STERN V. MARSHALL PANEL DISCUSSION

Panel Members

Judge Marvin Isgur
Judge Jeff Bohm
Judge David Jones
Zack Clement, Partner, Fulbright and Jaworski

Primary Issue to be Discussed

How does a practitioner determine whether an order on any particular matter must be entered by the District Court?

1. Zack's Theory on Summary v. Plenary Jurisdiction

2. Compare with Judge Isgur's historical discussion on preference cases in Apex.

3. We have cases on
    a. 523 actions – Stern does not apply (*Muhs*)
    b. 522 exemption issues – Stern does not apply (*Hill and Okwonna-Felix)*
    c. Attorney fee determinations including disgorgement – Stern does not apply (*Whitley*)
    d. Modification of confirmed Chapter 13 plan – Stern does not apply (*Hill*)
    e. Handling pre-trial matters in a case which must be ruled upon by District Court (*Yazoo Pipeline*)
    f. Violations of the Automatic Stay – Stern does not apply (*Turner)*
    g. Suits by non-debtor against other non-debtors – Stern does apply (*Special Value)*
    h. Preference cases – Stern does not apply (*Apex)*
    i. Lien priority – Stern does not apply (*A-Tap)*

4. What about the following (taken from the list of core proceedings where I think an issue might arise):
    a. Turnover and/or determination of whether an asset is property of the estate
    b. Fraudulent Transfers
    c. 544(b) claims
    d. Sworn account case to collect accounts receivable
    e. Alter ego claims
    f. Breach of fiduciary duty claims
    g. Mismanagement claims
    h. Assumption and assignment of executory contract where there is a dispute about a breach of contract and/or where the debtor is attempting to cure a default. Can the bankruptcy court determine the extent of the default and the cure.
    i. Determination of state and local taxes and related liens
    j. Right of a trustee of a general partnership to sue the general partners.

k. 364 DIP Orders – particularly where court grants a super priority lien ahead of an existing lien
l. Order approving use of cash collateral – particularly where cash of a secured creditor is dissipated
m. Orders approving sales free and clear where third party liens are wiped out.

DRAFT
02/27/12
11:52 AM

Proposed General Order for the United States District Court for the Southern District of Texas, similar to the current General Order 2002-2 concerning Referrals to the Bankruptcy Judges.

1. **The *Stern v Marshall* Rule and Related Procedures**

(a) If a party to a Litigated Matter wants to raise a question about which court should enter a final judgment on that matter, it can raise that question by filing a motion with the District Court pursuant to 28 U.S.C. §§ 151, 157(a) and 157(d) and this Rule (a "Motion for Clarification"). A notice of the filing of such a Motion for Clarification shall also be filed on the docket of the bankruptcy case to which the Litigated Matter relates.

(b) As to a Litigated Matter that arises under the provisions of the Bankruptcy Code and that is within the Summary Jurisdiction of the Bankruptcy Court, final judgment shall be entered by the Bankruptcy Court, unless a party to such a Litigated Matter is able to show cause why a final judgment should be entered by the District Court in that matter.

(c) As to a Litigated Matter that does not arise under the Bankruptcy Code and is a matter within the Plenary Jurisdiction of the Bankruptcy Court, final judgment shall be entered by the District Court, unless a party to such a Litigated Matter is able to show cause why a final judgment should be entered by the Bankruptcy Court in that matter.

(d) In deciding whether to assign a Litigated Matter to the Bankruptcy Court: (i) for entry of a final judgment, (ii) for trial or (iii) for pre-trial proceedings, including discovery, the District Court shall take into account, among other things, (1) whether the right being adjudicated is part of a federal regulatory scheme, (2) whether adjudication of the right is essential to the regulatory scheme and objective and, (3) if not, whether adjudication of the right so intertwined with adjudications that are essential to the regulatory scheme and objective that resolution of one necessarily involves resolution of the other.

(e) Any response to a Motion For Clarification shall be filed within 7 days after the Motion is filed, and the District Court shall rule on the Motion within three weeks after it is filed.

(f) At any time after filing of a Motion for Clarification, the District Court can ask the Bankruptcy Court for its comments concerning the Motion and the Bankruptcy Court can offer, on its own initiative, its comments and recommendations concerning the Motion.

(g) The court that will enter final judgment on a Litigated Matter will also conduct trial of and preside over pretrial discovery concerning that Litigated Matter; provided, however, that, in ruling on a Motion for Clarification, the District Court may assign some or all of such functions to the Bankruptcy Court, taking into account the views of the parties and the Bankruptcy Court.

2. **Definitions for this Order**

(a) Litigated Matter: shall mean a contested matter or an adversary proceeding as defined by the Bankruptcy Code and Rules 7001 and 9014 of the Federal Rules of Bankruptcy Procedure.

(b) Plenary Jurisdiction: shall mean plenary jurisdiction as defined by the U.S. Supreme Court in, among other cases, *Katchen v Landy*, 382 U.S. 323 (1966); *Tabel – Scott – Kitzmiller Co. v Fox*, 264 U.S. 426 (1924); *Schoenthal v Irving Trust Co.* 287 U.S. 92 (1932).

(c) Summary Jurisdiction: shall mean summary jurisdiction as defined by the U.S. Supreme Court in, among other cases, *Katchen v Landy*, 382 U.S. 323 (1966); *Tabel – Scott – Kitzmiller Co. v Fox*, 264 U.S. 426 (1924); *Schoenthal v Irving Trust Co.* 287 U.S. 92 (1932).

Z.A.C.

FULBRIGHT
& Jaworski L.L.P.
Attorneys at Law

Fulbright Tower • 1301 McKinney, Suite 5100 • Houston, Texas 77010-3095
www.fulbright.com

MEMORANDUM

FROM: Zack A. Clement

DATE: September 6, 2011

RE: *Stern v. Marshall* - - Bankruptcy Courts Cannot Decide Debtors' Common Law Claims to Bring Assets into the Estate

1. ***Stern* Holding**

In *Stern v. Marshall*, ___ U.S. ___, 2011 WL 2472792 (June 23, 2011), issued on June 23, the Supreme Court declared for the third time that a bankruptcy court does not have authority under the Constitution to issue a final judgment in a lawsuit arising solely under state common law seeking to bring assets into a debtor's bankruptcy estate. The Court held that the bankruptcy court lacked constitutional authority to enter a final judgment on a counterclaim filed by Vickie Lynn Marshall, more commonly known as Anna Nicole Smith, alleging interference with expected inheritance against her late husband's son, Pierce Marshall, after he filed a proof of claim in her Chapter 11 case alleging damages for defamation.

Previously, the Supreme Court had held that a bankruptcy court lacks the power to enter a final judgment on a debtor's state law contract claim against a non-debtor third party, *Northern Pipeline Const. Co. v. Marathon Pipe Line Co.*, 458 U.S. 50 (1982), and that a bankruptcy court lacks such power concerning a debtor's fraudulent conveyance claim against a non-debtor party who had not filed a proof of claim, *Granfinanciera, S.A. v. Nordberg*, 492 U.S. 33 (1989).

In *Stern*, the Supreme Court ultimately held that, even though Congress had provided in 28 U.S.C. §157(b)(2)(C) that a counterclaim against a party that has filed a proof of claim is a matter of "core" bankruptcy jurisdiction,[1] the bankruptcy court in Vickie Marshall's case "lacked

[1] 28 U.S.C. §157(b)(1) provides that "bankruptcy judges may hear and determine [enter a final judgment on] all [main bankruptcy] cases arising under title 11 [the Bankruptcy Code] and all core proceedings [lawsuits] arising under title 11 [the Bankruptcy Code] or arising in a [bankruptcy] case under title 11." As to "proceedings" (lawsuits) that are merely related to a bankruptcy case because they might affect the size of the bankruptcy estate, the bankruptcy court can only issue proposed findings subject to de novo review by the district court. 28 U.S.C. §157(c). 28 U.S.C. §157(b)(2) provides that core matters include, but are not limited to a list of sixteen items, including "counter-claims by the estate against persons filing claims against the estate." 28 U.S.C. §157(b)(2)(C).

the constitutional authority to enter a final judgment on a state law counterclaim that is not resolved in the process of ruling on a creditor's proof of claim." *Stern*, at *27.

The Supreme Court's decision turned on its assessment of the facts concerning three factors: (1) is the right being adjudicated part of a federal regulatory scheme, (2) is adjudication of the right essential to the regulatory scheme and objective and (3) , if not, is adjudication of the right intertwined with adjudications that are essential to the regulatory scheme and objective?

The Supreme Court held that a "public right" that can be assigned to a non Article III bankruptcy court must "derive . . . from a federal regulatory scheme" and "resolution of the claim by an expert governmental agency [such as a bankruptcy court] . . . must be essential to a limited regulatory objective," neither of which the Court found present in the *Stern* case. Additionally, the Supreme Court held that resolution the counterclaim at issue in *Stern* was not so intertwined with a core bankruptcy function (such as allowing a claim) as to bring it within the bankruptcy court's power to decide ("there was never any reason to believe that the process of adjudicating Pierce's proof of claim [for defamation] would necessarily resolve Vickie's counterclaim [for interference with expected inheritance].").

2. **What *Stern* Means**

The Supreme Court's decision in *Stern* is thus the third time it has said that it would not permit bankruptcy courts to enter final orders on trial of what had been called plenary matters under the old Bankruptcy Act - - matters that seek to bring assets into the custody of the bankruptcy court to be distributed to creditors through the bankruptcy process. *See, e.g., Katchen v Landy,* 382 U.S. 323 (1966); *Tabel – Scott – Kitzmiller Co. v Fox,* 264 U.S. 426 (1924); *Schoenthal v Irving Trust Co.* 287 U.S. 92 (1932).

The analysis in *Marathon, Granfinciera and Stern* actually supports the concept that bankruptcy courts can try and enter final judgments on matters falling into what was called the summary jurisdiction of the bankruptcy court - - that is jurisdiction over property of the estate in the custody of the court and the allowing and prioritizing of claims against those assets and approval of plans for their distribution. *See e.g. Katchen, 382 U.S. at* 327, 329. In *Stern*, the Supreme Court gave substantial deference to *Katchen*, going to great lengths to distinguish it so as not to overrule it

3. **Action in Response to *Stern***

The *Stern* decision gives parties defending against debtor claims (or counterclaims) arising under state common law a substantial reason to file a motion under 28 U.S.C. §157(d) asking the district court to withdraw reference of that cause of action from the bankruptcy court to have the issue heard by a district court. Even parties who wish to have such a claim tried in the bankruptcy court, but do not want the expense of a re-trial, now have reason to ask the district court for an early declaration under 28 U.S.C. §157(d) whether such a case should continue in the bankruptcy court and, if so, under what rules for district court review.

4. **More Detailed Analysis of *Stern***

(a) **Public Right Versus Common Law**

Stern held that Vickie Marshall's counterclaim did not meet the "public right" exception to the general rule that an Article III court (*i.e.*, a district court) must adjudicate a "matter which, from its nature, is the subject of a suit at the common law, or in equity or admiralty." *Id*. at *2. When Congress creates a right that did not exist as a private right among citizens under the common law, it can assign that public right to a non-Article III court. According to *Stern*, the Supreme Court "has continued, however, to limit the [public right] exception to cases in which the claim at issue derives from a federal regulatory scheme, or in which resolution of the claim by an expert government agency is deemed essential to a limited regulatory objective within the agency's authority," neither of which it found to be present in the *Stern* case. *Id*. at 3 (emphasis added).

Stern noted that the Supreme Court had held in *Granfinanciera* that the bankruptcy court lacked power to enter judgment on a debtor's fraudulent conveyance claim against a party that had not filed a creditor claim because "if a statutory right is not closely intertwined with a federal regulatory program Congress has power to enact, and if that right neither belongs to nor exists against the Federal Government, then it must be adjudicated by an Article III court." *Id*. at *19. In *Granfinanciera*, the court held that "fraudulent conveyance suits were 'quintessentially suits at common law that more nearly resemble state law contract claims brought by a bankrupt corporation to augment the bankruptcy estate than they do creditors' hierarchically ordered claims to a pro rata share of the bankruptcy res." *Id*.

Stern found Vickie Marshall's counterclaim to be similar to the fraudulent conveyance claims in *Granfinanciera*. It was not a claim created by Congress but "is instead one under state common law between two private parties. It does not depend on the will of Congress." *Id*. at 19.

(b) **Filing a Proof of Claim Does Not Necessarily Equal Submission to Bankruptcy Court Jurisdiction**

Stern held that Pierce Marshall's filing of a proof of claim in the bankruptcy case alleging defamation did not, by itself, give the bankruptcy court jurisdiction over Vickie Marshall's counterclaim for tortious interference. According to the Court, "Pierce did not truly consent to resolution of Vickie's claim in the bankruptcy court proceedings. He had nowhere else to go if he wished to recover from Vickie's estate." *Id*. at 20.

Stern thus appears on the surface to have overruled *Katchen v Landy*, 382 U.S. 323 (1966) which had held that a creditor who filed a proof of claim had submitted to the summary jurisdiction of the bankruptcy court over a counterclaim against it. *Stern*, however, distinguished *Katchen* because (1) the central bankruptcy function of allowing and paying the creditor's claim could not be completed in *Katchen* until the preference counterclaim was resolved and (2) the preference cause of action was contained in the federal bankruptcy statute. Moreover, *Stern*

ruled that, even though the courts below had concluded that Vickie Marshall's counterclaim was compulsory, "there was never any reason to believe that the process of adjudicating Pierce's proof of claim would necessarily resolve Vickie's counterclaim." *Id*. at 23.

(c) **Relatedness of a Counterclaim to a Core Matter**

Stern affirmed the circuit court's holding that a counterclaim under §157(b)(2)(C) is properly a "core" proceeding "arising in a case under the [Bankruptcy] Code only if the counterclaim is so closely related to [a creditor's] proof of claim that the resolution of the counterclaim is necessary to resolve the allowance or disallowance of the claim itself." *Stern*, at *8. *Stern* held that Vickie Marshall's counterclaim did not meet that standard.

> Here Vickie's Claim is a state law action independent of the federal bankruptcy law and not necessarily resolvable by a ruling on the creditor's proof of claim in bankruptcy. *Northern Pipeline* and our subsequent decision in *Granfinanciera,* 492 U.S. 33 . . . rejected application of the 'public rights' exception in such cases.

Id. at *16.

(d) **The New Rule From *Stern***

Ultimately, *Stern* distinguished *Katchen* and extended *Granfinanciera* to Vickie Marshall's case in which (1) the creditor had filed a proof of claim and (2) the lower courts had found her counterclaim to be compulsory. In essence, *Stern* held that the "public law" exception would be extended to counterclaims based on state law where the resolution of the counterclaim (1) involves the essence of the bankruptcy process or (2) is so intertwined with claims allowance that it will necessarily be decided in connection with it.

> *Granfinanciera's* distinction between actions that seek 'to augment the bankruptcy estate' and those that seek 'a pro rata share of the bankruptcy res' . . . reaffirms that Congress may not bypass Article III simply because a proceeding may have some bearing on a bankruptcy case; the question is whether the action at issue [1] stems from the bankruptcy itself or [2] would necessarily be resolved in the claims allowance process.

Id. at 24 (emphasis added).

5. **Conclusion and Actions to Take**

(a) **Conclusion**

***Stern* appears to apply only to a debtor's effort to use a state common law cause of action to bring assets into the bankruptcy estate (1) that does not involve a central bankruptcy function described by the Supreme Court in *Katchen* to include allowance of claims and distribution of estate assets to creditors in a reorganization, and (2) that is not so intertwined with such issues that the resolution of the core bankruptcy issues necessarily**

involves resolution of the common law claim. As such, *Stern* appears to re-invigorate the plenary/summary jurisdiction concepts discussed in *Katchen*. This means that the effect of *Stern* is largely, if not entirely, limited to plenary matters attempting to bring assets into the estate and that it should not affect matters within the traditional summary jurisdiction of the bankruptcy court concerning allowance of claims and distribution of a debtor's assets.

(b) **Actions**

When a case such as *Stern* is presented, or is arguably presented, it makes sense to start as soon as possible a collaboration between the bankruptcy court and the district court about (1) which court will conduct the trial and (2) which court will enter final judgment, (3) subject to what kind of review.

28 U.S.C. §157(d) gives the district court the power to withdraw reference of a lawsuit from the bankruptcy court on its own motion or the motion of a party. As a practical matter, many districts have procedures similar to Southern District of Texas Local Rule 5011-1 providing that "unless the district court orders otherwise, the [withdrawal of reference] matter will first be presented to the bankruptcy judge for recommendation."

Filing a motion to withdraw reference under 28 U.S.C. 157(d) will serve as mechanism to find out in greater depth (1) what the parties think are the issues in the lawsuit, (2) how much they are intertwined with other issues that are essential to the bankruptcy process (including claims allowance, plan confirmation and distribution issues), (3) whether the bankruptcy court believes it should keep the case, and (4), finally, possibly establishing in advance the rules for district court review of the bankruptcy court's findings and conclusions, if the case is to be tried by the bankruptcy court.

In the wake of *Stern*, whether a party's goal is to maximize or minimize the bankruptcy court's role in such a lawsuit, it makes sense to start the debate promptly about how the case should proceed.

February 28, 2012, American Inns of Court
Stern v. Marshall Matters

In re Yazoo Pipeline Co., L.P., et al (In re Yazoo), Case No. 08-38121, 2011 Bankr. LEXIS 3990 (Bankr. S.D. Tex., October 14, 2011) (Marvin Isgur)

Holding:
The Bankruptcy Court does have authority to decide pre-trial matters associated with an adversary. This is especially true if the District Court has ordered that the reference be withdrawn on the Bankruptcy's Court recommendation. The Bankruptcy Court reiterated that it does not have the authority to decide adversary proceedings filed by the Trustee, as it falls outside the "public rights" exception. The Court reasoned that it lacks authority as the adversary involves matters characterized as state-law claims. However, the Court did not dispose of the claims, and as such , the extent of the Court's authority of the claims was not discussed. Lastly, the Court has authority to determine pre-trial matters and orders.

Analysis:
The Court began its analysis by recognizing the Supreme Court's holding in *Stern v. Marshall*, 131 S.Ct. 2594, 2620, 180 L.Ed 2d 475 (2011). The Court discussed that Bankruptcy Courts are barred from issuing a final order or judgment within exclusive authority of an Article III matter. However, a Bankruptcy Court may decide matters relating to a "public scheme" or "public right".

The Court considered whether the adversary dispute was so intertwined with essential bankruptcy matters that the filing of the bankruptcy changed the character of the dispute to a "public rights" matter. *Id. at* 2; *Stern*, 131 S.Ct at 2618. Further, the Court reasoned the claims could not necessarily be resolved through the claims adjudication process. The Court issued the Memorandum Opinion with authority as it has authority to determine pre-trial matters.

Factual Background:
On December 23, 2008, the three Debtors, Yazoo Pipeline Co., L.P. ("Yazoo"), Sterling Exploration & Production Co., LLC ("Sterling"), and Matagorda Operating Co., LLC ("Matagorda"), (collectively, the "Debtors"), filed for bankruptcy protection in the United States District Bankruptcy Court, Southern District of Texas, Houston Division. During the course of the proceedings, Debtors sought to confirm a plan with the primary objective to sell an ownership interest to New Concept Energy. The sale never materialized and the plan was never confirmed.

On December 2, 2010, the Trustee, Mining Oil, and Randall O. Sorrels (collectively, the "Plaintiffs") filed an adversary proceeding against New Concept Energy ("NCE"), Coastland Operations, LLC ("Coastland"), Gulf Coast Exploitation, LLC ("Gulf Coast"), Dave Morgan, Charles Cheatham, and John Thibeaux (collectively, the "Defendants"). Plaintiffs settled with Gulf Coast and Thibeaux. Plaintiffs alleged Defendants committed certain misconduct before and after the bankruptcy cases were converted from Chapter 11 to Chapter 7 under the Bankruptcy Code. Specifically, Plaintiffs alleged Defendants committed the following acts of misconduct: (1) diverted estate assets without permission, (2) misrepresented NCE's interest in Debtors, (3) permitted an oil and gas lease and allowed it to be purchased by another entity, (4) misappropriated Debtors' data, and (5) filed inaccurate and misleading monthly operating reports and proposed budgets.

In re Special Value Continuation Partners, L.P. (In re Tennenbaum), Case No. 11-3304, 2011 Bankr. LEXIS 4475 (Bankr. S.D. Tex., November 15, 2011) (Marvin Isgur)

Holding:

The Bankruptcy Court held that a transfer of the case to the Delaware Federal Court is not warranted under 28 U.S.C. §1404 and §1412. Pursuant to §1334 (c)(l) the Court abstained. Further, pursuant to §1452 (b) the Court remanded the case to a Texas state Court. The Court has no authority to enter a final judgment on state-law cases brought by nondebtors against debtors.

Analysis:

The Court decided whether it should transfer the case as characterized as a related to proceeding to a Delaware Federal Court. At the same time, the Court also decided whether it should abstain and remand the case to a Texas state court pursuant to 28 U.S.C. §1404 and §1412.

The Courts analysis of the subject matter jurisdiction is akin to the bankruptcy court's authority. *Id.* at 3. The Court reasoned that the home bankruptcy rule is no longer applicable under §1412, as §1412 may not be used to transfer related to non-core proceedings. Although the Court reaffirmed the holding in Longhorn Partners, it believed it should have stated the following: the §1412 transfer is only applicable to core proceedings arising under Title 11.

The Court next turned to the matter of the §1404, whether the case could have been brought in the venue in which it was requested. The Court reasoned that even though the case could have possibly been brought in Delaware, the §1404 transfer was inappropriate for other reasons. *Id.* at 5. The Court may transfer a case for the convenience of the parties and witnesses. 28 U.S.C. § 1404. The Court considers private and public interest factors regarding a transfer for convenience.

The private factors are as follows: (1) the relative ease and access to the sources of proof, (2) the availability of the compulsory process to secure the attendance of a witness, (3) the cost of attendance of the witnesses, and (4) other problems that make a trial easy, expeditious, and inexpensive. *In re Volkswagen of Am., Inc.*, 545 F.3d 304, 315 (5th Cir. 2008); *Id.* at 5.

The public interest factors are as follows: (1) administrative difficulties from court congestion, (2) local interest regarding resolving local cases of interest in home court, (3) familiarity of forum with the law that will govern the case, and (4) avoidance of unnecessary problems associated with application of conflict of laws of foreign laws. *In re Volkswagen of Am., Inc.*, 545 F.3d 304, 315 (5th Cir. 2008); *Id.* at 5.

The *Stern* analysis relates to and involves the final public interest factor. The Bankruptcy Court has no authority to enter a final judgment on state-law cases brought by nondebtors against debtors. Further, the case does not derive from an agency regulatory scheme. *Stern*, 131 S.Ct at 2615. *Id.*, at 5. The Court reasoned the case could not be transferred to the Delaware Bankruptcy Court, as it also lacks authority to enter a final judgment or order. Combining all the factors, the Court decided that a transfer would not be more convenient.

Regarding the issue of Abstention and Remand, the Court may remand on equitable grounds and consider specific factors. *Sabre Techs. v. TSM Skyline Exhibits, Inc*., 2008 U.S. Dist. LEXIS 98515, 2008 WL 4330897 (S.D. Tex. Sept. 18, 2008). The factors include the following: (1) the effect on the efficient administration if the Court recommends abstention, (2) the extent state law issues take precedence over the bankruptcy issues, (3) difficult or unsettled applicable law, (4) presence of related proceeding commenced in state court, and (5) jurisdictional basis, if any, other than §1334, (6) the degree of relatedness or remoteness of a case to the main bankruptcy case, (7) substance rather than form of the asserted core proceeding, (8) the feasability of severing state claims from core matters to allow state court judgment, (9) the burden of Bankruptcy Court's docket, (10) the likelihood of commencement of the proceeding in Bankruptcy Court that involves forum shopping, (11) the existence of a right to a jury trial, (12) the presence of nondebtor parties, (13) comity, and (14) the possibility of prejudice to other parties. 2008 U.S. Dist. LEXIS 98515 AT 6 n.22.

The first factor, estate administration, supports abstention and remand. Pursuant to *Stern*, as stated above, the Delaware Bankruptcy Court lacks authority to enter a final order. Thus, the Court's decision to abstain and remand fails to negatively effect the administration of the estate. *Id.* at 7.

Factual Background:

On August 25, 2010, Holdco companies filed bankruptcy. Opco did not file bankruptcy. However, prior to that, Special Value Continuation Partners, L.P., Tennenbaum DIP Opportunity Fund, LLC, and Tennenbaum Opportunity Partners V, LP ("Tennenbaum") filed a state court lawsuit alleging Richard Bauchman, Geoff A. Jones, D. Michael Wallace, Rishi Varma, Brett Cenkus, Stephen Morrell, and Gerald Gray (collectively, the "Defendants") mislead them with financial projections and misrepresented in order to obtain financing. Defendants are officers and directors of Trico Marine Services, Inc. ("Holdco") and Trico Shipping AS, a foreign subsidiary of Holdco ("Opco"). Tennenbaum lent money to Holdco and secured the loans with Opco's assets. In the months before bankruptcy, Tennenbaum filed for protection in a California state court alleging Holdco had further revised its projections and committed fraud. Tennenbaum only sought its losses under the Opco loan. Defendants removed the case to federal court. Shortly thereafter, on May 20, 2011, Tennenbaum voluntarily dismissed its case and filed another proceeding in Harris County.

Defendants subsequently removed the case. In response, Tennenbaum filed a Motion to Remand for Lack of Subject Matter Jurisdiction. Defendants retaliated with a Motion to Transfer under §1404 and §1412.

In re Whitley, Case Nos. 08-60098 (Chapter 13) and 09-60044 (Chapter 7), 2011 Bankr. LEXIS 4545 (Bankr. S.D. Tex. Nov. 21, 2011) (Judge Bohm)

Issues

Whether the bankruptcy court had constitutional authority under *Stern* to sign a final order determining the reasonable value of the services the debtor's attorney rendered, whether a debtor's attorney was required to disgorge consideration paid to him, and whether the attorney was entitled to recover additional fees

Whether the debtor's attorney was required to disgorge the consideration paid to him when (1) he filed late fee applications, (2) failed to disclose compensation the debtor paid to him and the debtor's transfers of property to an entity controlled by him, and (3) his services provided no benefit to the debtor or the bankruptcy estate

Whether the debtor's attorney was entitled to recover the additional fees that he requested

Holding

The bankruptcy court had authority to sign a final order adjudicating the dispute.

The attorney must disgorge the compensation that the debtor had already paid because the attorney violated his duty of disclosure. The bankruptcy court also found that the attorney's services provided no benefit to the debtor or the estate so the services provided no reasonable value. Accordingly, the attorney had to disgorge all compensation that the debtor had already paid to him and was not entitled to recover any of the fees he requested.

Facts

On November 3, 2008, the debtor, acting *pro se* filed a voluntary petition under Chapter 13 of the Bankruptcy Code to stop a foreclosure on his income producing real properties (the "2008 Case"). *In re Whitley*, Case Nos. 08-60098 (Chapter 13) and 09-60044 (Chapter 7), 2011 Bankr. LEXIS 4545, at *5 (Bankr. S.D. Tex. Nov. 21, 2011). The Chapter 13 Trustee filed a motion to dismiss the 2008 Case because the debtor failed to file his schedules, tax returns, statement of financial affairs, and a plan. *Id.*

The debtor then retained the attorney and paid him $1,800.00 as a retainer. *Id.* at *5-6. The attorney did not file any pleadings disclosing the receipt of or seeking approval for this retainer. *Id.* at *6. The debtor did not oppose the Chapter 13 Trustee's motion to dismiss so the case was dismissed on March 4, 2009. *Id.*

On March 24, 2009, the attorney filed a disclosure of compensation and a fee application requesting that the court approve $16,474.62 in fees and expenses. *Id.* The Chapter 13 Trustee objected and, at the hearing on the fee application, the attorney withdrew his request for fees and expenses. *Id.*

On April 6, 2009, the debtor paid the attorney $10,274.00. *Id.* Of this amount, $10,000 related to the fees in the 2008 Case and $274.00 was the filing fees in contemplation of the debtor filing another Chapter 13 petition, which he did on April 7, 2009 (the "2009 Case"). *Id.* at *6-7. Although the debtor proposed five plans, none of them were confirmed. *Id.* at *7. The case was dismissed with prejudice. *Id.* The attorney then filed a fee application seeking compensation in the 2009 Case in the amount of $9,859.75 in fees and expenses. *Id.* The Chapter 13 Trustee and a secured creditor objected to this fee application. *Id.*

On August 27, 2009, the debtor transferred two properties to an entity owned and controlled by the attorney for no consideration. *Id.* at *7-8. The attorney did not disclose these transfers to the court. *Id.* at *8. On September 29, 2009, the attorney amended the fee application in the 2009 Case and filed his disclosure of compensation for the 2009 Case. *Id.* The court then vacated its order of dismissal, reinstated the case, and converted it to a Chapter 7 case. *Id.* The court also granted the attorney's motion to withdraw the fee application. *Id.* The court ultimately denied the debtor's discharge. *Id.*

The bankruptcy court entered a Show Cause Order and held a hearing to determine the reasonable value of the services the debtor's attorney rendered to the debtor in connection with his two bankruptcy cases and to show cause whether the attorney must disgorge compensation that the debtor had already paid to the attorney in connection with those cases. *Id.* at *1-2.

Stern Analysis

The bankruptcy court examined *Stern v. Marshall* to determine whether it has the constitutional authority to sign a final order adjudicating the dispute at bar. *Id.* at *10. The court found that the dispute was not a counterclaim of the debtor and did not arise out of state law so *Stern* did not apply. *Id.* at *11. The court noted that the suit arose out of alleged violations of the disclosure requirements imposed by § 329, and the Chapter 13 Trustee sought relief under § 330 which allows the court to deny or allow compensation to attorneys under the Bankruptcy Code. *Id.* State law has no equivalent to these statutes. *Id.* "Accordingly, the resolution of this dispute is not based on state common law, *Stern* does not apply, and this Court has the constitutional authority to enter a final judgment in this dispute pursuant to *28 U.S.C. §§157(a)* and *(b)(1).*" *Id.*

The court also noted that even if *Stern* did apply, the "public rights" exception would allow the bankruptcy court to enter a final order. *Id.* at *12. "Disputes over rights created by the Bankruptcy Code itself as part of the public bankruptcy scheme fall within the 'public rights' exception." *Id.* at *13. The compensation of the attorney is a right established by §§ 329 and 330 of the Bankruptcy Code and falls within the bankruptcy court's constitutional authority. *Id.* This determination also affects distribution to unsecured creditors. *Id.*

***In re Hill*, Case No. 08-36267, 2011 Bankr. LEXIS 5186 (Bankr. S.D. Tex. Dec. 30, 2011) (Judge Bohm).**

Issues

Whether the bankruptcy court has constitutional authority to sign final orders in a dispute relating to an objection to a claim of exemptions and a motion to modify a confirmed plan

Whether the debtor, who failed to timely disclose his cause of action against his insurance company relating to Hurricane Ike damage to his homestead, should be estopped from amending his Schedule C to exempt the settlement proceeds

If the debtor is not estopped, whether the homestead exemption provisions of the Texas Constitution and the Texas Property Code exempt proceeds from the settlement of a lawsuit against the insurance company insuring his homestead

If the debtor can exempt these proceeds, whether the holder of the lien on the homestead can control the proceeds to ensure they are used to repair the homestead

Holdings

The bankruptcy court has authority to enter final orders on the objection to the claim of exemptions and the motion to modify the confirmed plan

The debtor is not estopped from amending his Schedule C to exempt the proceeds to be paid from the settlement of the lawsuit.

Texas law regarding homestead exemptions allows the debtor to exempt all of the proceeds from the settlement of the lawsuit. The Texas Supreme Court has ruled that the proceeds of an insurance policy take the place of the property loss.

The lien holder has a voice as to how the proceeds are to be used. After payment of the attorney's fees and expenses (which are reduced by $1,000 due to the law firm's failure to timely file its application for employment), the lien holder will hold the funds to ensure they are used to repair the homestead. Then remaining funds after repairs are made will go to pay the arrearage. Finally, they will go to the Trustee for payment to unsecured creditors.

Facts

The insurance carrier allegedly failed to pay sufficient proceeds under the debtor's insurance policy after Hurricane Ike damaged the debtor's homestead on September 13, 2008. *In re Hill*, Case No. 08-36267, 2011 Bankr. LEXIS 5186, at *1, 4 (Bankr. S.D. Tex. Dec. 30, 2011). The debtor filed a Chapter 13 bankruptcy petition on October 3, 2008 but did not schedule any claim or cause of action against the insurance company. *Id.* at *5. In his Schedule C, the debtor listed his homestead as exempt property. *Id.*

The debtor retained a law firm to file suit against the insurance company and executed an engagement letter whereby the law firm was to receive 40 percent of the gross amount recovered and all out-of-pocket expenses. *Id.* at *5-6. Neither the debtor nor the law firm informed the bankruptcy court of the firm's retention or obtained approval of the terms of retention at that time. *Id.* at *6. The debtor's wife testified that she informed the person with whom she met at the initial meeting that her husband had filed for bankruptcy. *Id.* The attorney in charge of the insurance case lawsuit testified that he was unaware of the bankruptcy until June 14, 2011, at which time he filed an application to employ. *Id.*

The debtor filed a lawsuit against his insurance company on May 10, 2010. *Id.* at *7. On May 19, 2011, the debtor amended his Schedule A to disclose the lawsuit and Schedule C to exempt the lawsuit and any proceeds that he recovered. *Id.* at *7-8. He did not list an amount because, at that time, no settlement had been negotiated. *Id.* at *8. The Chapter 13 Trustee filed an objection to the exemption on June 22, 2011. *Id.* at *8-9. The Trustee also filed a motion to modify the confirmed plan to increase the total dollars required from the debtor by the amount of the net proceeds recovered from the lawsuit. *Id.* at *9. The lien holder objected to the motion to modify arguing that if there were proceeds remaining after repairs, they should be used to pay the arrearage owed. *Id.* at *13-14. On June 27, 2011, the debtor amended his schedules to list the settlement amount. *Id.* at *10.

The debtor filed his motion for approval of compromise of the lawsuit, which the court granted along with the law firm's application to employ. *Id.* at *10-13. However, the court continued the hearings to reflect on how the settlement proceeds should be distributed. *Id.* at *13.

<u>*Stern* Analysis</u>

The court began its analysis by distinguishing the facts of the present case from those in *Stern*. *Id.* at *16. The court found that the resolution of the issue as to whether the debtor should be allowed to amend his Schedule C to claim the proceeds as exempt is governed solely by bankruptcy law. *Id.* Resolution of this issue requires application of pure judicially-created bankruptcy law so *Stern* has no application. *Id.* at *17.

Even if *Stern* did apply, the public rights exception would allow the bankruptcy court to enter final orders. *Id.* at *18. A right closely integrated into a public regulatory scheme may be resolved by a non-Article III tribunal. *Id. (citing Thomas v. Union Carbide Agric. Prods. Co.*, 473 U.S. 568 (1985)). The key issue before the court involved a dispute over whether or not certain property is exempt or not exempt and thus property of the estate. *Id.* at *19. "The right to exempt property from the bankruptcy estate is established by an express provision of the Bankruptcy Code (*section 522*) and is central to the public bankruptcy scheme, as it relates to both the exercise of exclusive jurisdiction over the debtor's property (because before property can become exempt, it is property of the estate) and the equitable distribution of that property among a debtor's creditors." *Id.* Thus, the determination is inextricably tied to the bankruptcy scheme and involves the

adjudication of rights created by the Bankruptcy Code. *Id.* Consequently, the bankruptcy court has authority to enter a final order on the Objection to Exemptions. *Id.*

The Motion to Modify arises solely out of a pure bankruptcy statute, § 1329(a)(1). *Id.* at *20. The Trustee seeks to modify the plan so that the settlement proceeds can be distributed, which is a process uniquely done under the Bankruptcy Code. *Id.* There is no state law involved in the confirmation of a plan or modification of the plan. *Id.* Thus, the bankruptcy court also has constitutional authority to sign a final order regarding the Motion to Modify the Confirmed Plan. *Id.*

Sanders v. Muhs (In re Muhs), Case No. 09-10564, 2011 Bankr. LEXIS 3032 (Bankr. S.D. Tex. August 2, 2011) (Isgur, J.)

Holding: The Bankruptcy Court has the authority to decide nondischargeability actions under 11 U.S.C. § 523. The debtor, Muhs, owes the creditor, Sanders, $185,435.55 in principal and interest and $69,166.50 in legal fees. The debt is nondischargeable under §§ 523(a)(2)(A) and 523(a)(2)(B) of the Bankruptcy Code.

Facts: Sanders filed a nondischargeability action against the debtor, Muhs. Sanders had hired Muhs to build a restaurant on South Padre Island. *Id.* at *6. Muhs misapplied draw requests during the construction and did not complete the construction when promised. *Id.* *7-8. Muhs obtained a loan from Sanders, based on written misrepresentations, and Muhs also misrepresented his ownership of certain collateral in obtaining the loan. Muhs distributed the same amount of the loan to one of Muhs's own restaurants. *Id.* at *9-10.

Jurisdiction analysis: In *Muhs*, the court began the opinion with an analysis on the bankruptcy court's authority to hear a nondischargeability action under 11 U.S.C. § 523. The court began by recognizing that the Supreme Court held in *Stern* that "a bankruptcy court may not constitutionally enter a final judgment over a counterclaim that would not necessarily be resolved by the resolution of the proof of claim." *In re* Muhs, 2011 Bankr. LEXIS 3032, at *2. The court noted that the counterclaim did not constitute a "public rights" dispute, which is a dispute that involves rights integrally related to a particular federal government action and which may be decided by non-Article III tribunals. *Id.* (citing *Stern*, 131 S.Ct. 2594, 2011 WL 2472792, at *17-18).

The court noted that the broader application of *Stern* is unclear and cited *Granfinanciera, S.A. v. Nordberg*, 492 U.S. 33, 54-55 (1989), which held that the adjudication of a fraudulent transfer claim against a creditor who had not filed a proof of claim did not fall within the public rights exception. *Id.* The court commented that it is unclear after *Stern* whether the adjudication of a fraudulent transfer claim against a creditor who *has* filed a proof of claim falls within the public rights exception. *Id.* at *2-3.

The court concluded that it may exercise authority over essential bankruptcy matters under the "public rights" exception, citing *Thomas v. Union Carbide Agricultural Products Co.*, 473 U.S. 568, 593 (1985), which held that a right closely integrated into a public regulatory scheme may be resolved by a non-Article III tribunal. *Id.* at *3. The court reasoned that the Bankruptcy Code is a public scheme for restructuring debtor-creditor relations, necessarily including "'the exercise of exclusive jurisdiction over all of the debtor's property, the equitable distribution of that property among the debtor's creditors, and the ultimate discharge that gives the debtor a 'fresh start' by releasing him, her, or it from further liability for old debts.'" *Id.* (quoting *Central Va. Cmty. College v. Katz*, 546 U.S. 356, 363-64 (2006)).

The court recognized that at least two overlapping classes of claims fall within the Court's constitutional authority: (1) matters invoking only the Court's *in rem* jurisdiction over the bankruptcy estate and (2) disputes over rights created by the Bankruptcy Code as an integral part of the public bankruptcy scheme. *Id.* at *4.

The court stated that "the right to a discharge is established by the Bankruptcy Code and is central to the public bankruptcy scheme." *Id.* at *4. The court further noted that "[d]eterminations of whether a debtor meets the conditions for a discharge are integral to the bankruptcy scheme, and the Bankruptcy Court has the authority to make such determinations." *Id.* at *5. The court further stated that the Bankruptcy Court also has the authority to determine when the statutorily established right does not apply. *Id.* The court reasoned that in deciding dischargeability claims, the bankruptcy court is simply deciding whether "a particular creditor is entitled to something more than the creditor would otherwise get out of the bankruptcy bargain." *Id.* The court also found that the Bankruptcy Court may also determine the amount of the debt that is excepted from the discharge, which in the present case, was integral to the determination of the exception itself. *Id.* at *6.

In re Okwonna-Felix, Case No. 10-31663-H4-13, 2011 Bankr. LEXIS 3028 (Bankr. S.D. Tex. Aug. 3, 2011) (Bohm, J.).

This memorandum opinion concerns a debtor's right to exempt proceeds to be paid pursuant to a settlement of a lawsuit against the company insuring the debtor's homestead. The court found that it had authority to enter a final judgment on the matter because the debtor was requesting the court to approve a settlement under Rule 9019. *In re Okwonna-Felix*, Case No. 10-31663-H4-13, 2011 Bankr. LEXIS 3028, at *12. The court noted that there is no equivalent to Rule 9019 in state law and the factors the court is required to consider in Rule 9019 motions have been developed exclusively by federal courts. *Id.* The court held that the resolution of the motion was based entirely on federal bankruptcy law, and not state law. *Id.*

Alternatively, the court found that the "public rights" exception applied if *Stern* governed because the determination of the Rule 9019 motion was inextricably tied to the bankruptcy scheme and involved the adjudication of rights created by the Bankruptcy Code. *Id.* at *13-14. The court stated that the key issue was whether or not property of the estate is exempt. *Id.* at *14. The court recognized that the right to exempt property from the bankruptcy estate is established by the Bankruptcy Code and is central to the bankruptcy scheme because it related to the exclusive jurisdiction over the debtor's property and the equitable distribution of that property among the debtor's creditors. *Id.*