Circuit split over parties' expanding a bankruptcy court's power

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There is now a split among the circuits and the need for the Supreme Court to decide an issue that affects litigants across the country every day: Is it permissible for the parties to consent to allowing a bankruptcy court to issue a final judgment that it otherwise would not have the power to enter? From a practical perspective, few Supreme Court cases engender as much litigation and as much confusion in the lower courts as *Stern v. Marshall*, 131 S. Ct. 2594 (2011). In *Stern*, the Supreme Court held that it violated Article III of the Constitution for bankruptcy judges, who lack the tenure and salary protections accorded to Article III judges, to enter a final judgment over state law claims.

The case received media attention because Vicki Lynn Marshall, also known as Anna Nicole Smith, had married a much older man, J. Howard Marshall. Although he lavished gifts and significant sums of money on Vickie during their courtship and marriage, J. Howard did not include anything for Vickie in his will. Before J. Howard passed away in August 1995, Vickie filed suit in Texas probate court, claiming that Pierce Marshall - J. Howard's younger son - fraudulently induced his father to sign a living trust that did not include her. She maintained that J. Howard meant to leave her half of his estate. Pierce denied any fraudulent activity and defended the trust and, after his father's death, the will.

Soon after J. Howard died, in January 1996, Vickie filed a petition for bankruptcy in the U.S. District Court for the Central District of California. In June 1996, Pierce filed a proof of claim in the federal bankruptcy proceeding, alleging that Vickie had defamed him when attorneys representing Vickie told members of the press that Pierce had engaged in forgery, fraud and overreaching to gain control of his father's assets. Vickie answered, asserting truth as a defense. She also filed counterclaims, among them a claim that Pierce had tortiously interfered with a gift she expected.

The bankruptcy court granted summary judgment in favor of Vickie on Pierce's claim and, after a trial on the merits, entered judgment for Vickie on her tortious interference counterclaim. The court awarded Vickie compensatory damages of more than $449 million - less whatever she recovered in the ongoing probate action in Texas - as well as $25 million in punitive damages.

However, subsequent to the bankruptcy court decision, but prior to the decision of the federal district court which was reviewing it, the Texas probate court conducted a jury trial and ruled in favor of Pierce Marshall. The district court, however, did not give preclusive effect to this decision and agreed with the bankruptcy court that Pierce had tortuously interfered with Vickie's inheritance. The district court reduced the damages to approximately $88 million, divided equally between compensatory and punitive damages.

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U.S. Court of Appeals for the 9th Circuit
9th Circuit instructs federal judges to show how they determined attorney fees and costs
Like schoolkids sweating a math test, federal trial judges must show their work when awarding attorney fees and costs, a 9th U.S. Circuit Court of Appeals panel cautioned on Monday.

Government
New lawyers will need more skills training, pro bono work, according to bar panel's plan
A State Bar task force today will consider a proposal to require law students have 250 hours of skills training before admission plus pro bono experience and extra MCLE after admission.

Intellectual Property
Mountain View lawyer wins messy patent dispute
A Japanese semiconductor company's claim against the co-inventor of one of its patents has no legal grounds, since no federal law forbids the inventor of a technology from "slandering" his own work, a federal appeals court ruled Monday.

Law Practice
Entry-level hiring, law school recruiting nearly flat
Entry-level legal hiring and law school recruiting remained almost flat in 2012, according to report released Monday by the National Association for Law Placement.

Labor/Employment
Female Daiichi Sankyo employees allege gender discrimination
Six female employees of prescription drug company Daiichi Sankyo Inc. filed a putative class action in the Northern District of California Monday alleging gender discrimination.

Law Practice
Former federal prosecutor joins LA firm
Former Assistant U.S. Attorney Jeremy D. Matz left the Central District prosecutor's office to enter private practice this week.

Mergers & Acquisitions
Dealmakers
A weekly roundup of mergers and acquisitions and financing activity and the lawyers involved.

In the last 20 months, there have been literally hundreds of reported decisions interpreting and applying *Stern v. Marshall*.

The issue before the Supreme Court concerned preclusion. If the bankruptcy court had the authority to issue a final judgment, then its ruling was preclusive of the Texas probate court's decision and Vickie's estate wins. But if the bankruptcy court lacked the authority to issue a final judgment, then there was no preclusion of the Texas probate court and Pierce's estate wins.

The court, 5-4, took the latter approach. Chief Justice John Roberts wrote for the majority, joined by Justices Antonin Scalia, Anthony Kennedy, Clarence Thomas and Samuel Alito. The court said that the Bankruptcy Act in Section 157(b)(2)(c) expressly makes counterclaims "core" proceedings over which the bankruptcy court could issue a final judgment. But the court found that this violated the Constitution because bankruptcy judges do not have life tenure. Chief Justice Roberts majority opinion stressed the essential nature of Article III safeguards for separation of powers and the protection of individual liberties.

In the last 20 months, there have been literally hundreds of reported decisions interpreting and applying *Stern v. Marshall*. The most important unresolved question is whether the parties can consent to a bankruptcy court issuing a final judgment that otherwise would be impermissible under *Stern v. Marshall*.

The most important unresolved question is whether the parties can consent to a bankruptcy court issuing a final judgment that otherwise would be impermissible under *Stern v. Marshall*

The practical consequences of this are enormous. Bankruptcy courts hear a huge number of cases. As Justice Stephen Breyer noted in his dissent, "the volume of bankruptcy cases is staggering, involving almost 1.6 million filings last year, compared to a federal district court docket of around 260,000 civil cases and 78,000 criminal cases." A significant portion of these involve state law claims. If bankruptcy courts cannot issue final judgments on state law claims with the consent of the parties, there will be a huge effect as bankruptcy courts will need to do reports and recommendations to the district courts on such claims. Cases will ping-pong back and forth between bankruptcy courts and district courts, and there will be a great new burden on the district courts.

Also, magistrate judges can hold civil trials with the consent of the parties. Because they, too, are not Article III judges, this would seemingly be impermissible if consent is not sufficient.

The circuits now are split on the question of whether a bankruptcy court can issue a final judgment over state law claims. In December 2012, in *In re Bellingham Insurance Agency, Inc.*, 702 F.3d 553 (9th Cir. 2012), the 9th Circuit expressly held that consent is sufficient. Judge Richard Paez, writing for the court, said that "[t]he waivable nature of the allocation of adjudicative authority between bankruptcy courts and Article III courts is well established." The court said that the constitutional right to final judgment from an Article III judge in a bankruptcy proceeding "is waivable."

But three months earlier, in *Waldman v. Stone*, 698 F.3d 910 (6th Cir. 2012), the 6th Circuit came to the opposite conclusion. Although the 6th Circuit found that Waldman had consented to allow the bankruptcy court to issue a final judgment over a state law claim, the court concluded: "Waldman's [constitutional] objection ... implicates not only his personal rights, but also the structural principle advanced by Article III. And that principle is not Waldman's to waive."

There are persuasive arguments on each side of this issue. On the one hand, the 9th Circuit's approach can be defended by drawing a distinction between the subject matter jurisdiction of a court, which cannot be gained by consent, and the authority of a court to issue a final judgment. The latter is often gained by consent, such as when

Judicial Profile
Carol D. Codrington
Carol D. Codrington Court of Appeal Justice 4th District (Riverside)

Legal Ethics & Professional Responsibility
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Litigation
In unusual ruling, judge allows FCPA bribery suit
A federal judge's decision to allow a civil bribery suit against several executives at Deutsche Telekom AG's Hungarian subsidiary opens up some cracks that could help government attorneys in civil and criminal suits, observers say.

Law Practice
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Litigation
Circuit split over parties' expanding a bankruptcy court's power
Is it permissible for the parties to consent to allowing a bankruptcy court to issue a final judgment that it otherwise would not have the power to enter? By **Erwin Chemerinsky**

Criminal
'Code of silence' raised by Dorner
Police Chief Charles Beck has made a courageous decision to reopen the investigation into the incident that led to Dorner's charge against his sergeant. But he has not gone far enough. By **Gregory Yates**

Intellectual Property
First sale doctrine: Do you own or rent your digital media files?
Many people do not realize that their purchased content not owned - it's *rented*. By **Nick Solish**

California Supreme Court
Impact of high court's 'mixed-motive' opinion uncertain
Neither employers nor the plaintiffs' bar perceives *Harris*' mixed-motive decision as a "big win," and it remains to be seen how the ruling will affect the decision whether to settle a case or go to trial. By **Fraser McAlpine**

an arbiter decides a case that otherwise would be within the jurisdiction of a federal court.

Moreover, the Supreme Court has indicated that the protections provided by Article III judges with life tenure and salary assurance are more in the nature of individual rights, which can be waived, than structural guarantees. In *Commodities Futures Trading Commission v. Schor*, 478 U.S. 833 (1986), the court declared: "[O]ur prior discussions of Article III, [Section] 1's guarantee of an independent and impartial adjudication by the federal judiciary of matters within the judicial power of the United States intimated that this guarantee serves to protect primarily personal, rather than structural interests."

But I find that the arguments for the 6th Circuit approach, that *Stern* cannot be overcome by consent, to be more persuasive. Federal courts may exercise authority - whether it is subject matter jurisdiction or the power to issue a final judgment - only if authorized by Article III of the Constitution. The authority of a federal court never can be gained by consent. There is no meaningful reason why authority to issue a final judgment can be gained by consent in violation of Article III, but not subject matter jurisdiction.

Chief Justice Roberts opinion in *Stern v. Marshall* was explicit in its conclusion that it is the structure of the judiciary created by Article III that prevents a bankruptcy court from issuing a final judgment as to a state law claim. He wrote: "Is there really a threat to the separation of powers where Congress has conferred the judicial power outside Article III only over certain counterclaims in bankruptcy? The short but emphatic answer is yes. A statute may no more lawfully chip away at the authority of the Judicial Branch than it may eliminate it entirely." Structural constitutional limits cannot be overcome by consent.

From the perspective of expediency and efficient judicial administration, the 9th Circuit's approach in allowing consent is far preferable. And *Stern v. Marshall*'s rationale makes little sense: What is so objectionable about allowing a judge without life tenure to issue a final judgment over a state law claim since such claims are usually adjudicated by state judges without life tenure? But if *Stern* is to be followed, it will be difficult to allow its limitations to be overcome by consent. Hopefully, the Supreme Court will resolve this issue quickly.

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