No. 10-179

IN THE

Supreme Court of the United States

HOWARD K. STERN, EXECUTOR OF
THE ESTATE OF VICKIE LYNN MARSHALL,
Petitioner,

—v.—

ELAINE T. MARSHALL, EXECUTRIX OF
THE ESTATE OF E. PIERCE MARSHALL,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES
COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF IN SUPPORT OF PETITIONER FOR *AMICI CURIAE* PROFESSORS RICHARD AARON, LAURA BARTELL, JAGDEEP S. BHANDARI, SUSAN BLOCK-LIEB, ROBERT D'AGOSTINO, JACKIE GARDINA, INGRID HILLINGER, GEORGE W. KUNEY, LOIS LUPICA, C. SCOTT PRYOR, KEITH SHARFMAN, MICHAEL D. SOUSA, AND ROBERT M. ZINMAN

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INTEREST OF *AMICI*[1]

The *Amici Curiae* are law professors who have devoted their careers to the teaching and study of bankruptcy law and the subject matter jurisdiction of the courts of bankruptcy.[2] They are keenly interested in this appeal because its outcome could have a significant impact on the continued efficiency of the bankruptcy courts in their handling of bankruptcy proceedings referred to them by omnibus reference orders issued by all district courts pursuant to 28 U.S.C. § 157(a). Under 28 U.S.C. § 157(b)(1), bankruptcy judges have authority, subject to control by the Article III Judiciary, to adjudicate those referred proceedings that are

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[1] The *Amici* file this brief with the written consent of all parties. No counsel for a party has authored this brief in whole or in part. No person or entity, including the *Amici* or their counsel, made a monetary contribution for the preparation or submission of this brief; it has been prepared *pro bono*.

[2] The *Amici* are Richard Aaron, Professor of Law, University of Utah-S.J.Quinney College of Law; Laura Bartell, Professor of Law, Wayne State University Law School; Jagdeep S. Bhandari, Professor of Law, Florida Coastal Law School; Susan Block-Lieb, Professor of Law, Fordham Law School; Robert D'Agostino, Professor of Law, John Marshall Law School; Ingrid Hillinger, Professor of Law, Boston College School of Law; Jackie Gardina, Professor of Law, Vermont Law School; George W. Kuney, Professor of Law, University of Tennessee College of Law; Lois Lupica, Professor of Law, University of Maine School of Law; C. Scott Pryor, Regent University School of Law; Keith Sharfman, Professor of Law, St. John's University School of Law; Michael D. Sousa, Professor of Law, University of Denver-Sturm College of Law; and Robert M. Zinman, Professor of Law, St. John's University School of Law.

within the "core" category under 28 U.S.C. § 157(b)(2).

This appeal poses the question whether, in light of Article III of the Constitution, a non-Article III bankruptcy judge may be empowered to adjudicate a compulsory counterclaim of the bankruptcy trustee or debtor as a "core" proceeding against a creditor who has filed a proof of claim. It is the *Amici*'s view that in answering this question, a distinction should be made between a permissive counterclaim and one that is compulsory.[3] This is because, unlike permissive counterclaims, a compulsory counterclaim (1) must be asserted in response to the creditor's filed claim or it will be extinguished as a matter of law, and (2) is inseparably tied to the creditor's filed claim and thus must be determined as a part of the claims-allowance process for the restructuring of debtor-creditor relations, which is at the core of the federal bankruptcy power.

The *Amici* note policy concerns that if bankruptcy judges are precluded from adjudicating compulsory counterclaims, it will unduly delay the completion of bankruptcy cases and distribution to creditors while awaiting the resolution of compulsory counterclaims by the district court. It

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[3] Although 28 U.S.C. § 157(b)(2)(C) literally designates both permissive and compulsory counterclaim as "core" proceedings, the question whether Article III precludes a bankruptcy judge from adjudicating permissive counterclaims is not before the Court because the Court of Appeals below found that Petitioner's counterclaim is a compulsory counterclaim. *In re Marshall*, 600 F.3d 1037, 1057 (9th Cir. 2010). This *amicus* brief does not directly address permissive counterclaims.

will also impose an unnecessary burden on district courts and cause a significant increase in the costs of bankruptcy cases. The *Amici* are also concerned that the rejection of authorization for bankruptcy judges to adjudicate compulsory counterclaims under 28 U.S.C. § 157(b)(1) and § 157(b)(2)(C), despite their integral part of a core bankruptcy function, would generate uncertainty in the lower courts regarding whether Article III precludes bankruptcy judges from determining some of the *other* proceedings that are also designated as "core" by § 157(b)(2), and could call into question the constitutionality of the entire present bankruptcy jurisdictional system.

By this *pro bono amicus* brief in support of Petitioner, the *Amici* offer their analysis of the issue to provide assistance to the Court as it considers this important question. The *Amici* believe that unique aspects of their analysis demonstrate that Article III, when interpreted and applied in light of its purposes, does not preclude a bankruptcy judge from adjudicating a compulsory counterclaim.

SUMMARY OF ARGUMENT

The Court has decided a number of cases that address whether various non-Article III systems for the adjudication of claims passed constitutional muster, and has rejected Article III challenges in most of them. Although the Court's theory for when it has upheld a non-Article system of adjudication is not evident from the case law, its jurisprudence provides insight into the circumstances under which the vesting of adjudicatory authority in a non-Article III judge does not

run afoul of Article III. What emerges as a key factor in sustaining such authority is the ability of the Article III Judiciary to control the process conducted in the non-Article III tribunal. The 1978 bankruptcy jurisdictional system before the Court in *Northern Pipeline Construction Co. v. Marathon Pipe Line Company*, 458 U.S. 50 (1982) (herein, "*Northern Pipeline*") was invalidated because the Article III Judiciary had no control whatsoever over proceedings in the bankruptcy courts. As stated by the Court, that system actually "supplant[ed] our system of adjudication in independent Art. III tribunals." *Id.* at 73. In contrast, under the present system, the Article III Judiciary has control over bankruptcy, and the Article III judges decide what proceedings will be adjudicated by a bankruptcy judge.

The constitutionality of a bankruptcy judge's authority to adjudicate compulsory counterclaims should be determined by reference to Article III's underlying objectives, particularly where, as here, any intrusion upon the Article III system of adjudication is *de minimus*. Article III's institutional and individual objectives are to ensure the independence of the Judiciary and to protect it from control of the Executive and Legislative branches. *Northern Pipeline*, 458 U.S. at 59. In light of the Article III Judiciary's control, authorization of non-Article III bankruptcy judges to adjudicate compulsory counterclaims does not stand in the way of achieving Article III's institutional objective to protect the federal Judiciary from pressure exerted by the political branches of the government.

A creditor's personal right to an Article III adjudication does not extend to claims that are an integral part of the claims-allowance process triggered by its filing of a proof of claim. Such right does not extend to compulsory counterclaims, which must be adjudicated on the merits and their damages assessed to determine the fate of the creditor's claim, and in turn, all of the creditors' claims, in order to allocate the property of the estate for distribution to creditors. *Tennessee Student Assistance Corp. v. Hood*, 541 U.S. 440, 448 (2004). The bankruptcy courts' *in rem* jurisdiction thus encompasses the determination of compulsory counterclaims. The authorization of non-Article III bankruptcy judges to adjudicate claims that directly involve the bankruptcy *res* implements the bankruptcy function of distribution of estate assets to creditors, and does not stand in the way of accomplishing the objectives of Article III.

The determination of compulsory counterclaims is an essential part of "the restructuring of debtor-creditor relations, which is at the core of the federal bankruptcy power." *Northern Pipeline*, 458 U.S. at 71 (plurality); 458 U.S. at 95 (dissent); *See also Langenkamp v. Culp*, 492 U.S. 42, 44 (1990). The universe of claims against the bankruptcy estate must be fully determined in order to restructure debtor-creditor relations, and the total amount of allowed claims cannot be known without adjudicating compulsory counterclaims. Such counterclaims are forced into the bankruptcy case and become creatures of bankruptcy as an integral part of the debtor-creditor restructuring process. The bankruptcy judges' authority to adjudicate compulsory counterclaims should be upheld

because they are at the core of the federal bankruptcy power.

The system that has been established for bankruptcy is predicated on the fundamental principle that the bankruptcy court is a court of equity and "applies the principles and rules of equity jurisprudence." *Young v. United States*, 535 U.S. 43, 50 (2002) (quoting *Pepper v. Litton,* 308 U.S. 295, 304 (1939)). Under principles of equity jurisprudence, the equity power extends to all parts of the dispute between the parties that arise from the same operative facts. Thus, equity does not require parties to litigate one part of a controversy in one court, and another part in a different court. Under this principle of equity, Article III does not preclude non-Article III judges from determining compulsory counterclaims as part of the equitable claims-allowance process.

A right to an Article III adjudication should not fare any better than other constitutional rights that are lost because of the filing of a proof of claim. Creditors who have filed proofs of claim thereby lose various constitutional rights regarding determinations to be made within the equitable claims-allowance process. For example, a creditor who files a proof of claim forfeits a Seventh Amendment right to trial of the claim by a jury. Likewise, by filing a proof of claim, a State foregoes its Eleventh Amendment right not to be required to litigate in a federal court in order to establish its claim. Similarly, by filing a proof of claim, the creditor should be held to forego an Article III objection to the bankruptcy judge's authority to adjudicate a compulsory counterclaim.

A compulsory counterclaim must be adjudicated on its merits and the damages it seeks must be liquidated in order to know the outcome of the creditor's claim. It makes no sense for the parties to try the merits of a compulsory counterclaim and its damages before a bankruptcy judge, and then to require the counterclaiming party to bring another proceeding in district court to obtain a money judgment.

ARGUMENT

POINT I

THE AUTHORITY OF NON-ARTICLE III BANKRUPTCY JUDGES TO HEAR COMPULSORY COUNTERCLAIMS IS NOT PRECLUDED BY ARTICLE III IN LIGHT OF THE ARTICLE III JUDICIARY'S CONTROL OVER BANKRUPTCY

A. Under the Court's Jurisprudence, Control of Litigation in the Non-Article III Court by the Article III Judiciary Emerges as a Key Factor Supporting a Non-Article III Adjudication of Compulsory Counterclaims

Article III of the Constitution provides that the federal judicial power shall be exercised by life-tenured judges whose compensation is protected from reduction. However, the Court has held that in some circumstances, Congress may authorize various persons who lack Article III attributes to adjudicate the rights of the parties. During the 1800s, the Court established exceptions to Article III for territorial courts, military tribunals, and

so-called "public rights" cases.[4] In five more recent cases, the Court considered the constitutionality of various non-Article III systems for the adjudication of controversies. The Court upheld such systems in four cases: *Crowell v. Benson*, 285 U.S. 22 (1932); *United States v. Raddatz*, 447 U.S. 667 (1980); *Thomas v. Union Carbide Agric. Prods. Co.*, 473 U.S. 568 (1985); *Commodity Futures Trading Comm'n v. Schor*, 478 U.S. 833 (1986) (herein, "*Schor*"). In the fifth case, *Northern Pipeline*, the Court ruled that the system at issue violated Article III. However, the circumstances in which a non-Article III adjudication will pass constitutional muster are not altogether clear from the case law.

In *Northern Pipeline*, the Court illuminated the issue in the bankruptcy context. There, the Court invalidated the 1978 bankruptcy system, holding that Article III barred a non-Article III bankruptcy court from adjudicating a debtor's contract claim against a defendant who had not filed a proof of claim against the bankruptcy estate. The present jurisdictional structure, enacted in 1984, is materially different from the one invalidated by *Northern Pipeline*. Whereas the present system provides the Article III Judiciary with control over bankruptcy, the 1978 scheme violated Article III because it vested no control whatsoever in the Article III Judiciary. As explained by the Court, the problem with the 1978 system was that it "supplant[ed] completely our system of adjudication in independent Art. III tribunals," and "provide[d] no limiting principle." *Id.* at 73. By

[4] These early exceptions to Article III are discussed in *Northern Pipeline*, 458 U.S. at 64-68.

contrast, the present system vests control over the bankruptcy courts in the Article III Judiciary. Bankruptcy judges are appointed by the courts of appeals, and constitute units of the district court. 28 U.S.C. §§ 151 and 152(a)(1). Moreover, the district courts are empowered to decide, in their discretion, what proceedings they will send to the bankruptcy judges. Further, at any time, the district courts may withdraw the reference of any, or even all, of the proceedings previously referred to a bankruptcy judge, for adjudication by the district court itself. 28 U.S.C. §§ 151, 152 and 157(d). The Article III Judiciary thus decides who will be the bankruptcy judges, what proceedings will be sent to them, and which ones they will retain. Control by the Article III Judiciary of the adjunct bankruptcy judges is a key factor among those which, under the Court's jurisprudence, support the authorization of bankruptcy judges to adjudicate compulsory counterclaims. The present system for bankruptcy should be upheld because it is structured on control of the system by the Article III Judiciary.

Article III should be interpreted and applied in light of its objectives, and the resolution of an Article III challenge "cannot turn on conclusory reference to the language of Article III." *Schor*, 478 U.S. at 847. The primary objective of Article III is to protect the federal Judiciary from incursion by the Legislative and Executive branches of the federal government. *Northern Pipeline*, 458 U.S. at 59; *Schor*, 478 U.S. at 848. That objective is not impaired by the adjudication of compulsory counterclaims by non-Article III bankruptcy judges, and granting such authorization to non-

Article III bankruptcy judges is "consistent with, rather than threatening to, the constitutional mandate of separation of powers." *Northern Pipeline*, 458 U.S. at 64.

Not only does authorizing bankruptcy judges to adjudicate compulsory counterclaims not impair Article III's purpose, but moreover, the adjudication of compulsory counterclaims is an integral part of the equitable claims-allowance process, which is an essential part of the bankruptcy system. *Langenkamp*, 498 U.S. at 44. Compulsory counterclaims asserted against a proof of claim must be adjudicated and their damages assessed in order to determine the allowance of the creditor's claim. The process must be completed so that the universe of allowed claims against the bankruptcy estate will be known. That information is essential to restructure debtor-creditor relations, which is at the core of the federal bankruptcy power. The bankruptcy system operates under the control of the Article III Judiciary, and such control protects the system from incursions by the political branches. The adjudication of compulsory counterclaims by bankruptcy judges thus does not run afoul of Article III.

In the Bankruptcy Amendments and Federal Judgeship Act of 1984, by which the present system was enacted, Congress created the jurisdictional system that replaced the one held unconstitutional under Article III in *Northern Pipeline*. There the Court held that the 1978 scheme ran afoul of Article III because it totally supplanted the system of adjudication in independent Article III courts. In response to this ruling, the 1984 Amendments, which continue in

effect, vested bankruptcy jurisdiction in the district courts and authorized them to assign bankruptcy proceedings to the bankruptcy judges, and further authorized the district courts to take back from the bankruptcy judges any or all proceedings at any stage, for adjudication by the district court itself. By this means, the bankruptcy courts operate within the present system under the control of the Article III Judiciary. This is because the district courts decide whether to refer bankruptcy proceedings and whether to withdraw the reference so as to take them back for an Article III court's determination. The key factor supporting the constitutionality of the authorization to bankruptcy judges to adjudicate compulsory counterclaims is the control vested in the Article III Judiciary.

B. The Article III Judiciary's Control Over the Bankruptcy Courts Prevents Encroachment on the Independence of the Article III Judiciary, Thereby Satisfying the Institutional Purpose of Article III

Article III, § 1, of the Constitution protects the independence of the federal Judiciary from encroachment or aggrandizement by the Legislative and Executive branches of the government. While a system under which non-Article III judges have some adjudicatory authority must, for the most part, leave the "essential attributes of judicial power" in Article III courts, *Schor*, 478 U.S. at 852, the Court has recognized that Article III does not bar Congress from acting under Article I to vest some decision-making authority in non-Article III courts and federal agencies. *See, e.g.*, *Schor*, 478 U.S. at 852; *Waters v. National Assn. of Radi-*

ation Survivors, 473 U.S. 305 (1985); *Palmore v. United States*, 411 U.S. 389 (1973); *Crowell v. Benson*, 285 U.S. 22 (1932); *Murray's Lessee v. Hoboken Land & Improvement*, 18 How. 272 (1856).

Under various circumstances, the Court has upheld authorizations of non-Article III courts and agencies to make final adjudications. The plurality in *Northern Pipeline* endorsed the proposition that non-Article III tribunals could finally adjudicate particular matters without running afoul of Article III, specifically reaffirming the holding of *Crowell*, "that Congress may assign to non-Article III bodies some adjudicatory functions." *Northern Pipeline*, 458 U.S. at 80 n.32. Moreover, the plurality reaffirmed the constitutionality of the magistrate system, which was upheld in the face of an Article III challenge in *Raddatz*. *See id.* at 81. The Court's holding in *Northern Pipeline* is quite narrow, concluding that a debtor's contract action against a defendant who did not file a proof of claim could not constitutionally be adjudicated by a non-Article III judge. The critical element in *Northern Pipeline,* which differs from this case, was that the 1978 bankruptcy jurisdictional system granted unlimited adjudicatory authority to the non-Article III bankruptcy judges under a system that provided no control whatsoever for the Article III Judiciary. *Northern Pipeline*, 458 U.S. at 85. Under the 1978 system, Congress enabled the non-Article III bankruptcy courts to exercise "all powers of law, equity and admiralty." *Id.* at 55. Moreover, although the 1978 statute nominally vested bankruptcy jurisdiction in the district courts, that statute automatically empowered the

non-Article III bankruptcy judges, who were Presidential appointees, to exercise complete jurisdiction over all bankruptcy proceedings without any control or supervision whatsoever by the Article III Judiciary. As observed by the Court, all powers of an Article III court were given to the non-Article III bankruptcy judges, hidden "behind the façade of a grant to the district courts." *Id.* at 86.

The Court has upheld the constitutionality of numerous provisions authorizing non-Article III judges and administrative agencies to adjudicate controversies. In assessing whether a particular delegation of adjudicative power encroaches on the independence of the Article III Judiciary, this Court has been "guided by the practical effects of [a] congressional action rather than 'formalistic and unbending rules.'" *See Northern Pipeline*, 458 U.S. at 81; *see also Schor*, 478 U.S. at 581; *Thomas*, 473 U.S. at 587. As stated by the Court:

> Great constitutional provisions must be administered with caution. Some play must be allowed for the joints of the machine and it must be remembered that legislatures are ultimate guardians of the liberties and welfare of the people in quite as great a degree as the courts.

Mo., Kans. & Tex. Ry. Co. of Tex. v. May, 194 U.S. 267, 270 (1904) (Holmes, J.).

The Court's jurisprudence has focused on "substance rather than doctrinal reliance on formal categories" when considering Article III challenges. *Schor*, 478 U.S. at 848. When there are safeguards in place to ensure that the independence of the Article III Judiciary is not threat-

ened, the Court has upheld the grant of adjudicative authority to non-Article III judges and agencies. The Court has done so in at least seven of its decisions over the past 150 years. The 1978 bankruptcy jurisdictional system is the only one the Court held to have run afoul of Article III—and that because it *entirely* replaced the Article III courts with non-Article III bankruptcy judges without any protection whatsoever from pressures exerted by the political branches.

The Court has rejected Article III challenges to non-Article III adjudications—five times before *Northern Pipeline* and twice since—thus recognizing that non-Article III tribunals may enter final judgments without offending Article III. *E.g., Schor* 478 U.S 833; *Thomas*, 473 U.S. 568. In *Schor*, the Court held that allowing an administrative agency jurisdiction over state law counterclaims was not a violation of Article III. *Schor*, 478 U.S. at 857. Expressly rejecting a "slippery slope" argument, the *Schor* Court affirmed that Congress may constitutionally delegate decision-making authority to non-Article III tribunals when that delegation does not shift the "essential attributes of judicial power" to non-Article III courts to such extent that the system "impermissibly intrude[s] on the province of the judiciary." *Schor*, 478 U.S. at 851-852. To comport with Article III values, the independence of the Judiciary must be protected. The controls held by the Article III Judiciary under the present system provide that protection.

The importance of control is evident from *Northern Pipeline*'s rejection of the contention that the 1978 system was analogous to the earlier

bankruptcy referee system, because under the earlier system the referees were under the control of the district courts. In *Northern Pipeline*, the Court focused on the fact that under the 1978 structure, which replaced the referee system, the district court did not have any control whatsoever over the bankruptcy jurisdictional system. Under the pre-1978 system, the bankruptcy referee's power was derived solely from the district courts. The district courts appointed the referees, who served at the pleasure of the district courts, and the referees only heard matters at the discretion of the district court. The Article III judges' control over referees insulated the system from interference by the political branches of government, a protection that the 1978 system lacked, but which is once again provided by the present system. *Northern Pipeline*, 458 U.S. at 79 n.31.

Two years after *Northern Pipeline*, Congress enacted the Bankruptcy Amendments and Federal Judgeship Act of 1984. This was an effort to "cure the constitutional defect" in the 1978 system. *In re Arnold Print Works, Inc.*, 815 F.2d 165, 166-167 (1st Cir. 1987) (Breyer, J.). The 1984 amendments completely overhauled the bankruptcy jurisdiction scheme, giving the Article III Judiciary the control over bankruptcy courts that it lacked under the 1978 system. Under 28 U.S.C. § 157(a), bankruptcy judges have the authority, subject to control by the district courts, to adjudicate only those proceedings that have been referred to them by the district courts. Pursuant to 28 U.S.C. § 157(d), the district court has the authority to withdraw for cause any or all proceedings that have been so referred. Further, the 1984 Amend-

ments shifted the power to appoint bankruptcy judges from the Executive branch to the courts of appeals. 28 U.S.C. § 152(a)(1). The courts of appeals also decide whether to reappoint bankruptcy judges at the end of their 14-year term, and the judicial council of the circuit, composed of Article III judges, is empowered to remove them. 28 U.S.C. §§ 152(e) and 332. Therefore, the Article III Judiciary decides who will sit on the bankruptcy bench, what proceedings will be referred to the bankruptcy courts, and what proceedings the bankruptcy judges will retain. This control over the bankruptcy system insulates the bankruptcy judges from any attempts by the Legislative or Executive branches to exert influence over them.

The authority of the district court to withdraw any or all proceedings that have been referred to the bankruptcy judges is an especially important means for the Article III Judiciary to deal with efforts from outside the Judiciary to exercise control over bankruptcy judges. The power to decide which proceedings the bankruptcy judges will retain serves to protect bankruptcy judges from outside influence. If a district court has any concern about external interference, it has the authority to withdraw the reference *sua sponte*. 28 U.S.C. § 157(d). In 2008, district courts withdrew 429 proceedings from the bankruptcy courts; in 2009, they withdrew 407.[5]

District courts have exercised their control in significant ways. For example, after the District

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[5] United States Courts, Statistics: Judicial Business of the U.S. Courts 2009 (2009), http://www.uscourts.gov/Statistics/JudicialBusiness/JudicialBusiness2009.aspx (follow link at C2, page 2).

Court for the District of Delaware referred all bankruptcy proceedings to the bankruptcy judge of the district by its 1984 order, the District Court withdrew the bankruptcy court's *entire* caseload by an order entered in January 1997, which authorized the Chief Judge of the District Court to assign the particular bankruptcy proceedings to any of the several district judges or the bankruptcy judge. That order remained in effect until October 2001, when the District Court reinstated its previous automatic reference of all proceedings to the bankruptcy judges.[6] In the District of Delaware, therefore, for a period of almost five years, the Chief District Judge exercised discretion to select what proceedings would be retained in the district court or sent to the bankruptcy judge.

C. The Bankruptcy Courts' Ability to Adjudicate Compulsory Counterclaims, a Limited Class, Provides "a Limiting Principle" to the Bankruptcy Courts' Authority and Ensures that the Intrusion Upon the Article III Judiciary is *De Minimis*

The bankruptcy courts are not authorized under the present system to adjudicate claims of the *Northern Pipeline* type, and their full adjudicatory

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[6] Order of Jan. 23, 1997, In re Referral of Title 11 Proceedings to The United States Bankruptcy Judges For This District, District of Delaware, available at http://www.ded.uscourts.gov/StandingOrdersMain.htm (bottom of page) (withdrawing the automatic reference); *see also*, the website for the District Court of Delaware, http://www.ded.uscourts.gov/StandingOrdersMain.htm (bottom of page) (listing orders establishing, withdrawing and reinstating the reference of cases under title 11 to the bankrutpcy judges in Delaware).

authority is limited to claims that are central to bankruptcy and its process. 28 U.S.C. § 157(b)(1) and (2). In this case, the *Amici* only suggest that the Court uphold the bankruptcy courts' authority to determine a limited class of claims—compulsory counterclaims—which would be extinguished if not asserted in response to a creditor's proof of claim. Allowing the bankruptcy courts to determine this limited class of claims does not pose a danger that the other branches of the government will be able to intrude on the independence of the Judiciary.

In *Schor*, the Court upheld the authority given to a federal agency to adjudicate a broker's counterclaim to recover an account debit where the counterclaim arose out of the same operative facts as its customer's claim, and the scope of the counterclaim thus was limited. *Schor*, 478 U.S. at 854-857. The Court explained:

> It . . . bears emphasis that the CFTC's assertion of counterclaim jurisdiction is limited to that which is necessary to make the reparations procedure workable. The CFTC adjudication of common law counterclaims is incidental to, and completely dependant upon, adjudication of reparations claims created by federal law, and in actual fact is limited to claims arising out of the same transaction or occurrence as the reparations claims.
>
> In such circumstances, the magnitude of any intrusions of the Judicial Branch can only be termed *de minimis*.

Id. at 856.

Each of the elements present in *Schor* that sustained the counterclaim jurisdiction from an Article III challenge in that case are satisfied in the present case:

First: The counterclaim jurisdiction conferred on the bankruptcy judges is *limited*, and is *necessary* to make the claims-allowance process *workable*.

Second: The adjudication of the creditor's proof of claim is *completely dependant upon* adjudication of the compulsory counterclaim because a compulsory counterclaim must be adjudicated in order to determine whether to allow the creditor's claim.

Third: A compulsory counterclaim arises out of the *same operative facts* as the creditor's proof of claim, and must be asserted in a bankruptcy case in response to a proof of claim because of *federal* law. Fed. R Bankr. P. 7013.

Fourth: To the extent, if any, that such authorization makes any intrusion on Article III, the limitation to compulsory counterclaims makes such intrusion *de minimus*.

When measured by (a) Article III's objectives, (b) the Article III Judiciary's control over what proceedings a bankruptcy judge may adjudicate, (c) the importance of a workable and efficient bankruptcy system, (d) the enormously heavy workload of the district courts, and (e) the limited intrusion on Article III, that Article should not be interpreted to preclude bankruptcy judges from adjudicating compulsory counterclaims and entering money judgments thereon.

POINT II

A CREDITOR WHO HAS FILED A PROOF OF CLAIM DOES NOT HAVE A RIGHT TO AN ARTICLE III DETERMINATION OF A COMPULSORY COUNTERCLAIM

A. The determination of Compulsory Counterclaims as Part of the Claims-Allowance Process Lies at the Core of the Federal Bankruptcy Power

The Court has recognized that the determination of creditors' claims in the claims-allowance process is fundamental to the restructuring of the debtor-creditor relationship, *Langenkamp*, 498 U.S. at 44 (citing *Granfinanciera*, S.A. *v. Nordberg*, 492 U.S. 33, at 57-58 (1989)), and therefore lies at the very core of the federal bankruptcy power, *Northern Pipeline*, 458 U.S. at 71 (plurality opinion). It has also recognized that whether *federal* rights are involved is significant to the Article III issue. In this case, not only is the federal bankruptcy power involved, but because a proof of claim was filed, federal law is also the source of the obligation to interpose the compulsory counterclaim. Fed. R. Bankr. P. 7013; *Cf. Northern Pipeline*, 458 U.S. at 84.

When a debtor files for bankruptcy, any creditor seeking to share in a distribution from the bankruptcy estate must file a proof of claim. 11 U.S.C. § 501. Merely filing a proof of claim, however, does not entitle the creditor to allowance of that claim; rather, by filing a proof of claim the creditor initiates a *process*, which ultimately

results in the bankruptcy court's determination of the allowability and amount (if any) of the creditor's claim. 11 U.S.C. § 502. The Court has consistently recognized that bankruptcy jurisdiction's nature is *in rem*, *Gardner v. New Jersey*, 329 U.S. 565, 574 (1947)); *Tenn. Student Assistance Corp. v. Hood*, 541 U.S. at 447-48, and that the claims-allowance process lies at the core of the federal bankruptcy power, *Northern Pipeline*, 458 U.S. at 71.

Because claims allowance is a single, unitary process, the adjudication of a creditor's claim necessarily requires determination of all issues bearing upon the validity and amount of the claim—including any defenses thereto. 11 U.S.C. §§ 502(b), 502(d), and 558. One such defense is a compulsory counterclaim, which is a claim that arises out of the same transaction or occurrence as the creditor's claim against the bankruptcy estate. Fed. R. Bankr. P. 7013. Without determining the merits and liquidating the amount of a compulsory counterclaim, the bankruptcy court cannot adjudicate the creditor's net claim.

Thus, under the present jurisdictional scheme, if the claims-allowance process is to be conducted and completed efficiently, bankruptcy judges must have authority to adjudicate compulsory counterclaims. Bifurcating the claims-allowance process into one class of affirmative creditor claims and another class of responsive compulsory counterclaims—which would be tried in different fora—would create a false dichotomy undermining a well-settled primary function of bankruptcy courts, and running counter to the equitable nature of the claims-allowance process.

B. Once a Creditor has Filed a Proof of Claim, a Compulsory Counterclaim Filed by the Bankruptcy Trustee or Debtor Becomes an Inseparable Element of the Claims-Allowance Process Triggered by the Creditor's Filing a Proof of Claim

Any creditor seeking an equitable distribution from the *res* of the bankruptcy estate must file a proof of claim in the case. 11 U.S.C. § 501. The bankruptcy court may allow claims in one of three ways: (1) claims to which no objections are filed are deemed allowed, 11 U.S.C. § 502(a); (2) the court may allow a claim over a filed objection, 11 U.S.C. § 502(b); or (3) the court may estimate a claim, 11 U.S.C. § 502(c). Where a party objects to a filed proof of claim, all issues bearing upon the allowability of the claim must be determined. 11 U.S.C. § 502(b).

Once faced with a given claim, the bankruptcy trustee or debtor may responsively assert any defenses that the debtor otherwise could have asserted. 11 U.S.C. §§ 502(b), 502(d), and 558; Fed. R. Bankr. P.7013. To the extent a defense is sustained, it operates to reduce or negate the creditor's claim. Further, § 502(b)(1) stipulates that a creditor's claim is disallowed to the extent that the claim is unenforceable against the debtor or its property. 11 U.S.C. § 502(b)(1). In other words, the bankruptcy court *must* first adjudicate the merits of any defenses to a claim before determining the allowance or disallowance of that claim.

One such defense—which *must* be heard and determined as a condition precedent to adjudication of that creditor's net claim—is the compulsory

counterclaim. A compulsory counterclaim is a counterclaim that: (1) arises out of the same transaction or occurrence as the claim to which it responds; and (2) does not require joinder of parties over which the court cannot acquire jurisdiction. Fed. R. Bankr. P. 7013. Where a litigant fails to assert a compulsory counterclaim, that claim is barred permanently. *See, e.g.*, Charles Alan Wright et al., 6 Fed. Prac. & Proc. Civ. § 1401 (3d ed.) (citing *Baker v. Gold Seal Liquors, Inc.*, 417 U.S. 467, 469 n.1 (1974).

As the Court has explained, "[i]t is traditional bankruptcy law that he who invokes the aid of the bankruptcy court by offering a proof of claim and demanding its allowance must abide the consequences of that procedure." *Gardner v. New Jersey*, 329 U.S. at 573 (citing *Wiswall v. Campbell*, 93 U.S. 347, 351 (1876)). Because a creditor's filing *forces* the bankruptcy trustee or debtor to interpose a compulsory counterclaim, the "restructuring of debtor-creditor relations, which is at the core of the federal bankruptcy power," *Northern Pipeline*, 458 U.S. at 71, requires the bankruptcy court to determine that counterclaim.

Viewed structurally, then, claims allowance is a single, unitary process. An argument to the contrary is necessarily an argument that bankruptcy courts should not retain control over the claims-allowance process, and that claims allowance can be conducted only in an Article III court.

The fact that the *creditor's* affirmative act of filing a claim triggers the compulsory counterclaim —*i.e.*, the *creditor* puts the compulsory counterclaim at issue in the restructuring of the debtor-creditor relationship—carries important

consequences. The Court has drawn a "clear distinction" between cases where a creditor has filed a proof of claim and cases where a party with no connection to the bankruptcy case finds itself pulled unexpectedly into bankruptcy court. *Langenkamp*, 498 U.S. at 44. Specifically, a creditor that files a proof of claim subjects itself to the bankruptcy court's equitable jurisdiction. *Id.* (citing *Granfinanciera*, 492 U.S. at 57–58). Accordingly, such creditor should not be heard to complain that while the bankruptcy court has authority to determine the creditor's claim, that same court somehow lacks authority over the compulsory counterclaim. Thus, "to the extent that Article III reflects a concern for procedural fairness," *In re Arnold Print Works, Inc.*, 815 F.2d at 170 (Breyer, J.) (internal citation omitted), such creditor—having triggered bankruptcy court jurisdiction by filing its proof of claim—cannot be heard to complain of any unfair surprise when the bankruptcy court determines a compulsory counterclaim. *See also*, *Gardner v. New Jersey*, 329 U.S. at 573-574 (by filing a proof of claim, a State cannot complain that the process for adjudicating its claim constitutes a federal suit against it in violation of its Eleventh Amendment rights).

C. Preventing Bankruptcy Judges from Determining Compulsory Counterclaims to Proofs of Claim Would Undermine the Well-Settled, Equitable Nature of the Claims-Allowance Process

It is a fundamental tenet of the Court's bankruptcy jurisprudence that bankruptcy courts are courts of equity, which "appl[y] the principles and rules of equity jurisprudence." *Young v.*

United States, 535 U.S. at 50 (citing *Pepper v. Litton,* 308 U.S. 304). The Court has specifically recognized that the claims-allowance process is an equitable proceeding. *E.g. Katchen v. Landy*, 382 U.S. 323, 335 (1966) (citing *Alexander v. Hillman,* 296 U.S. 222, 241 (1935). In determining the parameters of such an equitable proceeding, the Court has consistently looked to the historical powers of courts of equity. *E.g., Grupo Mexicano de Desarrollo v. Alliance Bond Fund, Inc.*, 527 U.S. 308, 318 (1999) (citing *Atlas Life Ins. Co. v. W.I. Southern, Inc.*, 306 U.S. 563 (1939)) (equity jurisdiction is "an authority to administer in equity suits the principles of the system of judicial remedies which had been devised and was being administered by the English Court of Chancery at the time of the separation of the two countries.").

Historically, the powers of equity courts were broad and flexible, and evolved as a counterpoint to the rigid strictures of the common law pleading rules in the law courts. For example, a litigant desirous of pre-trial discovery in connection with a claim at law had to submit the controversy to the equity court because that was the only forum where discovery was available. *See* Story, Commentaries on Equity Jurisprudence, § 64k, at 70 (1st ed. 1836). Significantly, once a litigant thus invoked the equity court's jurisdiction for discovery, the court sitting in equity would adjudicate the entire dispute—including the claim that would otherwise be triable only at law. *See* Story, Commentaries on Equity Jurisprudence § 71, at 75-76 (1st ed. 1836); *Russell v. Clarke's Executors*, 7 Cranch. 69, 91 (1812) (After granting discovery, an equity court "will proceed to determine the whole matter in controversy"). The rationale was

to establish "a convenient and uniform principle of jurisdiction . . . that where [equity] jurisdiction once attaches for discovery, and the discovery is actually obtained, the [equity] court will further entertain the bill for relief, if the plaintiff prays it." Story, Commentaries on Equity Jurisprudence § 71, at 75.

Notably, the modern compulsory counterclaim rule is a direct descendant of the equitable doctrine of recoupment. *See, e.g.*, Charles Alan Wright et al., 6 Fed. Prac. & Proc. Civ. § 1401 (3d ed.) (citing Theodore Sedgwick, 3 Theory of Damages § 1042 (9th ed. 1912); Joseph Story, Commentaries on Equity Jurisprudence § 1878 (14th ed. 1918). Historically, courts have treated recoupment not as a separate counterclaim, but rather as an indivisible subpart of the same, unitary claim that the plaintiff initially filed, because their underlying operative facts were the same. *Id*. More recently, the Court has done the same. *See, e.g.*, *Stone v. White*, 301 U.S. 532, 539 (1937) (equitable recoupment "inheres in [plaintiff's] cause of action") (internal citation omitted).

Thus, a compulsory counterclaim—viewed in light of its historical antecedent, equitable recoupment—is an inseparable component of adjudicating the creditor's claim. Consequently, the bankruptcy court's equitable power over the creditor's claim necessarily includes authority over a compulsory counterclaim.

Furthermore, once a bankruptcy court has reached the merits of a compulsory counterclaim and necessarily begun liquidating damages, there is no sound reason for denying it authority to enter judgment for the damages in excess of the

claim—even though the result is a net recovery *against the creditor*. Referring to *Katchen v. Landy*, which concerned a preference action asserted defensively against a creditor's claim, the Court has stated that, "once a creditor has filed a claim against the estate, the bankruptcy trustee may recover the full amount of any preference received by the creditor-claimant, even if that amount exceeds the amount of the creditor's claim." *Granfinanciera*, 492 U.S. at 59 n.14 (citing *Katchen v. Landy*, 382 U.S. at 337–38). The Court's equity jurisprudence thus supports authorizing bankruptcy judges to determine compulsory counterclaims, even where the value of the counterclaim exceeds the value of the creditor's claim.

D. The Court's Bankruptcy Jurisprudence Since *Northern Pipeline* Supports the Proposition that Bankruptcy Judges May Adjudicate Compulsory Counterclaims to Filed Proofs of Claim

There is a distinction of constitutional significance between proceedings against a person with no independent connection to the bankruptcy, and a claim that a trustee or debtor must assert against a creditor that filed a proof of claim. In *Granfinanciera*, a party entirely unconnected to the bankruptcy case found itself sued in bankruptcy court for a fraudulent transfer. The Court addressed whether that party retained its constitutional right to a jury trial. *Granfinanciera*, 492 U.S. at 36. In holding that it did, the Court explained that because the defendant had not filed a proof of claim—and therefore had not triggered the bankruptcy court's equitable jurisdiction—the proceeding remained one at law, and the defen-

dant thus retained its jury-trial right. *Granfinanciera*, 492 U.S. at 57-59.

One year later, in *Langenkamp v. Culp*, the Court faced a different question: whether a creditor that *had* filed a proof of claim retained a jury-trial right in a preference action filed by the debtor. *Langenkamp*, 492 U.S. at 42-43. The Court explained that the creditor did *not* have a right to a jury trial precisely because it *had* filed a proof of claim—thus, the subsequent preference action became part of the claims-allowance process. *Langenkamp*, 492 U.S. at 45. As the Court explained, "the creditor's claim and the ensuing preference action by the trustee become integral to the restructuring of the debtor-creditor relationship through the bankruptcy court's equity jurisdiction." *Langenkamp*, 492 U.S. at 45 (citing *Granfinanciera v. Nordberg*, 492 U.S. at 57-58).

A compulsory counterclaim is drawn into a bankruptcy proceeding only because a creditor has first triggered the bankruptcy court's equitable jurisdiction by filing a proof of claim. Thus, like the preference claim in *Langenkamp*, the creditor's claim and the ensuing compulsory counterclaim by the bankruptcy estate "become integral to the restructuring of the debtor-creditor relationship through the bankruptcy court's equity jurisdiction." *Id*. Accordingly, there is no basis to treat a compulsory counterclaim differently from the way the Court treated the preference counterclaim in *Langenkamp*. By filing a proof of claim, the creditor foregoes the right to object to non-Article III adjudication of a compulsory counterclaim.

Recently, in a unanimous opinion, the Court addressed the profound importance of easily administrable jurisdictional schemes:

> [A]dministrative simplicity is a major virtue in a jurisdictional statute. . . . Complex jurisdictional tests complicate a case, eating up time and money as the parties litigate, not the merits of their claims, but which court is the right court to decide those claims. . . . Complex tests produce appeals and reversals, encourage gamesmanship, and, again, diminish the likelihood that results and settlements will reflect a claim's legal and factual merits. Judicial resources too are at stake.

Hertz Corp. v. Friend, — U.S. —, 130 S. Ct. 1181, 1193 (2010). The efficiency of a single adjudication of a creditor's claims and compulsory counterclaims thereto makes vastly greater sense than complicating and slowing down the bankruptcy process while further burdening already busy district courts and increasing costs to litigants.

CONCLUSION

Based upon the foregoing, the Court should reverse the judgment of the Ninth Circuit.

Respectfully submitted,

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