NADC
NATIONAL ASSOCIATION OF DEALER COUNSEL

DEFENDER

The National Association of Dealer Counsel Newsletter MAY 2012

In this Issue:

Contact Us:

NADC
1155 15th Street, NW
Suite 500
Washington, DC 20005
Phone: 202-293-1454
Fax: 202-530-0659
www.dealercounsel.com

Cars, Bankruptcy and Anna Nicole Smith

By Lawrence Young, HughesWattersAskanase

When the flamboyant Anna Nicole Smith passed away in 2007 she was survived by legal battles that began in 1995 in a California bankruptcy court. The court battles were triggered by a defamation claim brought by her opponent and stepson, E. Pierce Marshall, and Anna Nicole Smith's counterclaim against him for tortious interference. The battles raged across three venues for over sixteen years. They did not slow despite the death of both Anna Nicole Smith and E. Pierce Marshall.

The legal war was not resolved until June of last year. For the second time, the estates of Anna Nicole Smith and E. Pierce Marshall appeared before the United States Supreme Court. Only after the Court's ruling in *Stern v. Marshall* did the legal ramifications of Anna Nicole's final gift became clear.

Stern v. Marshall

In Stern, the Supreme Court found that bankruptcy courts possess the **statutory** authority to issue final judgments on private or state law counterclaims. They, however, lack the **constitutional** authority to do so.

> Article III of the United States Constitution provides in Section 1:
>
> The judicial Power of the United States shall be vested in one supreme Court, and in such inferior Courts as the Congress may from time to time ordain and establish. The Judges, both of the supreme and inferior Courts, shall hold their Offices during good Behavior, and shall, at stated Times, receive for their Services a Compensation, which shall not be diminished during their Continuance in Office.

A primary purpose of Article III is to assure an independent judiciary, not subject to political influence by Congress or the Executive. The bankruptcy court's jurisdictional grant allows it to hear and issue final judgments on counterclaims "core" to the bankruptcy proceedings. However, the bankruptcy courts are legislative courts created to carry out a particular legislative scheme, the Bankruptcy Code, not Article III courts vested with the judicial power of the United States. Their compensation can be "diminished." They do not serve during "good Behavior" for life but instead have a limited term of 14 years. Without Article III protections for their salary and tenure, political pressure can be brought to bear on individual bankruptcy judges.

Accordingly, the Supreme Court found that allowing bankruptcy courts to issue final judgments on private or state law counterclaims would create an inherent conflict under the separation of powers doctrine in Article III. Ultimately, the Court's ruling indicates that a bankruptcy court can issue a final judgment only if a counterclaim arises under the express provisions of the Bankruptcy Code and is therefore a "public" right (one in which a claim derives from a federal regulatory scheme), not a private right under state law. As an example, the Court examined claims for tortious interference and fraudulent transfers. It concluded that each is a common law action "that simply attempts to augment the bankruptcy estate" and is thus a private right of action. Thus, both must be adjudicated only by an Article III (United States District Court) judge.

Why Does It Matter?

The rippling impact of *Stern v. Marshall* is being felt in every bankruptcy court. First, *Stern* has altered potential choices of venue. Now, if a trustee or debtor-in-possession wishes to assert, for example, a fraudulent transfer claim against a creditor, the debtor will no longer be able to bring the action in the same venue as the bankruptcy proceeding. Instead, the debtor must use a venue that would otherwise have jurisdiction over the creditor, most likely the state or federal court where the creditor is located.

Second, the threshold for determining consent to bankruptcy court jurisdiction has been elevated. One can consent to personal jurisdiction. The Supreme Court discounted the argument that by filing his proof of claim for defamation, E. Pierce Marshall impliedly consented to bankruptcy court jurisdiction to adjudicate Anna Nicole Smith's counterclaim for tortious interference. The counterclaim in the bankruptcy court would have been permissible only if E. Pierce Marshall had expressly consented to the bankruptcy court's jurisdiction.

Finally, since *Stern*, bankruptcy courts have conducted their proceedings in one of three ways:

1. First, the bankruptcy court will hear an arguably private or state law cause of action and provide a final ruling, but include a caveat that should the district court find the bankruptcy court lacked authority to enter the final ruling, the opinion is instead deemed the bankruptcy court's proposed findings of fact and conclusions of law.
2. Second, in accordance with 28 USC §157(c)(1), the bankruptcy court hears the private or state law cause of action but does not enter a final judgment. Instead, the bankruptcy court only provides recommendations on findings of fact and conclusions of law to the district court for its final judgment, much as a magistrate does.
3. Third, under the strictest interpretation of the *Stern* decision, the bankruptcy court finds that its authority is completely void to hear a private or state law cause of action because Article III goes to subject matter jurisdiction. Subject matter jurisdiction cannot be waived or conferred by consent. The reference to the bankruptcy court must be immediately withdrawn or the court must abstain or dismiss the case for lack of jurisdiction. The case must start anew in the United States District Court or another court that has jurisdiction.

In addition to the change brought to bankruptcy proceedings and counterclaims, *Stern's* effects have rippled into other areas of the judiciary. In March, the Fifth Circuit[1] considered the impact of *Stern* on the authority of magistrate judges to enter final judgments on state law causes of action. Ultimately, the Fifth Circuit did not broaden the holding of Stern, concluding that despite the parallels between magistrates and bankruptcy judges, *Stern's* limitation on authority applied only to bankruptcy proceedings. The Fifth Circuit's consideration suggests more courts will continue to ponder the jurisdictional implications of Stern in all areas touched by Article III.

The war of attrition between Anna Nicole Smith and E. Pierce Marshall has ended, as have their lives. But, the long term implications of *Stern v. Marshall* are just beginning.

BAPCA, 910 Vehicles, and a Debtor's Options

Since the enactment of the Bankruptcy Abuse Prevention and Consumer Act (BAPCA) in 2005, debtors have been forced to choose among surrendering automobile collateral, redeeming automobile collateral, or reaffirming the automobile secured debt within 45 days of the first date set for the first meeting of creditors. If the debtor fails to act, the automatic stay terminates and the property is no longer property of the estate. Automobile secured creditors can then proceed to exercise their rights under state law.

BAPCA brought many beneficial changes to automobile creditors' rights by removing most ride-through and lien stripping provisions. Significantly, BAPCA eliminated cram-down of automobile secured creditors' liens to the fair market value of vehicles purchased within 910 days of the bankruptcy filing.

Imaginative debtors, however, sought to erase any remaining debt on such vehicles. At first, the majority of courts held that

NADC
NATIONAL ASSOCIATION OF DEALER COUNSEL

Volume VIII, Number 5
MAY, 2012

Michael Charapp, Editor
mike.charapp@cwattorneys.com
Trudy Boulia, Assistant Editor
tboulia@jpharveylaw.com

Defender, The NADC Newsletter is published by the National Association of Dealer Counsel
1155 15th Street, NW
Suite 500
Washington, DC 20005
Phone: 202-293-1454
Fax: 202-530-0659
www.dealercounsel.com

surrendering any "910 vehicle" in this way would result in the full satisfaction of the debt, regardless of whether the car was worth less than the total amount of the debt. A minority of courts allowed creditors to pursue any remaining debt on a 910 vehicle if its value did not satisfy the entire debt.

By 2009, however, the majority view had been rejected by every circuit court of appeals that had examined the question, including the Fourth, Fifth, Seventh, Eight, Tenth, and Eleventh Circuits. All these circuit courts held that even if a debtor surrenders a 910 vehicle, a creditor has the right to pursue the remainder of the debt so long as the vehicle fails to fully satisfy the remaining debt. (e.g. *In re Miller,* 570 F.3d 633 (5th Cir. 2009)).

Starter Interrupt Devices

Once a debtor files for bankruptcy, the protection of the automatic stay prohibits the creditor from exercising control over the property of the estate. Any violations of the automatic stay are punishable by sanctions for contempt, which can include actual damages and attorney's fees.

A starter interrupt device prevents a debtor from starting his or her car for missing a scheduled payment. In bankruptcy, this violates the automatic stay because it exerts control over the debtor's and the estate's property. In *Hampton v. Yam's Choice Plus Autos, Inc.,*[2] the court held it was not the existence of the device on the car that violated the stay but instead the inaction of the creditor to nullify the device and make sure the debtor had use of the car during bankruptcy. The debtor had to call in each month to make a payment and receive the starting code, but the codes frequently failed to work and the dealer did not resolve the problem. Since *Hampton,*[3] courts have required dealers to prevent starter interrupt devices from disabling a bankruptcy debtor's vehicle.

In re Garner[4] heightened the stakes. "Intentionally" is always a bad word when the bankruptcy court applies it to a creditor. The bankruptcy court held that by refusing to promptly remove the starter interrupt device upon Garner's post-petition request, the dealer had intentionally: (1) exercised control over estate property because the dealer became the only source for the codes for the continuous use of the vehicle and (2) engaged in actions to collect a pre petition debt by requiring Garner to request a code every two weeks.

The Chapter 13 Trustee was making payments on the vehicle through the Chapter 13 plan. In bankruptcy, the only purpose of the starter interrupt device was to pressure Garner to remit payments on his pre petition debt. These intentional violations of the automatic stay entitled Garner to actual damages and attorney's fees. They also opened the dealer up to additional contempt sanctions.

Once you know the debtor has filed bankruptcy, it is prudent to give all the codes necessary to start the vehicle or disable the device. The better course is to disable the device. Any failure of the codes to operate will be at the creditor's peril.[5]

In the words of Bugs Bunny, "That's all, folks!" ■

Footnotes

[1] *Technical Automation Servs. Corp. v. Liberty Surplus Ins. Corp.,* 673 F.3d 399 (5th Cir. 2012).

[2] 319 B.R. 163 (Bankr. E.D. Ark. 2005).

[3] Id.

[4] 2010 WL 890406 (Bankr. M.D.N.C. 2010).

[5] *See also In re Peterkin,* 2009 WL 1076816, (Bankr. E.D.N.C.2009).

Larry Young is a partner in HughesWattersAskanase, Houston, Texas (email: lyoung@hwa.com; Tel: 713-328-2805). He is the First Vice President of NADC. He wrote part of the Bankruptcy Code and was involved in two U.S. Supreme Court cases challenging the constitutionality of the Bankruptcy Court and certain provisions of the Bankruptcy Code. Larry is a Fellow of both the American College of Consumer Financial Services Lawyers and the American College of Commercial Finance Lawyers. He is the Texas State Editor for ***CarLaw.***