



Case Alert: Stern v. Marshall Update from Delaware

***Michaelson v. Golden Gate Private Equity, Inc. (In re Appleseed's Intermediate Holdings, LLC)*, Civ. No. 11-807 (JEI/KM) (D. Del. Dec. 15, 2011)**

Defendants in fraud and breach of fiduciary duty actions moved to withdraw the reference, arguing that they were entitled to a jury trial and that the U.S. Supreme Court's decision in *Stern v. Marshall* "raises serious questions about whether the 'Bankruptcy Court is constitutionally empowered to decide [the] adversary proceeding, jury trial or no jury trial.'" The plaintiff joined in the motion in order to "avoid potential collateral litigation" but the motion was opposed by other defendants in the action.

As a preliminary matter, the court noted that its determination of whether a claim is core or non-core is not dispositive of whether the reference should be withdrawn and, in fact, "guides a cause analysis and, therefore, must be considered preliminary." Finding that the counts in the complaint were "a mixture of core and non-core claims all arising from the same facts[,]", the court addressed whether the movants "satisfied the minimum standards necessary to show cause" to withdraw the reference. In so doing, the court ruled as follows:

1. Promotion of uniformity in bankruptcy administration – While the court's "immediate reaction" disfavored withdrawal as against uniformity of process, its deeper analysis led to the conclusion that withdrawal furthered uniformity. Specifically, the court noted that withdrawing the reference would result in rulings on all claims by a single court and the application of uniform standards of review.

2. Reduction in forum shopping and confusion – The movants argued that if the bankruptcy court lacked jurisdiction to enter final judgment, the parties could potentially have to re-litigate the entire case after the bankruptcy court entered its ruling. While the court had "serious doubts that *Stern* requires such a result," it decided that the confusion created by *Stern* and potential attacks on a bankruptcy court judgment would be mooted if the reference was withdrawn.

[View as Web Page](#)

[Unsubscribe](#)

[Forward to a Friend](#)

Opinion

In re: USDigital, Inc.

In re: Appleseed's
Intermediate Holdings, LLC

The Bankruptcy and Corporate Restructuring Partners

Joseph M. Barry
Sean M. Beach
Robert S. Brady
M. Blake Cleary
John T. Dorsey
Daniel F.X. Geoghan
Edwin J. Harron
David R. Hurst
Matthew B. Lunn
Pauline K. Morgan
Edmon L. Morton
Michael R. Nestor
James L. Patton, Jr.
Joel A. Waite
Sharon M. Zieg

About Young Conaway Stargatt & Taylor, LLP

Young Conaway Stargatt & Taylor, LLP, one of Delaware's largest law firms, counsels and represents national, international and local clients, handling sophisticated advisory and litigation matters involving bankruptcy, corporate law and intellectual property. Young Conaway also guides regional businesses and individuals through a myriad of employment, real estate, tax, estate planning, environmental, and banking issues from the firm's offices in downtown Wilmington, Delaware. Through its office in New York City, Young Conaway offers its law firm and other referral sources conflicts counsel, special counsel and other restructuring and commercial litigation representation in the New York area and the Southern District of New York.

3. Preservation of resources – The court determined that withdrawing the reference would avoid the inefficiency and costs of collateral litigation regarding the bankruptcy court's jurisdiction and the appellate process.

4. Expediting the bankruptcy process – the court next found that withdrawing the reference would expedite the bankruptcy process since the parties can now "skip the Bankruptcy Court and proceed directly in [District] Court, which will eliminate a round of appeals."

5. Impact of jury trial demand – The court recognized that it was vested with the authority to refer a case to the bankruptcy court pursuant to 28 U.S.C. § 257(c), rejecting the argument offered by the objecting defendants that the moving defendants "did not object to the provision of the reorganization plan that granted the Bankruptcy Court exclusive jurisdiction over the Litigation Trust." Instead, the court found that the moving defendants timely moved to withdraw the reference, preserving their rights under the plan.

The court ultimately decided the issue without addressing the impact of *Stern*, expressly making "no opinion concerning the scope and impact of *Stern* on future bankruptcy cases."

Whereas the District Court in *Appleseed's* elected not to address the impact of *Stern* in any detail, Judge Sontchi, a Delaware bankruptcy judge, did just that in his recent opinion in

Burtch v. Huston, et al.(In re USDigital, Inc.), Case No. 07-10374, Adv. No. 09-50469 (Bankr. D. Del. Dec. 20, 2011).

In *USDigital*, the bankruptcy court offered its general observations regarding the *Stern* decision and, more specifically, its limits and its import.

In the context of determining whether an equitable subordination claim against various defendants was a core or non-core proceeding, the court made 7 preliminary observations regarding *Stern*:

1. *Stern* does not limit a bankruptcy court's subject matter jurisdiction, and, at the very least, the bankruptcy court must have "related to" jurisdiction.
2. *Stern* does not affect the statutory distinction between core and non-core proceedings, and for a matter to be core, it must, at least, be core under the statute.
3. If a matter is core under the statute, a bankruptcy judge must also have the judicial authority under the Constitution to enter a final order for the proceeding to be truly core.
4. If a matter is core under both the statute *and* the U.S. Constitution, then the bankruptcy judge may enter final orders.
5. Non-core proceedings are those that (a) are not core under the statute; or (b) are core under the statute but over which the bankruptcy judge lacks the judicial power under the Constitution to enter final orders.
6. A bankruptcy judge's power over non-core proceedings is limited to issuing proposed findings of fact and conclusions of law that are subject to *de novo* review.
7. A finding that a matter is a non-core proceeding when it has been asserted to be core does not, in and of itself, result in dismissal of the claim.

The court framed a two-part analysis, first considering whether the equitable subordination claim met the statutory definition of a core proceeding, and, if so, whether a bankruptcy judge has the power to enter final orders on the matter under the Constitution. The court then made the dispositive determination as to whether *Stern* was applicable under the present facts, finding that (i) the equitable subordination claim was a core proceeding under the statute and (ii) *Stern* was not applicable because the equitable subordination claim did not involve a state law counterclaim to a proof of claim filed by the trustee (invoking the most narrow interpretation of *Stern*, as discussed below).

After finding that the equitable subordination claim was a core proceeding under the

statute, the court then addressed whether it had the constitutional authority to enter a final order. In so doing, the court considered whether *Stern* should be read narrowly or broadly, thoroughly parsing the language of Supreme Court's opinion while noting the seemingly contradictory nature of the Supreme Court's intent (the conclusion itself expressly indicated that the holding was quite narrow) with the Supreme Court's own use of broad and expansive language (repeated references to "cause of action under common law", "state law claim", "state common law claim," "state cause of action," "claim under state common law," and "state tort action"). In sum, the court endeavored to determine whether *Stern* applies to "common law tort claims or state law counterclaims" and ultimately found that the Supreme Court, in *Stern*, "took back what it had appeared to have given and made it clear that its holding was a narrow one."

Judge Sontchi endorsed a narrow interpretation of *Stern* largely because of the Supreme Court's clear belief that its ruling would have little effect, finding that "[i]t is simply incredulous to conclude that the Supreme Court contemplated that its holding would transform all state common law claims from core under the statute to non-core under the Constitution while stating that its ruling would not meaningfully change the division of labor in the current statute!"