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THINK BEFORE YOU FILE A BANKRUPTCY PROOF OF CLAIM: LESSONS FROM ANNA NICOLE SMITH

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When a bankruptcy case is filed, the notice sent to creditors often states that if a creditor wishes to be paid any money it must file the enclosed "Proof of Claim" form with the Bankruptcy Court within four months. Many creditors immediately go to their receivable report, look up the amount owed, write the figure down on the proof of claim, and send it in. Sometimes the creditor makes sure to add every amount that could possibly be included, out of frustration with the whole process. Such reflexive filing of a proof of claim, however, can have significant consequences later. Consider E. Pierce Marshall, who filed a proof of claim in the bankruptcy case of model and celebrity Anna Nicole Smith. The proof of claim Pierce filed in Anna Nicole's bankruptcy case in 1996 ignited 10 years of litigation that has gone all the way to the United States Supreme Court, Marshall v. Marshall, 547 U.S. 293 (2006), yet still has not ended despite the Supreme Court decision and the deaths of both Pierce and Anna Nicole during the nine months thereafter.

Anna Nicole had been married to J. Howard Marshall II for about a year when he died, leaving a vast fortune and a will under which his son, Pierce, was the ultimate beneficiary. J. Howard's estate was probated in the Probate Court in Houston, which eventually declared the will valid. During this time Anna Nicole filed a Chapter 11 bankruptcy case in Los Angeles. Pierce filed a complaint in Anna Nicole's bankruptcy case alleging that she owed him a debt because she and her lawyers had defamed him. He then filed a proof of claim in the bankruptcy case. In neither the complaint nor the proof of claim did Pierce quantify the amount Anna Nicole allegedly owed him.

Anna Nicole responded to the proof of claim by filing a counterclaim in the bankruptcy case. She accused Pierce of tortiously interfering with J. Howard's intended gift to her and said Pierce was the one who owed her money, namely the amount of J. Howard's estate. Suddenly there were a multitude of legal issues involving the Bankruptcy Court's jurisdiction over Anna Nicole's counterclaims. The Bankruptcy Court resolved all of these issues against Pierce, stating that by filing his proof of claim, Pierce voluntarily submitted to Bankruptcy Court jurisdiction over all counterclaims that might be filed against him. After a trial the Bankruptcy Court found in favor of Anna Nicole on both her counterclaim and Pierce's underlying claim, and it entered judgment against Pierce in an amount exceeding of \$450

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million. Although appellate courts have subsequently found the Bankruptcy Court's jurisdictional analysis to be simplistic, their ultimate operative rulings as currently in effect all resolve the jurisdictional questions in favor of Anna Nicole and the Bankruptcy Court's jurisdiction. (The case continues in litigation)

Now, suppose Pierce had not filed a proof of claim in Anna Nicole's bankruptcy. Anna Nicole could still have tried to sue Pierce in Bankruptcy Court, but she would have had to initiate the action, rather than make a counterclaim. In response to such a suit, Pierce could have filed a motion for "mandatory abstention" under 28 U.S.C. § 1334(c)(2), a provision that requires a Bankruptcy Court to abstain from a suit that is based solely on state law and that could be adjudicated in a pending state court case, unless the suit is a "core" bankruptcy matter. Anna Nicole's suit for tortious interference is clearly a suit based on state law that could be adjudicated in the Texas state courts, so the only issue in such an abstention motion would be whether such suit is considered a core matter. Without the proof of claim by Pierce to counterclaim against, it is difficult to see how a Bankruptcy Court could conclude that Anna Nicole's suit was core and could deny a motion for mandatory abstention. And if the Bankruptcy Court abstained, then Anna Nicole could only have asserted her claim against Pierce in the same Texas courts that had validated the will leaving the estate to Pierce.

While most people will not have to consider whether filing a proof of claim risks giving up home court advantage in defending against a potential half billion dollar counterclaim, there are many more common strategic reasons not to file a proof of claim. Any proof of claim invites counterclaims, regarding which a motion seeking Bankruptcy Court abstention will be more difficult, and meaning the creditor will be stuck in the Bankruptcy Court chosen by the debtor. Moreover, the Supreme Court has held in Langenkamp v. Culp, 498 U.S. 42 (1990), that the filing of a proof of claim does constitute a waiver of a right to a jury trial under both the claims and the counterclaims. A jury trial claim could be a useful tactic in opposing a bankruptcy trustee who is trying to wrap up claims quickly and whose claims, such as preferences, may not fare as well before an unsympathetic jury. There are even situations where no proof of claim is required, such as fully secured claims and Chapter 11 claims in which the debtor has scheduled the claim in the proper amount. Given all these possibilities, a creditor should always think about the question before filing a proof of claim.

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If you would like more information or assistance regarding creditor decisions in facing bankruptcies, or relating to bankruptcy matters in general, you may contact Adam Ruttenberg at (617) 235-8656 or aruttenberg@lgllp.com.

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