Legal Backgrounder

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WILL MORE BANKRUPTCIES MEAN MORE FORUM SHOPPING?

by

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The current recession has spurred an increase in the number of bankruptcy filings. March 2009 saw 130,831 filings, "an increase of 46 percent over March 2008 and 81 percent over the same month in 2007."[1] Based on the recent trend, there could be as many as 1.5 million bankruptcy filings in 2009, approaching the rate of 1.6 million filings per year that occurred before Congress enacted bankruptcy reform in 2005.[2] While this surge generally has more to say about the state of the economy than the law, it could nonetheless have far-reaching legal consequences if bankruptcy courts are allowed to be used by debtors to evade state court venues or disfavored judgments or orders. Whether this kind of forum shopping becomes more pervasive will likely depend upon the U.S. Court of Appeals for the Ninth Circuit's decision in *Marshall v. Marshall.*

Bankruptcy allows for the orderly repayment, restructuring, and discharge of debt. Notwithstanding the broad scope of interests, obligations, and rights implicated in bankruptcy law, "[a]part from ensuring flesh-and-blood individuals a fresh start, nothing about the policies of bankruptcy requires a change in substantive nonbankruptcy rights. . . . In the absence of a specific bankruptcy provision to the contrary, bankruptcy takes nonbankruptcy rights as it finds them."[3] This is the *Butner* principle, derived from the 1979 Supreme Court decision acknowledging the federalism concerns necessarily involved in bankruptcy. There, the Court found:

> Property interests are created and defined by state law. Unless some federal interest requires a different result, there is no reason why such interests should be analyzed differently simply because an interested party is involved in a bankruptcy proceeding. Uniform treatment of

[1]Mike Baker, *Bankruptcies surge despite law meant to curb them,* Associated Press, April 14, 2009, http://www.google.com/hostednews/ap/article/ALeqM5ikymwYIOopCKgNCXplo_p58i7QAQD97HRUSG0 (last visited Apr. 17, 2009).

[2]*Id.* The rush to file before the new bankruptcy law took effect led to an even larger one-time spike of 2 million filings in 2005.

[3]Douglas G. Baird et al., CASES, PROBLEMS, AND MATERIALS ON BANKRUPTCY 28 (rev. 3d ed. 2001).

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> property interests by both state and federal courts within a State serves to reduce uncertainty, to discourage forum shopping, and to prevent a party from receiving "a windfall merely by reason of the happenstance of bankruptcy."[4]

While *Butner* addressed definition of property interests, how these interests are factually applied by different courts may greatly affect uniformity and the incentives to forum shop. As eminent bankruptcy expert Professor Douglas Baird has noted, if people are treated differently merely by the happenstance of bankruptcy, this "would invite people to seek or avoid the bankruptcy forum for reasons that have nothing to do with the policies bankruptcy law advances."[5]

Yet it is just this kind of action—seeking the bankruptcy forum for reasons having little or nothing to do with the policies of bankruptcy—that is alleged in two bankruptcy actions related to Vickie Lynn Marshall ("Vickie"), the deceased Playboy playmate who was better known as Anna Nicole Smith.

The first case, *Arthur v. Stern*, involves defamation and conspiracy claims brought in Harris County, Texas court by Vickie's mother, Virgie Arthur ("Arthur"), against a group of defendants including TMZ, bloggers, and Vickie's lawyer and companion Howard K. Stern's sister, Bonnie Stern ("Bonnie"). Following a discovery order that required Bonnie to turn over computer hard drives for analysis to assess whether she conspired in defamation, Bonnie filed for bankruptcy in the Central District of California. Upon doing so, the litigation against Bonnie in Texas court was automatically stayed, including the pending discovery order.

For debtors in financial distress, bankruptcy offers a number of benefits, including notably the automatic stay, which in most circumstances halts collection activities and litigation against the debtor.[6] But the bankruptcy code states that relief may be granted from the stay for cause.[7] Cause may include allegations that the party who filed for bankruptcy did so in bad faith, in order to delay, hinder, or interfere with prosecution of a non-bankruptcy action. And indeed, this is just what Arthur alleged, in addition to claims that the issues in the pending lawsuit would be better handled in the non-bankruptcy court, and that the stay could remain in effect as to any judgment.[8] After briefing by both parties, the court lifted the stay at a hearing on the motion.[9]

Here, the bankruptcy system appears to have worked as it should. There were allegations of potential gamesmanship and forum shopping, but the bankruptcy court was able to resolve those by allowing the pending discovery to continue in Texas court, while still maintaining the stay for any judgment which

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[4]*Butner v. U.S.*, 440 U.S. 48, 55 (1979) (quoting *Lewis v. Manufacturers Nat'l Bank of Detroit*, 364 U.S. 603, 609 (1961).

[5]Baird, *supra* note 3, at 29.

[6]11 U.S.C. § 362.

[7]11 U.S.C. § 362(d)(1).

[8]Notice of Motion and Motion for Relief from the Automatic Stay Under 11 U.S.C. § 362 (with supporting declarations), *In re Stern*, No. 1:09-BK-11995-BR (Bankr. C.D. Cal. Mar. 23, 2009).

[9]"The judge ruled from the bench to lift the stay." *Bonnie Stern Bankruptcy Stay Lifted Today*, The Life and Death of Anna Nicole Smith, http://annanicoleandhowardkstern.com/2009/04/bonnie-stern-bankruptcy-stay-lifted-today/ (last visited Apr. 17, 2009).

may be entered against Bonnie.[10] Assuming, *arguendo*, that Bonnie was seeking a different result regarding the discovery by filing bankruptcy, it maintained uniformity, and prevented a party from achieving a different result because of what *Butner* called "the happenstance of bankruptcy."[11]

The second case, *Marshall v. Marshall*, arises from the bankruptcy of Vickie Lynn Marshall.[12] By way of background, Vickie married wealthy Texas octogenarian J. Howard Marshall II ("J. Howard") in 1994. J. Howard gave Vickie more than $6 million in gifts in consideration of the marriage, which were memorialized in an "Act of Donation," but he did not include Vickie in his written estate plan.[13] Prior to his death, Vickie filed an action in Texas probate court suing J. Howard's son E. Pierce Marshall ("Pierce") for tortiously interfering with her statutory right of support from her husband—in spite of the millions of dollars in cash, homes, jewelry and other gifts that she had already received from J. Howard.[14] Following J. Howard's death, Vickie sought substantial funds from J. Howard's estate in Harris County, Texas probate court, claiming that the decedent verbally promised her such funds, and alleging, *inter alia*, that Pierce tortiously interfered with her expectancy of an inheritance or inter vivos gift.[15]

While the Texas probate case was proceeding, Vickie filed for bankruptcy in California, putatively based upon a sexual harassment default judgment rendered against her (which was subsequently settled).[16] Pierce filed an adversary complaint in the bankruptcy court seeking a determination that damages Vickie owed him related to alleged defamation committed against Pierce by her lawyers with her complicity were nondischargeable in bankruptcy.[17] Vickie filed a counterclaim for, *inter alia*, tortious interference with a gift or bequest.[18] This should sound familiar, because this was among the claims that Vickie made in Texas probate court. The *Butner* principle suggests that there should be uniform treatment of property interests to avoid forum shopping, and the *Erie* doctrine makes clear that Texas law governs the substantive elements of the tortious interference claim.[19] And yet the courts' decisions were anything but uniform.

Prior to a final order in Vickie's federal court proceeding, the Texas probate court held a five-month jury trial, following which the jury unanimously upheld J. Howard's estate plan, and of relevance found 1) that J. Howard was not the victim of fraud or undue influence, 2) that he did not intend to give Vickie a gift or bequest from his estate either prior to or upon his death, and 3) that Vickie was not entitled to any distribution from the estate or to any judgment from Pierce.[20] By contrast, the bankruptcy court and the

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[10]If the defamation or conspiracy is found to be deliberate or willful, however, it would not be dischargeable in bankruptcy. *See* 11 U.S.C. § 523(a)(6).

[11]*Butner*, 440 U.S. at 55.

[12]*In re Marshall*, 253 B.R. 550 (Bankr. C.D. Cal. 2000).

[13]*See Marshall v. Marshall*, 392 F.3d 1118, 1122-23 (9th Cir. 2004).

[14]*Id.* at 1124-25.

[15]*Id.* at 1125.

[16]*In re Marshall*, 253 B.R. at 554 & n.3.

[17]*Marshall v. Marshall*, 392 F.3d at 1126; s*ee also* 11 U.S.C. § 523(a)(6) (deliberate and willful action is non-dischargeable in bankruptcy).

[18]*Marshall v. Marshall*, 392 F.3d at 1126.

[19]*See Erie R. Co. v. Tompkins*, 304 U.S. 64 (1938).

[20]*Marshall v. Marshall*, 392 F.3d at 1129.

district court on review both rendered sizable monetary judgments in Vickie's favor for tortious interference with the expectancy of an inter vivos gift.[21] The Ninth Circuit reversed Vickie's judgment, finding that the probate exception barred federal jurisdiction in the case.[22] But the Supreme Court reversed the Ninth Circuit, finding that the probate exception is not so broad as to preclude jurisdiction in the case of a transient tort rather than a case seeking jurisdiction over the rem that made up the state probate proceeding.[23]

The Supreme Court remanded with instructions for the Ninth Circuit to now consider whether Vickie's claim was a core proceeding in bankruptcy, and whether the judgment in Vickie's favor was barred by claim and issue preclusion. The Ninth Circuit has ordered briefing and argument on these questions, as well as whether the statute of frauds affects Vickie's estate's ability to establish its claim.[24]

The outcome of these questions has potential implications far beyond this case. Vickie clearly sought to use the federal bankruptcy forum to achieve a different result than the one she recognized that she would receive in Texas probate court. While the Supreme Court's decision in *Marshall* permits the federal courts to hear more claims which may ancillary touch on issues related to probate, there is no indication that the Court intended to undermine the uniformity that the bankruptcy law seeks to offer. That is, it is undoubtedly true that the Supreme Court did not intend for parties to use this opening to receive "a windfall merely by reason of the happenstance of bankruptcy."[25] And yet, this is precisely what Vickie attempted to do. It would be bad enough if she were successful in manipulating this particular case to prevent J. Howard's detailed financial plans from being carried out as he intended. However if her case is successful, others will inevitably follow suit, leading to more forum shopping. Indeed, we may see an even larger surge in bankruptcy than the one currently brought about by the current recession as, to paraphrase Professor Baird, individuals seek bankruptcy for reasons having nothing to do with the policies that bankruptcy seeks to advance.

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[21] *See In re Marshall*, 253 B.R. 550; and *Marshall v. Marshall*, 275 B.R. 5 (C.D. Cal. 2002).

[22] *Marshall v. Marshall*, 392 F.3d 1118.

[23] *Marshall v. Marshall*, 547 U.S. 293 (2006).

[24] Order, *Marshall v. Marshall*, No. 02-56067 (9th Cir. Mar. 19, 2009).

[25] *Butner*, 440 U.S. at 55.