No. 10-179

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

PETITIONER'S REPLY IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

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PETITIONER'S REPLY

This case presents a clear, clean, vitally important issue for review – is the Ninth Circuit correct that 28 U.S.C. §157(b)(2)(C) violates Article III of the Constitution by investing bankruptcy courts with core jurisdiction over all compulsory counterclaims to creditors' proofs of claim? As the leading bankruptcy treatise recognizes, this issue has been brewing since *Northern Pipeline Construction Co. v. Marathon Pipe Line Co.*, 458 U.S. 50 (1982) and its much-discussed footnote 31. *See* 1 Alan N. Resnick & Henry J. Sommer, Collier on Bankruptcy (16th ed. 2010) 3-32 to 3-34, ¶ 3.02[3][d][I].

While the bulk of this reply answers Pierce's legal arguments, his opposition brief also presents a highly misleading factual summary intended to dilute the candidacy of this case for certiorari; in particular, he portrays Vickie as forum-shopping her tortious interference claim, dragging Pierce into a federal forum he did not choose. Opp'n 1-2, 6-18. These distortions continue the win-at-any-cost litigation style that Pierce and his attorneys have pursued in this case at every level. The bankruptcy court called them on it,[1] as did the district court.[2] This Court saw

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[1] The bankruptcy court found some of Pierce's counsel's representations to be "directly opposite" to the truth, *In re Marshall*, 273 B.R. 822, 832 (Bankr. C.D. Cal. 2002), and it imposed issue sanctions because of Pierce's "massive discovery abuse" (App. 320-26).

[2] The district court characterized some of Pierce's litigation tactics as "the height of bad faith" (App. 148-49 n.21), noted that

(Continued on following page)

through it, too.[3] There is insufficient space to correct all the distortions, but we briefly set the record straight regarding the most significant one.

As even the Ninth Circuit now recognizes, Pierce deliberately moved his pending state court defamation claim into the bankruptcy court, requiring Vickie to file her tortious interference compulsory counterclaim in response or lose it forever. App. 13-17. The suggestion that Vickie chose the federal forum to litigate against Pierce is a canard.[4]

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if the evidence of the trust for Vickie had been insufficient "the discovery abuses in this case might have led the Court to deem this fact as established" (App. 137 n.17), and "encourage[d]" the Justice Department to investigate Pierce's chief witness, Edwin Hunter, for perjury prosecution (App. 160 n.28).

[3] When this case was previously before this Court, at oral argument Justice Stevens raised the fact that Pierce's brief contained a highly misleading quotation. *Marshall v. Marshall*, No. 04-1544, Tr. 51-52, Feb. 28, 2006. Two terms later, Justice Kennedy adverted to Pierce's counsel's tactics in the *Marshall* case during his argument of another case, stating, "And if you have repeated statements in your brief that require qualifications, if in your former argument in Marshal [sic], the Court is concerned with the accuracy of one of your citations, shouldn't we view with some skepticism what you tell us?" *Preston v. Ferrer*, No. 06-1463, Tr. 51, Jan. 14, 2008; *see also* Tr. 47-50.

[4] The opposition brief asserts that the petition "contends incorrectly that Vickie 'first appeared in [the Texas probate court] proceeding in 1998, when she joined a pending will contest,'" because in 1995 "Vickie commenced proceedings in the Texas probate court (the "Probate Court"), seeking a declaration concerning the validity of the living trust and alleging that Pierce had tortiously interfered with her property rights concerning J. Howard's assets." Opp'n 6.

(Continued on following page)

Having thus distorted the facts, the opposition brief then obfuscates the law, straining to make it appear as if the Ninth Circuit's newly-minted interpretation of §157(b)(2)(C) is simply business as usual, when in fact the Ninth Circuit radically departed from the uniform practice in the federal courts of treating all compulsory counterclaims as core by holding that core jurisdiction can constitutionally exist only in the rare circumstance that the resolution of the counterclaim is a "necessary precursor" to the allowance or disallowance of the claim itself.

The scores of bankruptcy court decisions the petition cites (Pet. 25-27) show this is an issue bankruptcy courts deal with every day. Yet because so few bankruptcy cases reach the circuit courts, the issue may fester for many more years unless the Court seizes this opportunity to confront it.

The bracketed words Pierce interpolates above wholly change what the petition actually stated, which was, "A Texas probate court *began administering Howard's estate* in August 1995 [citation] [and] Vickie first appeared in *that proceeding* in 1998, when she joined a pending will contest." Pet. 4 (emphases added). The earlier 1995 probate court proceeding was a *guardianship* proceeding initiated by *Pierce* to declare Howard incapacitated in which Vickie claimed Pierce was interfering with *Texas statutory spousal support* and which terminated when Howard died. Excerpts of Record ("ER") 724-37; Supplemental Excerpts of Record ("SER") 7959, 8005-06, 10194, 12595-96.

I. THE NINTH CIRCUIT'S NEW RULE DEPARTS SHARPLY FROM SETTLED LAW.

A. The Opinion Creates A Circuit Split.

Commentators have recognized that the opinion below "is a game-changing decision." Kevin M. Baum, *Ninth Circuit Holds That A Debtor's Compulsory Counterclaims Can Be "Non-Core,"* Am. Bankr. Inst. J. 48, 48 (July/Aug. 2010). It decisively "changed the law." *In re Gorilla Cos.*, 429 B.R. 308, 310 (Bankr. D. Ariz. 2010).

Undaunted, Pierce argues the Ninth Circuit's rule is nothing new because all other appellate courts holding compulsory counterclaims core "follow the reasoning of this Court's decision in *Katchen v. Landy* [, 382 U.S. 323 (1966)]." Opp'n 2. Nonsense. Only one of the five circuit decisions (Pet. 22-23), even mentions *Katchen* and it does so only on an irrelevant vacatur issue. *See In re CBI Holding Co.*, 529 F.3d 432, 459-65 (2d Cir. 2008) (core jurisdiction analysis); *id.* at 438, 466-69 (references to *Katchen*). Far from following the other circuits' cases, the Ninth Circuit cites none of them.

To make the opinion sound like business as usual, Pierce recharacterizes its holding that the resolution of the counterclaim must be a "necessary precursor" to resolving the creditor's claim (*see* App. 4) as meaning simply that the claim and counterclaim must be "inextricably intertwined"; he then points to similar language in *CBI*, 529 F.3d at 438 ("integrally related to the Proof of Claim") and *In re Baudoin*, 981

F.2d 736, 743 (5th Cir. 1993) ("common nucleus of operative facts"). Opp'n 18-19, 25, 27-28. But a compulsory counterclaim by definition is "integrally related" and "inextricably intertwined" with the proof of claim. Fed. R. Bankr. P. 7013; Fed R. Civ. P. 13(a); *In re Yagow*, 53 B.R. 737, 740 (Bankr. D.N.D. 1985) ("[a] counterclaim, compulsory in nature, is the type of counterclaim which would be considered integral"); *In re Beugen*, 81 B.R. 994, 1000 (Bankr. N.D. Cal. 1988) ("[a] compulsory counterclaim against a creditor that has asserted a claim is closely connected to the central bankruptcy function of determining claims").

Under the Ninth Circuit's "necessary precursor" standard, as opposed to Pierce's re-write, the counterclaims in the other circuit cases all would be non-core because each entails factual and legal elements beyond what would be required to prove or disprove the proof of claim. *See* Pet. 22-23.

In *CBI*, for example, the debtor counterclaimed for $70 million in damages for accounting malpractice committed from 1992 through 1994 in response to an auditor's proof of claim for an unpaid 1994 audit; the Second Circuit held the counterclaims were core, even though the proof entailed factual elements far beyond what would have been necessary to resolve the proof of claim. 529 F.3d at 439-42, 461 & n.12. Significantly, the court held another set of counterclaims core although "none of them affect the allowance of [the auditor's] fees claim against the estate," because they "are related to and arise out of the same transaction as [the auditor's] fee claim, and a determination on

[those counterclaims] would likely be dispositive of [the auditor's] claim." *Id.* at 464.[5]

Similarly, *In re American Bridge Products*, 599 F.3d 1, 4 (1st Cir. 2010) involved a receiver's proof of claim seeking compensation for services; the debtor's compulsory counterclaims addressed not only the value of those services but also "losses to the estate caused by negligence and/or breach of fiduciary duty." *In re Am. Bridge Prods.*, 398 B.R. 724, 730 (D. Mass. 2009). Even though the tort claims required proof beyond mere allowance/disallowance of the receiver's compensation claim, the First Circuit held the counterclaims core, broadly pronouncing that "a compulsory counterclaim appears to fall within the statutory definition of core proceedings." 599 F.3d at 4.

The opinion below is the only circuit case ever to hold a compulsory counterclaim non-core, and it finds Vickie's counterclaim non-core even though its successful resolution establishes the affirmative defense of truth to Pierce's defamation claim. A compulsory counterclaim will rarely "essentially merge" (*see* App. 4) with the creditor's claim in terms of proof; otherwise it would merely constitute an affirmative defense. Under the Ninth Circuit's new test, few counterclaims would be core other than "avoiding

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[5] Although Pierce claims *Germain v. Connecticut National Bank*, 988 F.3d 1323 (2d Cir. 1993) supports his "reading of *CBI*" (Opp'n 26), *CBI* itself distinguishes *Germain*, noting the debtor's claims "were not asserted to counter the proof of claim" and the debtor never objected to the proof of claim. *CBI*, 529 F.3d at 467.

power" counterclaims, such as the preference counterclaim in *Katchen*, since only those would be necessary precursors to resolving the proof of claim.

B. Pierce Ignores The Legion Of Contrary Bankruptcy And District Court Authority.

Pierce argues that, "as Stern concedes, the issue [raised in the petition] arises only sporadically." Opp'n 20. But the petition explains that these issues rarely reach *the circuit level*, given the nature and economics of bankruptcy cases. Pet. 38-39. Issues involving compulsory counterclaims to proofs of claim occur frequently in bankruptcy, as the trial court decisions cited at pages 24-27 of the petition show.

Pierce is wrong that these cases all follow the Ninth Circuit's new rule. Opp'n 29. Rather, the bankruptcy and district courts (other than in a few outdated cases, *see* Pet. 28-29) uniformly have treated as core *all* compulsory counterclaims, i.e., those arising from the same transaction as the proof of claim. *See, e.g.*, *In re Geneva Steel, LLC*, 343 B.R. 273, 278 (Bankr. D. Utah 2006) (creditors "may not claim against the estate without subjecting themselves to compulsory counterclaims attaching to their claims"); *In re Asousa P'ship*, 276 B.R. 55, 67 (Bankr. E.D. Pa. 2002) ("a creditor who files a claim in the bankruptcy court in this circuit impliedly consents to being sued on counterclaims arising out of the same but not unrelated transactions"); *In re Iridium Operating*, 285 B.R. 822, 832 (S.D.N.Y. 2002) ("non-core claims

against a creditor in an adversary proceeding will be considered core" where "the claim arises out of the same transaction as the creditor's proofs of claim or setoff claim"); *In re Lion Country Safari, Inc.*, 124 B.R. 566, 569 (Bankr. C.D. Cal. 1991) ("a debtor's counterclaim arising from the same transaction as the creditor's claim against the estate may be decided in the same manner as the claim").

II. PIERCE'S MISCONSTRUCTION OF §157(b) IS NO BASIS FOR DENYING CERTIORARI.

Pierce insists the Opinion "is fully consistent with the governing statutory text and Congress' intent in crafting the current bankruptcy jurisdictional provisions." Opp'n 2. But his argument rests on an insupportable reading of the statute.

Faced with the reality that Congress expressly included counterclaims to proofs of claim in its non-exhaustive list of proceedings that Congress designated as "core," Pierce argues that §157(b)'s language authorizes bankruptcy courts to enter final judgment only if the proceeding is *both* "core" *and also* "arises under" the bankruptcy code or "arises in" the bankruptcy case. Opp'n 34-35. However, the statute demonstrates that Congress divided proceedings into two categories: "core" proceedings (i.e., claims that fall within the "arise under" and "arise in" definitions), which the bankruptcy court can finally decide, and proceedings merely "related to" the bankruptcy

case, which the district court must finally decide. For example,

- §157(b)(3) specifies bankruptcy judges shall determine "whether a proceeding is a core proceeding under this subsection or is a proceeding that is otherwise related to a case under title 11" and a determination that "a proceeding is not a core proceeding shall not be made solely on the basis that its resolution may be affected by State law";
- §157(c)(1) specifies that bankruptcy judges "may hear a proceeding that is not a core proceeding but that is otherwise related to a case under title 11" but "[i]n such proceeding" can only submit proposed findings.

If Congress had intended Pierce's construction, it would have required bankruptcy courts to determine whether a proceeding is "a core proceeding" *and* whether it "arises under" or "arises in," and it would have similarly qualified all other "core" references.

III. CERTIORARI IS NECESSARY BECAUSE THE CIRCUIT SPLIT ARISES FROM DIFFERING INTERPRETATIONS OF THIS COURT'S PRECEDENT.

Pierce attempts to validate the opinion by claiming it simply applies this Court's precedent. *See* Opp'n 20-22, 29-32, 36-39. But that is exactly why certiorari is necessary. This Court has *never* addressed the

constitutionality of §157(b)(2)(C), and courts have reached differing conclusions on the application of this Court's existing precedent to that statute. *See* Pet. 29-38. Absent certiorari, the issue will remain unsettled.

For example, in attempting to transform *Katchen* into an Article III case that imposes limitations on compulsory counterclaim adjudication, Pierce (like the Ninth Circuit) ignores that:

- *Katchen* did not consider Article III and only *construed* the 1898 Bankruptcy Act. *Marathon*, 458 U.S. at 79 n.31.
- The 1898 Act had no provision authorizing bankruptcy courts to decide counterclaims and, until this Court considers §157(b)(2)(C), the power of bankruptcy courts to enter final judgment on counterclaims will remain unsettled. 1 Collier on Bankruptcy, *supra*, at 3-32 to 3-34, ¶ 3.02[3][d]; Pet. 30-32.
- Even after *Katchen*, courts applying the 1898 Act recognized that bankruptcy courts had summary jurisdiction over compulsory counterclaims (Pet. 14-15).
- This Court itself has construed *Katchen* as supporting a bankruptcy court's entry of final judgment on state-law counterclaims to a proof of claim that "arose out of the same transaction." *Commodity Futures Trading Comm'n v. Schor*, 478 U.S. 833, 852 (1989).

IV. THIS CASE IS AN APPROPRIATE VEHICLE FOR CERTIORARI NOTWITHSTANDING STATEMENTS IN THE CONCURRENCE.

Pierce argues that this case is a poor vehicle for reviewing the issues raised in the Petition because the concurrence purportedly provides additional reasons Vickie's counterclaim might be non-core. Opp'n 41-44. But he ignores that the concurrence rests on factual assertions the majority rejected and the record refutes. Pet. 10-11 n.4. Moreover, even if the circuit court might address additional issues on remand, that is no reason to deny certiorari. *See Marshall v. Marshall*, 547 U.S. 293 (2006) (review of probate-exception ruling granted, even though Ninth Circuit had not addressed other potentially dispositive arguments).

In any event, the only issue mentioned in the concurrence that Pierce expressly discusses involves §157(b)(5), which provides that "the district court shall order that personal injury tort and wrongful death claims shall be tried in the district court." Opp'n 41-43. Pierce argues that his proof of claim for defamation and Vickie's counterclaim for tortious interference with a gift were both "personal injury torts" within the meaning of §157(b)(5), and that this Court should not grant certiorari because §157(b)(5) independently compels the conclusion that Vickie's counterclaim was non-core. Opp'n 42-43.

Far from being a reason to deny certiorari, Pierce's argument provides an additional basis for

certiorari review. Courts are in substantial conflict regarding §157(b)(5)'s scope and meaning. *See, e.g.*, *In re Smith*, 389 B.R. 902, 907-08 (Bankr. D. Nev. 2008) (noting at least three conflicting views regarding which "personal injury" claims fall within the statute). Pierce fails to acknowledge that courts have concluded defamation falls outside §157(b)(5)'s scope. *E.g.*, *Massey Energy Co. v. W. Va. Consumers For Justice*, 351 B.R. 348, 351 (E.D. Va. 2006); *In re Davis*, 334 B.R. 874, 878 n.2 (Bankr. W.D. Ky. 2005), *aff'd in part, rev'd in part on other grounds*, 347 B.R. 607 (W.D. Ky. 2006).

Moreover, even courts that have extended §157(b)(5) to defamation have recognized that creditors can impliedly consent to the bankruptcy court entering final judgment on such claims. *Smith*, 389 B.R. at 910-16. *Smith*, for example, concluded that the creditor consented to the bankruptcy court finally adjudicating his defamation claim where he both sought a nondischargeability determination and filed a proof of claim for unliquidated damages and never timely objected to the court adjudicating his defamation claim. *Id.* at 908, 910-16.

As in *Smith*, Pierce filed a proof of claim for defamation and told the bankruptcy court that "[a]ll parties are in agreement that *the amount* of the contingent Proof of Claim filed by [Pierce] shall be *determined by the adversary proceedings filed herein*" and that he would be "happy" and "pleased" to litigate "[his] claim here" because "we did choose this forum." SER 6101-02, 6801 (emphases added). The district

court recognized that Pierce thereby consented to the bankruptcy court adjudicating his defamation claim. App. 266-67 n.17.[6]

In sum, this Court should grant certiorari to resolve the important constitutional and statutory questions posed by the opinion's holding. That such review could (but need not) entail consideration of important §157(b)(5) issues is no reason to deny certiorari.

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[6] Moreover, although Pierce attempted to withdraw his claim from the bankruptcy court some two years into the process, the district court rejected that effort, a decision partly "driven by [Pierce's] selection of forum." SER 6185, 6717; *see Sec. Farms v. Int'l Bhd. of Teamsters*, 124 F.3d 999, 1007 n.3 (9th Cir. 1997) (withdrawal motion must be "made as promptly as possible"). Pierce never appealed that ruling.

CONCLUSION

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

Dated: August 31, 2010

Respectfully submitted,

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