen* that the 1898 Bankruptcy Act conferred summary jurisdiction on the bankruptcy court to determine a trustee's counterclaim to recover a voidable preference, regardless whether the counterclaim arose from the same or a different transaction as the proof of claim. 382 U.S. at 325 & n.1. It held that the bankruptcy court could issue affirmative relief on the counterclaim because the creditor, by submitting a proof of claim, had subjected itself "'to all the consequences that attach to an appearance.'" *Katchen*, 382 U.S. at 335.

After *Katchen*, some commentators argued for summary jurisdiction over all debtor counterclaims. *See In re Depo*, 40 B.R. 537, 541-42 (N.D.N.Y. 1984) (citing authorities). Yet, most courts held that a proof

of claim established the creditor's implied consent to summary jurisdiction over all compulsory counterclaims *plus* any permissive counterclaims directly related to allowance or disallowance of the creditor claim, such as voidable preferences. *See*, *e.g.*, *id.*; *Los Angeles Trust*, 464 F.2d at 1138-39; *In re Carnell Constr. Corp.*, 424 F.2d 296, 298-99 (3d Cir. 1970).

2. *Marathon* (a non-counterclaim case).

In 1978, Congress broadened the jurisdiction of bankruptcy judges by eliminating the summary/plenary distinction and conferring bankruptcy court jurisdiction over all proceedings arising under the Bankruptcy Code or arising in or related to bankruptcy cases. *Marathon*, 458 U.S. at 54.

In its splintered 1982 *Marathon* decision, this Court held it was unconstitutional for a non-Article III bankruptcy judge to determine a claim that was merely "related to" the bankruptcy case – in that case, a state law breach of contract action the debtor commenced against non-creditor Marathon, which had not filed a proof of claim or otherwise previously appeared in the bankruptcy case. *Id.* at 75, 86 (plurality), 89-91 (Rehnquist, J., concurring), 92 (Burger, J., dissenting).

The Court never addressed whether a non-Article III bankruptcy judge could determine debtor counterclaims to a proof of claim. The three-justice dissent, citing *Katchen*, noted that had Marathon filed a claim against the estate, the bankruptcy court

properly could have adjudicated the debtor's state-law claim as a counterclaim. 458 U.S. at 99-100 (White, J., dissenting). But in a footnote response, the plurality noted that *Katchen* neither discussed Article III nor involved the 1978 Act. 458 U.S. at 79 n.31.

The *Marathon* plurality's Article III concerns were partly based on the political branches' potential encroachment on the judiciary's powers. *See* 458 U.S. at 57-60, 64 n.15, 74, 83-84. Under the 1978 Act, the political branches appointed the bankruptcy judges and bankruptcy courts were independent of, and required to exercise all jurisdiction conferred on, the district courts. *Id.* at 79 n.31, 84-87.

B. In Enacting §157(b)(2)(C), Congress Intended Bankruptcy Courts To Have Core Jurisdiction Over Debtors' Compulsory Counterclaims To Proofs Of Claim.

Congress enacted the 1984 Bankruptcy Act "for the specific purpose of curing the constitutional problems of the scheme under which [*Marathon*] arose." *In re Mankin*, 823 F.2d 1296, 1306 (9th Cir. 1987). Among the changes: (1) bankruptcy courts are now units of the district courts, 28 U.S.C. §151; (2) Article III judges appoint the bankruptcy judges, 28 U.S.C. §152; and (3) district courts have discretion to delegate matters to bankruptcy courts and the power to withdraw referred matters, 28 U.S.C. §§1334(a), (b), 157(a), (d).

Congress also divided bankruptcy court jurisdiction into "core" proceedings that the bankruptcy court could finally adjudicate and "non-core" proceedings subject to district court de novo review. §157(b)(1), (3), (c)(1)-(2). Congress recognized *Marathon*'s narrow scope:

> *Marathon* was concerned with a very limited kind of proceeding. . . . It was not concerned even with all bankruptcy proceedings involving questions of State law in some way. It was concerned only with State law issues that did not arise in the core bankruptcy function of adjusting debtor-creditor rights.

130 Cong. Rec. 6242 (daily ed. March 21, 1984) (§157's co-sponsor Representative Kindness); 130 Cong. Rec. 6046-47 (daily ed. March 20, 1984) (co-sponsor Kastenmeier acknowledging constitutionality of bankruptcy jurisdiction by consent and describing *Katchen* as recognizing "that State common law actions become transformed into Federal bankruptcy matters when brought in proceedings integral to a bankruptcy case").

In accordance with its view of *Marathon*, Congress broadly defined core proceedings as those "arising under" the bankruptcy code and "arising in" bankruptcy cases, and specified in §157(b)(2) a non-exhaustive list of "various types of proceedings deemed by Congress to be core proceedings." *Mankin*, 823 F.2d at 1299-1300. Congress "'realized that the bankruptcy court's jurisdictional reach was essential to the efficient administration of bankruptcy proceedings

and intended that the 'core' jurisdiction would be construed as broadly as possible subject to the constitutional limits established in *Marathon*.'" *In re CBI Holding Co.*, 529 F.3d 432, 459-60 (2d Cir. 2008). It believed that *almost all proceedings* before bankruptcy judges – the sponsors said 95% – would be core. *In re Arnold Print Works, Inc.*, 815 F.2d 165, 168-69 (1st Cir. 1987) (Breyer, J.); *Mankin*, 823 F.2d at 1301; *see also* 130 Cong. Rec. 6045 (Kastenmeier stating core jurisdiction is "broader than the summary jurisdiction of the bankruptcy courts under pre-1978 law").

By specifying in §157(b)(2)(C) that "counterclaims by the estate against persons filing claims against the estate" are core proceedings, Congress sought to streamline bankruptcy administration while accommodating *Marathon* by providing that bankruptcy courts could enter final orders on such counterclaims. Congress understood that while bankruptcy courts would have "related to" (non-core) jurisdiction over non-bankruptcy-specific claims against persons who had not filed proofs of claim (the *Marathon* context), core jurisdiction would exist over counterclaims to proofs of claim that, by definition, concern the adjustment of debtor-creditor relations. *See* 130 Cong. Rec. 6046-47; *Marathon*, 458 U.S. at 71 (distinguishing "the restructuring of debtor-creditor relations, which

is at the core of the federal bankruptcy power" from the claim at issue).[5]

Unlike the debtor's claim against the non-creditor in *Marathon*, a debtor's counterclaim to a proof of claim "arises in" the bankruptcy case because the claims allowance process only exists in bankruptcy. *In re Bar M Petroleum Co.*, 63 B.R. 343, 346 (Bankr. W.D. Tex. 1986). A compulsory counterclaim, in particular, necessarily "arises in" the bankruptcy case because the debtor *must* file it in the bankruptcy case; if the debtor fails to assert it and the creditor's claim is successful, res judicata bars its subsequent assertion. 10 Alan N. Resnick & Henry J. Sommer, Collier on Bankruptcy ¶ 7013.02 (15th ed. 2008).

"By specifically including as core proceedings counterclaims brought by a debtor as a result of claims filed by creditors against the estate, Congress apparently believed that it is more efficient having a single court decide all cases based on the same facts and circumstances." *In re Fang Operators*, 158 B.R. 643, 647 (Bankr. N.D. Tex. 1993). Congress

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[5] Judiciary-created emergency bankruptcy rules enacted in *Marathon*'s wake similarly prohibited bankruptcy courts from entering final judgments in "related proceedings," which included "claims brought by the estate against parties *who have not filed claims against the estate*" and did "*not* include . . . counterclaims by the estate in whatever amount against persons filing claims against the estate." 1 Collier on Bankruptcy, *supra* at 3-96 to 3-97 n.15, ¶ 3.10[2][b] (emphasis added).

Significantly, §157's sponsors intended to codify those emergency rules. *Id.* at 3-99; 130 Cong. Rec. 6045, 6242-44.

enacted the 1984 Act "to reduce substantially the time-consuming and expensive litigation regarding a bankruptcy court's jurisdiction over a particular proceeding" and to ensure "the efficient and expeditious resolution of all matters connected to the bankruptcy estate." *In re Fietz*, 852 F.2d 455, 457 (9th Cir. 1988).

C. The Opinion's Construction Of §157(b)(2)(C) Nullifies The Entire Provision.

The opinion recognizes that courts should avoid construing statutes "'in a manner that is strained and, at the same time, would render a statutory term superfluous.'" App. 43. It applies that rule to reject Pierce's contention that Vickie's counterclaim is non-core because it could have been brought in state court and is not bankruptcy-specific, reasoning "[w]e do not believe that Congress intended § 157(b)(2)(C) to be a meaningless (or near meaningless) provision, which is what it would become under Pierce Marshall's overly restrictive approach." App. 43-44.

Perversely, however, the opinion's core jurisdiction test itself renders §157(b)(2)(C) meaningless. By prohibiting core jurisdiction over a compulsory counterclaim unless it is necessary to determine the allowance or disallowance of the creditor claim and raises no issues outside that claim, the opinion makes §157(b)(2)(C) entirely superfluous, because Congress already specified in §157(b)(2)(B) that core proceedings include the "allowance or disallowance of claims

against the estate." If Congress had intended to limit core counterclaim jurisdiction to the allowance/disallowance of creditor claims, as the opinion holds, the counterclaim provision would have been unnecessary.

As this Court recognized in *Schor*, rejecting a circuit court's similar effort to straight-jacket a counterclaim statute under *Marathon*, the canon that courts should construe statutes to avoid constitutional questions "does not give a court the prerogative to ignore the legislative will in order to avoid constitutional adjudication." 478 U.S. at 841. The Ninth Circuit's narrow core jurisdiction test contravenes Congress' intent. Whether Article III compels that nullification is a question for this Court. Determining whether Congress exceeded its constitutional authority is "'a delicate exercise in constitutional interpretation, and is a responsibility of this Court as ultimate interpreter of the Constitution.'" *Marathon*, 458 U.S. at 62.

II. THE OPINION CREATES A CIRCUIT SPLIT AND CONTRAVENES THE DECADES-LONG PRACTICE OF COURTS NATIONWIDE.

A. The Opinion Creates A Circuit Split.

The opinion's narrow construction of §157(b)(2)(C) creates a circuit split. It is the only circuit decision in the three decades since the statute's enactment to ever find a compulsory counterclaim to a proof of claim to be non-core.

In *In re CBI Holding Co.*, for example, the Second Circuit considered a case where the debtor's auditor filed a proof of claim for $210,000 in unpaid pre-petition services for a 1994 audit, and the debtor's successor responded with compulsory contract and tort counterclaims, claiming the creditor committed $70 million in malpractice damages from 1992 through 1994. 529 F.3d at 355, 438, 441-42. The alleged malpractice was a defense to the creditor's claim, but the counterclaims also sought millions in malpractice damages relating to different years than those underlying the proof of claim. *Id.* at 461-62. In holding the counterclaims core, the Second Circuit recognized that *Marathon* merely held that "a non-Article III bankruptcy judge could not adjudicate a pre-petition contract dispute arising under state law against a party that had not filed a proof of claim and was not otherwise related to the bankruptcy proceedings." *Id.* at 459. It further recognized that nothing in *Marathon* "'alters the basic principle that the filing of a proof of claim invokes the special rules of bankruptcy,'" and thus counterclaims that are factually and legally connected to a proof of claim are core proceedings – regardless whether they rest on state law, could have existed independently of the bankruptcy, are disproportionate to the creditor's claim or involve issues that are not a defense to the creditor's claim. *Id.* at 461-65 & n.12. Thus, in *CBI*, the counterclaims went beyond mere allowance/disallowance of the creditor's claim – the boundary under the Ninth Circuit opinion.

Moreover, the First Circuit, citing *CBI* in support, has held that compulsory counterclaims to proofs of claim fall within §157(b)(2)'s definition of core proceedings. *In re Am. Bridge Prods.*, 599 F.3d 1, 4 (1st Cir. 2010). In that case, it upheld a bankruptcy court's authority to adjudicate the trustee's counterclaims seeking damages for negligence and breach of fiduciary duty against a receiver who filed a compensation claim. *Id.* at 2, 4.

Every other circuit decision involving a compulsory counterclaim to a proof of claim – decisions by the Third, Fifth and Sixth circuits – has found core jurisdiction even though the counterclaim went beyond mere allowance or disallowance of the proof of claim. *In re Baudoin*, 981 F.2d 736, 741-43 (5th Cir. 1993) (holding, for res judicata purposes, that debtor's lender liability claim should have been brought as core compulsory counterclaim to lender's proof of claim given common nucleus of operative facts); *In re MacLeod Co., Inc.*, 935 F.2d 270, 1991 WL 96718, *4 (6th Cir. 1991) (table) (upholding damage award to debtor on counterclaim for breach of contract);[6] *In re Meyertech Corp.*, 831 F.2d 410, 418 n.9 (3d Cir. 1987) (upholding open account damages to debtor exceeding creditor's breach-of-warranty damages).

[6] Unpublished Sixth Circuit decisions are not precedentially binding but may be considered for persuasive value. *United States v. Sanford*, 476 F.3d 391, 396 (6th Cir. 2007).

B. The Opinion Fundamentally Changes Bankruptcy Law Within The Ninth Circuit And Contravenes The Decades-Long Practice Of Courts Across The Country.

The opinion doesn't just create a circuit split. It fundamentally changes bankruptcy law as applied for decades by bankruptcy and district courts.

Courts within the Ninth Circuit have uniformly held that bankruptcy courts have core jurisdiction over debtors' compulsory counterclaims to proofs of claim. *See In re Gorilla Cos.*, 429 B.R. 308, 310, 313 (Bankr. D. Ariz. 2010) (noting "*Marshall* changed the law" and *Marshall* never addresses the Ninth Circuit's own precedent in *Peters*, 275 F.2d at 925, that filing a proof of claim constitutes consent to the bankruptcy court determining trustee counterclaims arising out of the same transaction); *In re PNP Holdings Corp.*, 184 B.R. 805, 806 (B.A.P. 9th Cir. 1995), *aff'd*, 99 F.3d 910 (9th Cir. 1996) ("[i]t is well settled that a creditor consents to jurisdiction over related counterclaims by filing a proof of claim"); *In re Lion Country Safari, Inc.*, 124 B.R. 566, 569 (Bankr. C.D. Cal. 1991); *In re County of Orange*, 203 B.R. 977, 980 (Bankr. C.D. Cal. 1996); *In re Marshland Dev.,* 129 B.R. 626, 631 n.10 (Bankr. N.D. Cal. 1991); *In re Beugen*, 81 B.R. 994, 1000 (Bankr. N.D. Cal. 1988); *In re Sun West Distribs.*, 69 B.R. 861, 863-64 (Bankr. S.D. Cal. 1987).

That also has been the decades-long view of bankruptcy and district courts everywhere. *See*, *e.g.*:

First Circuit: *In re Am. Bridge Prods.*, 398 B.R. 724, 729-30 (D. Mass. 2009), *vacated on other grounds*, 599 F.3d 1 (1st Cir. 2010); *In re Envisionet Computer Servs.*, 276 B.R. 7, 11 (D. Me. 2002); *In re Cont'l Fin. Res.*, 149 B.R. 260, 262-63 (Bankr. D. Mass. 1993), *aff'd,* 154 B.R. 385 (D. Mass 1993); *In re BKW Sys.*, 66 B.R. 546, 547-48 (Bankr. D. N.H. 1986); *Bedford Computer Corp. v. Ginn Publ'ns*, 63 B.R. 79, 81-83 (D. N.H. 1986).

Second Circuit: *In re S.W. Bach & Co.*, 425 B.R. 78, 90 (Bankr. S.D.N.Y. 2010); *In re G.M. Crocetti, Inc.*, 2008 WL 4601278, *3-*4 (S.D.N.Y. 2008); *In re Northwest Airlines Corp.*, 384 B.R. 51, 58 (S.D.N.Y. 2008); *In re Enron Corp.*, 349 B.R. 108, 112-13 (Bankr. S.D.N.Y. 2006); *In re CBI Holding Co.*, 311 B.R. 350, 362-63 (S.D.N.Y. 2004), *aff'd in part, rev'd in part on other grounds*, 529 F.3d 432, 459-64 (2d Cir. 2008); *In re Iridium Operating*, 285 B.R. 822, 831-32 (S.D.N.Y 2002); *In re Caldor, Inc.-NY*, 217 B.R. 121, 128 (Bankr. S.D.N.Y. 1998); *In re Paige*, 106 B.R. 346, 347 (Bankr. D. Conn. 1989); *In re Wiener Pharmaceuticals, Inc.*, 1988 Bankr. LEXIS 1097, *10-*16 (Bankr. E.D.N.Y. 1988); *In re STN Enters.*, 73 B.R. 470, 483-84 (Bankr. D. Vt. 1987); *In re Lombard-Wall, Inc.*, 48 B.R. 986, 990-91 (S.D.N.Y. 1985).

Third Circuit: *In re Asousa P'ship*, 276 B.R. 55, 66-72 (Bankr. E.D. Pa. 2002); *In re Milbourne*, 108

B.R. 522, 530 (Bankr. E.D. Pa. 1989); *Matter of L.B. Trucking, Inc.*, 75 B.R. 88, 91-92 (Bankr. D. Del. 1987).

Fourth Circuit: *Blackshire v. Litton Loan Servicing, L.P.*, 2009 WL 426130, *3 (S.D. W. Va. 2009); *In re Mercer's Enters.*, 387 B.R. 681, 686 (Bankr. E.D.N.C. 2008); *In re Doctors Health, Inc.*, 335 B.R. 95, 101 (Bankr. D. Md. 2005).

Fifth Circuit: *In re Gunsmiths, Inc.*, 271 B.R. 487, 490-91 (S.D. Miss. 2000); *In re Efficient Solutions, Inc.*, 2000 WL 1876356, *6 (E.D. La. 2000); *Allen v. City Fin. Co.*, 224 B.R. 347, 352 (S.D. Miss. 1998); *Fang Operators*, 158 B.R. at 647-48; *Bar M*, 63 B.R. at 346-48.

Sixth Circuit: *In re Federated Dep't Stores, Inc.*, 240 B.R. 711, 722 (Bankr. S.D. Ohio 1999); *In re Nationwide Roofing & Sheet Metal*, 130 B.R. 768, 776 (Bankr. S.D. Ohio 1991).

Seventh Circuit: *In re K & R Express Sys., Inc.*, 382 B.R. 443, 447 (N.D. Ill. 2007); *In re ABC-Naco, Inc.*, 294 B.R. 832, 837 (Bankr. N.D. Ill. 2003); *In re Chapman*, 154 B.R. 258, 261 (Bankr. N.D. Ill. 1993).

Eighth Circuit: *In re SRC Holdings Corp.*, 352 B.R. 103, 165 (Bankr. D. Minn. 2006), *rev'd on other grounds*, *Leonard v. Dorsey & Whitney LLP*, 553 F.3d 609 (8th Cir. 2009); *In re Aerni*, 86 B.R. 203, 206-08 (Bankr. D. Neb. 1988); *In re Yagow*, 53 B.R. 737, 740 (Bankr. D. N.D. 1985).

Tenth Circuit: *In re C.W. Mining Co.*, 2009 WL 4906702, *3 (D. Utah 2009); *In re Geneva Steel, LLC*, 343 B.R. 273, 277-78 (Bankr. D. Utah 2006); *In re Applied Thermal Sys., Inc.*, 294 B.R. 784, 787-89 (Bankr. N.D. Okla. 2003); *In re Bokum Res. Corp.*, 64 B.R. 924, 928-30 (Bankr. D. N.M. 1986).

Eleventh Circuit: *In re Norrell*, 198 B.R. 987, 994 n.4 (Bankr. N.D. Ala. 1996); *In re I.A. Durbin, Inc.,* 62 B.R. 139, 143 (S.D. Fla. 1986); *In re Macon Prestressed Concrete*, 46 B.R. 727, 730 (M.D. Ga. 1985).[7]

C. The Opinion Exacerbates Confusion Over *Marathon* By Announcing A Standard No Other Court Has Embraced.

On the other side of this mountain of authority lie a handful of decisions from the mid-1980's that proffer an outdated view of *Marathon*. For example, in stating it is "unsettled" and "unclear" as to whether core jurisdiction exists over counterclaims arising out of the same transaction as the creditor claim, the Collier bankruptcy treatise cites three circuit court decisions for the view that core jurisdiction exists (1 Collier on Bankruptcy, *supra* at 3-33 n.49, 3-34, ¶ 3.02[3][d], citing *CBI*, *Baudoin* and *Meyertech*), but cites only two 1985 bankruptcy court decisions for

[7] Although no published D.C Circuit case directly addresses the issue, dicta supports the prevailing view that core jurisdiction exists. *See In re Auto-Pak, Inc.*, 52 B.R. 3, 4-5 (Bankr. D.C. Cir. 1985).

the view that some compulsory counterclaims might be non-core (1 Collier on Bankruptcy, *supra* at 3-33 n.51, ¶ 3.02[3][d], citing *In re Nanodata Computer Corp.*, 52 B.R. 334 (Bankr. W.D.N.Y. 1985), *aff'd on other grounds*, 74 B.R. 766 (W.D.N.Y. 1987) and *In re Illinois-California Express, Inc.*, 50 B.R. 232 (Bankr. D. Colo. 1985)).

Those two 1985 bankruptcy court decisions, both decided before *Schor*, broadly construed *Marathon* as requiring an Article III judge to decide all routine state law claims, including those asserted as counterclaims. *See* 1 Collier on Bankruptcy, *supra* at 3-33 to 3-34, ¶ 3.02[3][d]; *Nanodata*, 52 B.R. at 342; *Illinois-California Express*, 50 B.R. at 239. Their view of *Marathon* has been criticized as unsound and inconsistent with this Court's post-*Marathon* decisions. *See*, *e.g.*, *Crocetti*, 2008 WL 4601278 at *5; *Fang Operators*, 158 B.R. at 647; *In re Kaiser Steel Corp.*, 95 B.R. 782, 786-87 (Bankr. D. Colo. 1989); *Wiener Pharmaceuticals*, 1988 Bankr. LEXIS 1097, at *11-*14; *STN*, 73 B.R. at 483-84; *Bokum*, 64 B.R. at 928; *Durbin*, 62 B.R. at 141-43; *Bar M*, 63 B.R. at 346-48. Not only does their view contravene the settled rule "that merely because a claim involves consideration of state law issues, it does not mean that a bankruptcy court cannot consider such issues" (*Fang Operators*, 158 B.R. at 647), it contravenes this Court's subsequent decisions, such as *Schor* and *Thomas v. Union Carbide Agricultural Products Co.*, 473 U.S. 568 (1985), which "narrow the scope and impact of *Marathon* and confirm the concept of jurisdiction by

consent" (*Bokum*, 64 B.R. at 928; *accord*, *Kaiser Steel*, 95 B.R. at 786-87). Indeed, *Nanodata* relied on the circuit decision this Court reversed in *Schor*. *See* 52 B.R. at 343 n.32.

The Ninth Circuit opinion, by holding that the state law predicate for Vickie's compulsory counterclaim does not render it non-core, joins the modern chorus rejecting the outdated view of *Marathon* espoused in *Nanodata* and *Illinois-California Express*. Unfortunately, it adds a new layer of confusion by announcing a core jurisdiction test for compulsory counterclaims that no other court has adopted in the three decades since *Marathon*.

III. THE OPINION MISAPPLIES *MARATHON* AND *KATCHEN*, WHILE IGNORING THIS COURT'S POST-*MARATHON* PRECEDENT.

This Court's review is particularly warranted because the circuit split arises from confusion over this Court's decisions. This Court has acknowledged problems inherent in its Article III precedents. *Schor*, 478 U.S. at 847 ("our precedents in this area do not admit of easy synthesis"); *Thomas*, 473 U.S. at 583 ("[a]n absolute construction of Article III is not possible in this area of 'frequently arcane distinctions and confusing precedents'").

The uncertainty is magnified in the debtor-counterclaim context because this Court has never addressed §157(b)(2)(C), and its only bankruptcy-counterclaim decisions (*e.g.*, *Katchen*, *Langenkamp v.*

Culp, 498 U.S. 42 (1990)) have involved avoiding powers such as preferences or voidable transfers – a context where "[i]t is a simple matter to conclude that . . . core treatment should be afforded the counterclaim," since "the creditor's claim cannot be allowed unless the property received by the creditor or its value has been returned." 1 Collier on Bankruptcy, *supra* at 3-33, ¶ 3.02[3][d]. "When the counterclaim asserted is not based upon the avoiding powers, but instead is either compulsory or permissive, the considerations become more complex." *Id.*

A. *Katchen*.

The Ninth Circuit opinion states, without explication of rationale, that its "construction of §157(b)(2)(C) . . . follows *Katchen*." App. 50.

However, *Katchen* was not an Article III case and it involved a statutory construction issue peculiar to the 1898 Bankruptcy Act. Although Congress had not expressly conferred summary jurisdiction on bankruptcy referees to order claimants to surrender preferences, this Court concluded that the trustee's preference counterclaim fell within the bankruptcy referee's express statutory power over the allowance/disallowance of creditor claims, because the creditor claim depended on whether the creditor received a voidable preference and the counterclaim therefore was part and parcel of the claims allowance process. *Katchen*, 382 U.S. at 328-35. It held that its statutory interpretation did not violate the right to jury trial,

because issues that arise in the claims allowance process are triable in equity. *Id.* at 335-40.

As one court recently recognized, the Ninth Circuit's reliance on *Katchen* to narrow core jurisdiction over compulsory counterclaims is puzzling, because *Katchen* did not abrogate the then-prevailing view that a bankruptcy court's summary jurisdiction included compulsory counterclaims; rather, *Katchen* held summary jurisdiction extended to preference counterclaims even if permissive, *i.e.*, those "unrelated to the transaction in which the creditor had received a preference." *Gorilla Cos.*, 429 B.R. at 312; *see Katchen*, 382 U.S. at 325-26 & n.1.

Other courts have construed *Katchen* as supporting bankruptcy court power to decide compulsory counterclaims, both before §157(b)(2)(C)'s enactment (*see* §I.A.1, *supra*) and after (*e.g.*, *Applied Thermal Systems*, 294 B.R. at 787-88; *Beugen*, 81 B.R. at 998-99; 2 Hon. William H. Brown, The Law of Debtors and Creditors §11:11, 11-41 (2010) [*Katchen* "has generally been broadly read to stand for the proposition that a creditor, by filing proof of claim, has consented to the jurisdiction of the bankruptcy court to grant an affirmative judgment against the claimant"]).

Only review by this Court can resolve the confusion. 1 Collier on Bankruptcy, *supra* at 3-34, ¶ 3.02[3][d] ("[u]ntil the Supreme Court sees fit specifically to disavow the *Katchen* rationale," it "seems that" counterclaims based on avoiding powers should

be core, counterclaims arising out of a different transaction should be non-core, and it "is unclear" whether counterclaims arising out of the same transaction are core).

B. *Marathon*.

Although the Ninth Circuit opinion states that *Marathon* compels its construction of §157(b)(2)(C), it never attempts to explain why. App. 49-50.

It couldn't even if it tried. This Court's fractured *Marathon* decision held only that it was unconstitutional for a bankruptcy court to determine a debtor's pre-petition state law claim against a defendant that was dragged into the bankruptcy case *involuntarily*, because it had not filed a proof of claim or otherwise previously appeared in the case. *CBI*, 529 F.3d at 459; *In re SG Philips Constructors, Inc.*, 45 F.3d 702, 706 (2d Cir. 1995) (the *Marathon* defendant was "involuntarily subjected to having the debtor's state law claim against it decided by an Article I judge" because it "had not filed a proof of claim and had no other connection with the bankruptcy").

The *Marathon* plurality's Article III concerns were clear in the context of a non-Article III judge appointed by the political branches determining claims against someone dragged into the bankruptcy. But the Ninth Circuit opinion fails to explain why those concerns would apply to a creditor who files a proof of claim under today's very different bankruptcy scheme controlled by Article III judges.

C. *Thomas/Schor.*

The Opinion also ignores this Court's subsequent decisions limiting *Marathon*'s scope and impact.

In 1985, this Court acknowledged that the justices could not agree on Article III's scope in *Marathon* and that *Marathon* only establishes that a non-Article III court cannot render final judgment "in a traditional contract action arising under state law, *without consent of the litigants*, and subject only to ordinary appellate review." *Thomas*, 473 U.S. at 584 (emphasis added). The Court advised that "practical attention to substance rather than doctrinaire reliance on formal categories should inform application of Article III" and that courts must consider the "concerns guiding the selection by Congress of a particular method for resolving disputes" when "assessing the degree of judicial involvement required by Article III." *Id.* at 587.

A year later, in *Schor*, it rejected an Article III challenge to a statutory scheme that allowed customers to sue their commodity brokers before non-Article III commissioners, the Commodity Futures Trading Commission (CFTC), and allowed the CFTC, in conformance with Congress' goal of efficient dispute resolution, to adjudicate counterclaims "'aris[ing] out of the transaction or occurrence or series of transactions or occurrences set forth in the complaint.'" *Schor*, 478 U.S. at 837, 850. The subject counterclaim was a state-law claim normally reserved to Article III courts, and the customer who filed the CFTC claim

objected to the counterclaim jurisdiction. *Id.* at 838-39, 853.

This Court rejected the Circuit Court's conclusion that *Marathon* made the statute unconstitutional. *Id.* at 839-40. It recognized that the right to adjudication of claims and counterclaims by an Article III judge is a personal right that can be impliedly waived by filing a claim in a non-Article III forum, and that the absence of such consent was a crucial factor in *Marathon*. *Id.* at 839-40, 848-49. It rejected "formalistic and unbending rules" that would "unduly constrict Congress' ability to take needed and innovative action pursuant to its Article I powers," and instead advised courts to give due regard in each case to the "practical consequences" of Congress' adjudicatory scheme "in light of the larger concerns that underlie Article III," concluding that the CFTC statute did not impermissibly intrude on the judiciary. *Id.* at 851, 857. In observing that the CFTC's jurisdiction was "not without precedent," it described *Katchen* as upholding "a bankruptcy referee's power to hear and decide state law counterclaims against a creditor who filed a claim in bankruptcy when those counterclaims arose out of the same transaction." *Schor*, 478 U.S. at 852.

Numerous courts have concluded that "a fair reading of *Schor* leads to the conclusion" that bankruptcy courts have core jurisdiction over debtor counterclaims arising out of the same transaction as the proof of claim. *Bokum*, 64 B.R. at 930; *accord Applied Thermal Sys.*, 294 B.R. at 787 n.8; *Beugen*, 81 B.R. at 1000; *STN*, 73 B.R. at 483; *Sun West*, 69 B.R. at 865;

see Kaiser Steel, 95 B.R. at 787 ("The holdings of *Schor* and *Thomas* in the bankruptcy setting had, in fact, been anticipated by Congress in the enactment of 28 U.S.C. §157(c)(2)").

They recognize that filing a proof of claim is sufficiently voluntary to constitute consent to compulsory counterclaims. *See*, *e.g.*, *Applied Thermal Sys.*, 294 B.R. at 791 ("if [the creditor] was concerned about defending counterclaims in bankruptcy court, it should have foregone filing its proof of claim against the estate of [the debtor]"); *Lion Country Safari*, 124 B.R. at 572 ("The filing of a proof of claim by a creditor is 'voluntary' in the sense that a creditor is not required to file a proof of claim, and pursue it within the bankruptcy court"); *Wiener Pharmaceuticals*, 1988 Bankr. LEXIS 1097 at *16 ("To call it jurisdiction by ambush is simply to use pejorative terms for what is the well known consequence of filing a claim. The defendants here could have avoided the jurisdiction of the bankruptcy court by refraining from asserting a right to share in the distribution of the debtor's estate.").

Consistent with *Schor*'s pragmatic balancing approach, courts and commentators have also recognized that the 1984 Act's procedural changes – e.g., the appointment and dismissal of bankruptcy judges by Article III judges (instead of the political branches) and the district court's unfettered discretion to refer or withdraw jurisdiction – substantially diminish the threat of political-branch encroachment on the judiciary that undergirded much of the

Marathon plurality's concerns. *E.g.*, *Mankin*, 823 F.2d at 1309; *In re Finevest Foods, Inc.*, 143 B.R. 964, 967-71 (Bankr. M.D. Fla. 1992); *In re Jennings*, 83 B.R. 752, 760-61 (D. Nev. 1988); Troy A. McKenzie, *Judicial Independence, Autonomy, and the Bankruptcy Courts*, 62 Stan. L. Rev. 747, 793 (2010) ("[d]espite lacking the structural protections of tenure during good behavior and undiminished salary, bankruptcy judges are, perhaps counterintuitively, *more* insulated from the legislative and executive branches than most federal district judges"); *id.* at 806 ("[a] more full-bodied assessment of the bankruptcy courts suggests that the qualities of the bankruptcy bench and bar provide adequate substitutes for the qualities that courts and commentators reference when they invoke 'Article III values' ").

Courts also have recognized that *Schor* and *Thomas* "turned to history and tradition to help define the type of adjudicatory proceeding that the Constitution reserves exclusively for Article III Courts." *Arnold Print Works*, 815 F.2d at 169 (Breyer, J.). A historical definition supports core jurisdiction over compulsory counterclaims, since "[c]ounterclaims arising from the same transaction as the creditor's claim have also been traditionally adjudicated by non-Article III bankruptcy judges." *Beugen*, 81 B.R. at 1000.

D. *Granfinanciera/Langenkamp*.

A few years after *Schor*, this Court rendered two bankruptcy decisions that confirm the constitutional importance of filing a proof of claim:

- *Granfinanciera, S.A. v. Nordberg*, 492 U.S. 33, 56-59 (1989) held that a defendant who had not filed a proof of claim had a right to jury trial on a trustee's fraudulent conveyance action, because the absence of a proof of claim made the trustee's right to recover a fraudulent conveyance a private right, rather than a counterclaim arising in the claims allowance process.
- A year later, *Langenkamp* held that creditors who filed proofs of claim had no right to jury trial on a trustee's preference counterclaim because the proofs of claim triggered the process of claims allowance/disallowance, bringing the creditor within the bankruptcy court's equitable jurisdiction. 498 U.S. at 44-45.

Cases and commentators have construed these decisions as supporting core jurisdiction over compulsory counterclaims. *E.g.*, *Fang Operators*, 158 B.R. at 646; *Asousa P'ship*, 276 B.R. at 67; Jonathan P. Friedland, Commercial Bankruptcy Litigation §3:27, 3-56 (2d ed. 2009) ("*Granfinanciera* and *Langenkamp* establish the constitutionality of the bankruptcy court's core jurisdiction over . . . counterclaims by the

estate against persons filing claims against the estate, designated core by section 157(b)(2)(C)").

Yet, *Granfinanciera* and *Langenkamp* only addressed trustee claims for fraudulent conveyance and preference. Thus, "[e]ach of the three Supreme Court cases speaking to the waiver effected by filing a proof of claim – *Katchen v. Landy*, *Granfinanciera* and *Langenkamp v. Culp* – involved avoiding power counterclaims. It is not surprising that the Court found the counterclaims to be part of the claims allowance process; a claim cannot be allowed if the claimant has not returned property conveyed by the debtor in an avoidable transaction. Whether the same is true of other types of counterclaims is less clear." 1 Collier on Bankruptcy, *supra* at 3-81 ¶ 3.08[2][a].

IV. THE COURT SHOULD RESOLVE THE CIRCUIT SPLIT IMMEDIATELY.

A. The Presented Issues Rarely Reach The Circuit Level.

The issues presented by this petition rarely reach the circuit level, as confirmed by the paucity of relevant circuit decisions in the three decades since §157(b)(2)(C)'s enactment. "The nature of bankruptcy cases tends to discourage further appellate review in the Article III courts because of the twin concerns of delay and cost associated with prolonged litigation." McKenzie, *supra*, 62 Stan. L. Rev. at 782. Between 2000 and 2007, the ratio between cases filed and the number of appeals was only one for every 1,580

bankruptcy cases, compared to one for every 12 civil cases. *Id.* at 783-84.

Moreover, not only do "[b]ankruptcy cases generate few appeals," but "the structure of appellate review in bankruptcy cases complicates the generation of binding precedent to guide the resolution of future disputes, and the Article III courts have little appetite for entertaining those appeals that do make it out of the bankruptcy courts." *Id.* at 751-52. Consequently, a gap often exists "between appellate decisionmaking and the law as applied in the bankruptcy courts. The disputes that generate reported opinions in bankruptcy cases tend not to be ordinary disputes involving somewhat unsettled areas of law. Rather, they tend to be decisions that are notable outliers, with resulting interpretations of the law that are . . . 'often out of sync with long-standing practice.'" *Id.* at 784. That aptly describes the opinion here – an outlier decision in an extraordinary case that alters long-standing practices.

Decades could pass before these important issues reach this Court again.

B. The Opinion Is Already Causing Confusion.

The prevailing view that core jurisdiction exists over all debtor compulsory counterclaims to proofs of claim rests on multiple analytical rationales:

- Since compulsory counterclaims arise from the same subject matter as the proof of claim, they relate to the core bankruptcy power of adjusting creditor-debtor relations and therefore adjudicate public rights. *Applied Thermal Sys.*, 294 B.R. at 789; *Beugen*, 81 B.R. at 1000; *Bar M*, 63 B.R. at 346-47.

- *Marathon* did not alter the rule that filing a proof of claim invokes the special rules of bankruptcy. *CBI*, 529 F.3d at 462.

- Creditors who file proofs of claim consent to the bankruptcy court adjudicating compulsory counterclaims. *Applied Thermal Sys.*, 294 B.R. at 788-89; *Asousa P'ship*, 276 B.R. at 66-67; *Beugen*, 81 B.R. at 1001; *STN*, 73 B.R. at 483; *Sun West*, 69 B.R. at 864-65; *Bokum*, 64 B.R. at 930.

- Because compulsory counterclaims arise from the same transaction as the creditor's claim against the estate, they "need no jurisdictional basis beyond [§157(b)(2)(C)] because the bankruptcy court's jurisdiction is ancillary to its jurisdiction over the creditor's claim." 9 Am. Jur. 2d Bankruptcy § 782 (2010); *accord*, *Lion Country Safari*, 124 B.R. at 569; *Yagow*, 53 B.R. at 740.

In stark contrast, the Ninth Circuit's opinion provides no such analytical moorings for its new core

jurisdiction test for compulsory counterclaims. As Bankruptcy Judge Randolph Haines recently explained in a detailed critique, the opinion's new test is difficult to decipher, let alone apply, because *Katchen* and *Marathon* – the two cases the opinion cites – did not find any constitutional problem with bankruptcy courts deciding compulsory counterclaims to proofs of claim, the opinion never clearly identifies what constitutional limits exist for such counterclaims, it never addresses the Ninth Circuit's own precedent concluding that filing a proof of claim constitutes consent to summary jurisdiction over compulsory counterclaims, and its test for non-core jurisdiction rests on imprecise guideposts, such as the nexus between the claim and counterclaim being "'somewhat attenuated'" or the claims not being sufficiently "'part and parcel'" of each other. *Gorilla Cos.*, 429 B.R. at 312-13. Unless this Court steps in, the opinion will wreak confusion among Ninth Circuit bankruptcy courts.

C. The Opinion Will Confound Bankruptcy Administration In An Area Where Nationwide Uniformity Is Crucial.

The opinion will flout Congress' goal of efficient and expeditious bankruptcy administration. *See* §I.B, *supra*. It splinters the determination of creditor claims against the estate and compulsory counterclaims into different forums. It produces the absurd result that debtors must file compulsory counterclaims in bankruptcy courts that cannot finally

adjudicate them. It will swamp bankruptcy and district courts with abstention and withdrawal motions. And by requiring district courts to determine compulsory counterclaims, which by definition are legally and factually interconnected to creditor claims being adjudged by the bankruptcy court, it will spawn endless litigation and confusion over jurisdictional limits and claim and issue preclusion – the exact opposite of what Congress intended.

If Article III truly compels this result, this Court should say so immediately so Congress can address the repercussions. And if, as petitioner submits, the opinion is simply wrong, this Court should say so immediately to prevent the jurisdictional and administrative complication that the opinion will engender. Moreover, the presence of a circuit split in this area is repugnant; bankruptcy is an area where the Constitution itself recognizes the importance of nationwide uniformity. U.S. Const. Art. I, §8 (granting Congress the power to establish "uniform Laws on the subject of Bankruptcies throughout the United States").

CONCLUSION

For all the foregoing reasons, the petition for writ of certiorari should be granted.

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Respectfully submitted,

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