

## Anna Nicole Smith – The Continuation of the Legal Saga and Its Impact on Federal Jurisdiction

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For over 15 years, Vickie Lynn Marshall (aka Anna Nicole Smith) and, following her death, her estate have been embroiled in a legal battle with E. Pierce Marshall (and now, his estate), over the assets of the estate of Texas oil tycoon J. Howard Marshall II. Pierce Marshall was the younger son of Howard Marshall and the primary heir under his father's living trust. Smith, a former Playboy model, had been married to the elder Marshall (who was 63 years her senior) for a little over a year at the time of his death, and was not provided for under his living trust or his will.

This legal drama, which is reminiscent of the *Jarndyce* case in Dickens' *Bleak House* that dragged on for generations, has made its way to the U.S. Supreme Court for a second time.<sup>1</sup> The Supreme Court is again reviewing the scope of the bankruptcy court's jurisdiction over the dispute, focusing this time on the jurisdiction afforded to bankruptcy courts under 28 U.S.C. § 157. The Supreme Court's ruling will determine whether the bankruptcy court presiding over Smith's chapter 11 case had "core" jurisdiction to enter a final judgment on her counterclaim to Pierce Marshall's defamation claim in Smith's bankruptcy case. If it did, Smith's heirs will be able to enforce a \$475 million judgment against the assets of Howard Marshall's estate.

This decision could have a major impact on the powers of bankruptcy courts across the country, as the Court revisits the issue of whether non-Article III bankruptcy courts can enter final judgments in bankruptcy proceedings. In § 157, Congress gave broad jurisdiction to bankruptcy courts to enter final judgments as to claims against the bankruptcy estate and counterclaims thereto, which are considered among the enumerated "core proceedings" that do not have to be reviewed by a district court before judgment is entered. The Supreme Court could decide that the scope of that jurisdiction is unconstitutional because the bankruptcy courts are not Article III courts, or, less ominously for the bankruptcy courts, that the filing of a proof of claim does not open the jurisdictional door to counterclaims that have an insufficient nexus to the bankruptcy – like the state law fraud and interference claims in the *Marshall* case.

### *Early Proceedings in Probate Court*

The dispute between Smith and Pierce Marshall actually began in April 1995, before Howard Marshall's death, in the context of Texas probate court guardianship proceedings involving Howard Marshall. In that proceeding, Smith filed suit against Pierce Marshall and others claiming that Pierce Marshall had tortiously interfered with her right to support from her husband and had breached his

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fiduciary duty as trustee of his father's living trust. She also asserted that Pierce Marshall had used undue influence and fraud to get his father to make his living trust irrevocable and to make other estate planning changes in his favor two weeks after Howard Marshall married Smith. After Howard Marshall's death, Smith filed an application with the Texas probate court requesting a finding that her husband had died intestate. Pierce Marshall opposed this application and petitioned for a declaration that his father's living trust and will were valid. He also offered the will for probate.

#### *Bankruptcy Court Proceedings*

In January 1996, while probate proceedings in Texas were pending and unresolved, Smith, who had run out of money following her wealthy husband's death and had a sizable default judgment entered against her in an unrelated matter, filed a chapter 11 bankruptcy case in Los Angeles. Pierce Marshall filed a proof of claim in Smith's bankruptcy case, alleging that Smith had defamed him when her attorneys told the press that he had engaged in forgery, fraud, and overreaching to gain control of his father's assets. Smith filed a compulsory counterclaim alleging that Pierce had tortiously interfered with her expectation of a gift or inheritance from her late husband. Approximately 27 months after he filed his adversary proceeding, Pierce Marshall moved to have the reference withdrawn from the bankruptcy court and the proceeding transferred to the district court. This request was ultimately denied by the district court.

In November 1999, the bankruptcy court granted summary judgment in favor of Smith on the defamation claim. In September 2000, the bankruptcy court entered judgment in her favor on the merits of her tortious interference counterclaim against Pierce Marshall, awarding her over \$449 million in compensatory damages plus punitive damages that it later determined were \$25 million, less any amounts that Smith received from Howard Marshall's estate.<sup>2</sup> Pierce Marshall filed a post-trial motion to dismiss the case for lack of subject-matter jurisdiction, asserting that Smith's

counterclaim for tortious interference could only have been tried in Texas probate court. The bankruptcy court denied that motion, finding that a federal court had jurisdiction to adjudicate rights in probate property so long as its final judgment did not interfere with the state probate court's possession of the property.

#### *Back to Probate Court*

A few days after the bankruptcy court entered its judgment, Smith voluntarily dismissed her claims in the Texas probate court, despite warnings from the probate judge that by doing so she was giving up her right to any claim for money from her late husband's estate, in the apparent belief that her bankruptcy court judgment was sufficient to protect her interests. Pierce Marshall then filed an amended counterclaim against Smith in the probate court for declaratory relief to determine her rights in the estate. After a five month jury trial, in which Smith actively took part, the probate court entered judgment consistent with the jury's verdict, declaring that Howard Marshall's living trust and will were valid, and entering judgment in Pierce Marshall's favor on all claims.<sup>3</sup>

#### *District Court*

Meanwhile, Pierce Marshall appealed the bankruptcy court's judgment on Smith's counterclaim to the district court. After his victory in the probate court, he moved the district court to dismiss Smith's claims against him on the grounds of claim and issue preclusion. The district court denied Pierce Marshall's motion because it found the requisite identity of issues was missing, because the motion was untimely, and due to concerns regarding fundamental fairness. The district court determined that the tortious interference claim was a compulsory counterclaim but was not a "core proceeding" because it did not have a strong factual nexus to the original claim, it relied on different legal theories, and it was in an amount far larger than the original claim. As a result, the district court vacated the bankruptcy court's judgment and treated it as a proposed judgment. After a *de novo*

review of the entire matter, the district court largely affirmed the bankruptcy court's findings and entered judgment in Smith's favor, awarding her compensatory and punitive damages of approximately \$88 million.<sup>4</sup>

#### *Round One in the Ninth Circuit*

On appeal, the Ninth Circuit reversed the district court's decision, holding that the probate exception to federal court jurisdiction barred Smith's counterclaim in the bankruptcy court.<sup>5</sup>

#### *Round One in the Supreme Court – The Probate Exception to Federal Jurisdiction*

In the first appeal, the Supreme Court reversed the Ninth Circuit's ruling, rejecting the lower court's broad interpretation of the probate exception to federal court jurisdiction and holding that the probate exception reserved to state probate courts the probate or annulment of a will and the administration of a decedent's estate and also precluded federal courts from disposing of property that was in the custody of a state probate court. It remanded to the Ninth Circuit the question of whether the counterclaim was a "core proceeding" and Pierce Marshall's claims that the Texas probate judgment precluded Smith's claims in the bankruptcy court.<sup>6</sup>

#### *Remand to the Ninth Circuit*

On remand, the Ninth Circuit determined that Smith's interference counterclaim was not a "core proceeding" arising in a bankruptcy case because it was "not so closely related" to the defamation claim that it had to be resolved to determine the allowance of the Pierce Marshall defamation claim. It also determined that the parties had fully and fairly litigated the issues in the Texas probate proceedings, and that the district court had erred in not finding that the probate court's judgment, which was entered prior to the district court's judgment, had a preclusive effect on that judgment.<sup>7</sup>

In its decision, the Ninth Circuit adopted a two step approach in determining whether a claim is a "core proceeding," a position that had been argued in an amicus brief. The Ninth Circuit held that in order for a counterclaim to a proof of claim to constitute a "core proceeding": (1) such claim must meet Congress' definition of a "core proceeding" and (2) such claim must "arise under" the Bankruptcy Code or "arise in" a bankruptcy case, as distinguished from a claim that is "related to" a bankruptcy case. A counterclaim brought in bankruptcy court may be considered compulsory but not "core," according to the Ninth Circuit. The Ninth Circuit further held that a compulsory counterclaim "arising in" a bankruptcy case will only be a core proceeding if it is so closely related to the proof of claim that it must be resolved in order to determine the allowance or disallowance of the claim against the bankruptcy estate.<sup>8</sup> Ultimately, the Ninth Circuit concluded that since certain factual and legal questions not necessary to decide Pierce Howard's defamation claim would have to be answered in order for Smith to have prevailed on her counterclaim, Smith's counterclaim was not an integral part of the claims allowance and disallowance process and was thus not a core proceeding.

The Ninth Circuit noted that it was following the principles set forth in *Northern Pipeline Construction Co. v. Marathon Pipe Line Co.*,<sup>9</sup> the Supreme Court decision that significantly curtailed the powers given to bankruptcy courts in 1978 under the Bankruptcy Code, and asserted that it was abiding by Congress' intent in amending the Bankruptcy Code to address the constitutional problems with the bankruptcy courts noted in the *Marathon* decision.<sup>10</sup>

#### *Round Two in the Supreme Court – Core Proceedings and Bankruptcy Court Jurisdiction*

The Supreme Court granted Smith's certiorari petition. The crux of the issues now before the Supreme Court is whether the compulsory counterclaim against Pierce Marshall in Smith's bankruptcy case was a "core proceeding" arising in or related to a case under title 11 or a "noncore

proceeding,” merely related to a case under title 11. In core proceedings, a bankruptcy court is authorized to issue final judgments. If Smith's counterclaim was a “core proceeding,” the bankruptcy court's judgment in her favor would have been a final judgment entered prior to the probate court's judgment and would have a preclusive effect on that judgment. If it was a “non-core proceeding,” however, the bankruptcy court's judgment only constituted proposed findings of fact and conclusions of law that were then reviewed *de novo* by the district court. Since the district court's judgment in Smith's favor was entered after the probate court's judgment, the probate court's judgment, under the full faith and credit clause of the Constitution, would be the first final judgment and would therefore have a preclusive effect on the later district court judgment.

#### *Statutory Interpretation*

One of the things that the Supreme Court must determine is the statutory meaning of “core proceedings.” In pertinent part, core proceedings are defined under 28 U.S.C. 157(b)(2) as follows:

Core proceedings include, but are not limited to . . . (B) allowance or disallowance of claims against the estate or exemptions from property of the estate, and estimation of claims or interests for the purposes of confirming a plan under chapter 11, 12, or 13 of title 11 but not the liquidation or estimation of contingent or unliquidated personal injury tort or wrongful death claims against the estate for purposes of distribution in a case under title 11; (C) counterclaims by the estate against persons filing claims against the estate . . .

According to Smith's estate and the United States (which filed an amicus brief supporting her), *all* counterclaims to proofs of claim are within the specifically enumerated list of core proceedings under the statute. In response, Pierce Marshall's estate counters by arguing that the structure of the

statute mandates that in order to be a “core proceeding,” a counterclaim must arise under the Bankruptcy Code or arise in a bankruptcy case, and preexisting state law claims fall outside of those parameters. The Ninth Circuit's decision skirts this issue, perhaps because it in effect rewrites the statute by superimposing an additional requirement for a counterclaim to be considered core – *it must be so closely related to the proof of claim that it must be resolved in order to determine the allowance or disallowance of the proof of claim.*

In the Supreme Court, Pierce Marshall's estate also made a separate “plain meaning” argument, utilizing the alternative ground for the holding in Pierce Marshall's favor contained in a concurring opinion to the Ninth Circuit's primary opinion. That argument is that the defamation claim filed by Pierce Marshall in the bankruptcy case was an unliquidated personal injury tort claim falling within the exclusion from the enumerated list of “core proceedings” under 28 U.S.C. § 157(b)(2)(B) and (O) and that, accordingly, trial of those types of claims was required to occur in the district court under 28 U.S.C. § 157(b)(5).

Pierce Marshall's estate argued that the bankruptcy court can never adjudicate personal injury tort proceedings and that § 157(b)(5) is jurisdictional. Smith's estate representative contested that notion, citing to several cases in which courts found a waiver of § 157(b)(5) where the issue had not been timely raised. He noted that Pierce Marshall had failed to raise the issue for 27 months and had failed to appeal the bankruptcy court's summary judgment on his defamation claim.

#### *Constitutionality*

Even if the Supreme Court interprets 157(b)(2)(B) and (C) as including among “core proceedings” all counterclaims to proofs of claim filed in a bankruptcy case, the Court will still need to address whether the statute is constitutional.

Prior to the 1984 amendments, the Bankruptcy Code empowered bankruptcy courts to exercise the entire jurisdiction conferred on the district courts in bankruptcy cases. This broad grant of jurisdiction was held in *Marathon* to have “impermissibly shifted essential attributes of judicial power from the Article III district court to the non-Article III bankruptcy court.”<sup>11</sup>

In *Marathon*, the Supreme Court considered whether the Constitution permitted the bankruptcy court to exercise jurisdiction over a state law breach of contract claim filed by a debtor against a third party who was a stranger to the bankruptcy proceeding. The Court in *Marathon* was divided on the precise scope and nature of the limitations of Article III but did hold that Congress could not vest in non-Article III courts the power to render final judgments in traditional contract actions under state law without the consent of all litigants, distinguishing between “public right” matters (rights arising between government and persons subject to its authority) and “private right” matters.<sup>12</sup>

Congress attempted to address this problem in the 1984 amendments to the Bankruptcy Code and by changes to title 28 wherein: (1) bankruptcy courts were made a unit of the district courts; (2) bankruptcy judges were appointed for limited terms by Article III judges rather than by the President; and (3) district courts were given the discretion to delegate certain matters to bankruptcy courts and the power to withdraw such matters.<sup>13</sup>

The executor of Smith's estate, and the United States in its amicus brief supporting Smith, argued that Supreme Court jurisprudence distinguishes in these contexts persons who file bankruptcy proofs of claim and submit themselves to the jurisdiction of the bankruptcy courts and those who do not, citing the pre-*Marathon* case of *Katchen v. Landy*<sup>14</sup> and two post-*Marathon* cases.

In *Katchen*, the Supreme Court held that the right to a jury trial under the Seventh Amendment did not prevent a bankruptcy court from ordering the

return of a voidable preference if the party that received the preference had previously filed a claim against the bankruptcy estate.<sup>15</sup> In its analysis, the Court stated that the allowance and disallowance of claims is the traditional work of bankruptcy judges, so that when a bankruptcy trustee objects to a claim based on the claimant's receipt of a preference under the Bankruptcy Act (which was then in effect), since the claim cannot be allowed or disallowed until the preference counterclaim is adjudicated, the bankruptcy court has jurisdiction over the preference claim.

In *Granfinanciera, S.A. v. Nordberg*,<sup>16</sup> the Supreme Court held that a defendant who did not file a proof of claim could not be deprived of its jury trial right on a trustee's fraudulent conveyance action because such action did not arise as part of the process of allowance or disallowance of claims and was thus not integral to the restructuring of debtor-creditor relations. In contrast, in *Langenkamp v. Culp*,<sup>17</sup> in which creditors did file a proof of claim, the Supreme Court decided that such creditors were not entitled to a jury trial on the trustee's avoidable preference claims because the filing of the proof of claim triggered the process of allowance or disallowance of claims and subjected such creditors to the bankruptcy court's equitable power. Although *Granfinanciera* and *Langenkamp* dealt with the right to a jury trial rather than the adjudication of counterclaims to proofs of claim by a non-Article III tribunal, Smith's estate and the United States argued that these cases were relevant to analyzing all Article III issues.<sup>18</sup>

Since *Marathon*, the Supreme Court has revisited the scope of Article III jurisdiction in *Thomas v. Union Carbide Agricultural Products, Inc.*,<sup>19</sup> and *Commodity Futures Trading Commission v. Schor*,<sup>20</sup> although neither of these cases arose in the bankruptcy context. In *Thomas*, the Court upheld binding arbitration for resolving disputes about licensing fees under the Federal Insecticide, Fungicide and Rodenticide Act (“FIFRA”) because it held that Article III did not prohibit Congress from establishing non-Article III forums when the dispute at issue involved “public rights,” such as those

created by FIFRA.<sup>21</sup> In *Schor*, the Court upheld the ability of the Commodity Futures Trading Commission (“CFTC”) to adjudicate state law counterclaims to reparations claims by brokers seeking damages for violations of the Commodity Exchange Act because even though the counterclaim was a “private right,” the jurisdiction was limited to counterclaims arising out of the same transaction or occurrence, and the resolution of such counterclaims was a necessary incident to the adjudication of such federal claims.<sup>22</sup> Notably, Smith's estate contends in the Supreme Court that *Thomas and Schor* stand for the proposition that core jurisdiction over all compulsory counterclaims is constitutional.<sup>23</sup>

Pierce Marshall's estate argues that the tortious interference counterclaim was a classic common law tort that was strictly a “private right” not created by Congress and is thus a matter that must be decided by an Article III judge. Marshall distinguishes the counterclaims in *Katchen and Langenkamp* as involving preference claims that had to be decided before the creditor's claim could be allowed. The Marshall estate also distinguishes *Schor* because Schor had the option to pursue his claim in an Article III court but instead chose to adjudicate his claim with the CFTC. In contrast, in the case at hand, Pierce Marshall had no choice but to file his proof of claim with the bankruptcy court in order to secure his right to a portion of Smith's bankruptcy estate.<sup>24</sup>

#### *Reading the Tea Leaves*

Ultimately, the Supreme Court could find that the statutory changes that followed the *Marathon* decision were inadequate to satisfy the Constitution, either wholly or only to a lesser extent. For example, the Court could determine that even matters plainly in the “core” jurisdiction set out by Congress must be reviewed by an Article III court before final judgment can be entered. Any limitations placed on current practices could be disruptive to the bankruptcy system in this country, which relies heavily on the prompt and efficient administration of bankruptcy cases by bankruptcy

courts. This was a concern of the United States and prompted its filing of an amicus brief in support of Smith's position and its meaningful participation in the oral argument before the Supreme Court.

Based on questions asked during oral argument, it is difficult to predict how the Supreme Court will rule in this case. The first question posed by Justice Sotomayor was whether a bankruptcy court could even adjudicate proofs of claims under Article III, let alone counterclaims filed in response thereto. This calls into question the entire jurisdictional premise that the bankruptcy courts can enter final judgments in some matters. The Justices also focused on the less extreme, such as the distinction between permissive and compulsory counterclaims, suggesting that it may be far easier from a constitutional perspective to permit a bankruptcy court to determine a compulsory counterclaim to a proof of claim as a “core proceeding,” even though 157(b)(2)(B) and (C) make no such distinction. Both sides agreed that Smith's counterclaim was a compulsory counterclaim because it arose from the same set of facts as Pierce Marshall's claims in the bankruptcy case. The Justices also examined at oral argument whether Pierce Marshall's claim was, as his estate now claims, a “personal injury tort claim,” which would be outside the bankruptcy court's core jurisdiction. Even if it was, some of the Justices suggested that it may be relevant that Pierce Marshall waited 27 months to make a motion to withdraw the reference to bring his alleged personal injury tort claim before the district court.

Beyond the constitutional and jurisdictional issues at stake in this case, the outcome of which could dramatically alter the administration of bankruptcy cases, the Supreme Court's decision may settle the question once and for all of whether Smith's heirs are entitled to the \$475 million that she was awarded by the bankruptcy court against Howard Marshall's estate. The Supreme Court will not address the Ninth Circuit's determination that issue preclusion principles apply in this case, so if the bankruptcy court had core jurisdiction, its judgment in Smith's favor will preclude the later Texas probate court judgment. Alternatively, if it did not,

the Texas probate court's judgment in Pierce Marshall's favor will preclude the later district court judgment. It is also possible that a Supreme Court decision to reinstate the bankruptcy court's judgment will merely be the start of a new appellate process, as Pierce Marshall's appeal of the \$475 million judgment entered by the bankruptcy court has never been considered by higher courts.

The Supreme Court's ruling is expected to issue prior to the end of the current term.

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- <sup>13</sup> 28 U.S.C. 1334(a), 1334(b), 157(a), and 157(d).  
<sup>14</sup> 382 U.S. 323 (1966).  
<sup>15</sup> *Id.*  
<sup>16</sup> 492 U.S. 33 (1989).  
<sup>17</sup> 498 U.S. 42 (1990).  
<sup>18</sup> Brief of Petitioner, *In re Marshall*, U.S. Supreme Court, No. 10-179.  
<sup>19</sup> 473 U.S. 568 (1986).  
<sup>20</sup> 478 U.S. 833 (1986).  
<sup>21</sup> *Thomas*, 473 U.S. at 569-70.  
<sup>22</sup> *Schor*, 478 U.S. at 834-35.  
<sup>23</sup> Brief of Petitioner, *In re Marshall*, U.S. Supreme Court, No. 10-179.  
<sup>24</sup> Brief For Respondent, *In re Marshall*, U.S. Supreme Court, No. 10-179.

<sup>1</sup> *Stern v. Marshall*, No. 10-179, 2010 BL 225391 (cert. granted Sept. 28, 2010).

<sup>2</sup> *In re Marshall*, 253 B.R. 550, 553 (Bankr. C.D. Cal. 2000).

<sup>3</sup> *In re Marshall*, 600 F.3d 1037, 1047 (9th Cir. 2010).

<sup>4</sup> *Id.* at 1048-1049.

<sup>5</sup> *In re Marshall*, 392 F.3d 1118, 1137 (9th Cir. 2004).

<sup>6</sup> *Marshall v. Marshall*, 547 U.S. 293, 296-97 (2006).

<sup>7</sup> 600 F.3d at 1039.

<sup>8</sup> *Id.* at 1055-58.

<sup>9</sup> 458 U.S. 50 (1982)

<sup>10</sup> 600 F.3d at 1058-59.

<sup>11</sup> *Marathon*, 458 U.S. at 51.

<sup>12</sup> *Id.*