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Federal Practice & Bankruptcy: SCOTUS on Bankruptcy: Jurisdiction and Inherited IRAs Clarified

By Jennifer Rood | July 16, 2014

In a rare burst of bankruptcy enthusiasm, the US Supreme Court in June issued two decisions on matters important to the administration of bankruptcy cases.

In re Bellingham, decided June 9, addressed a seemingly esoteric but central issue of bankruptcy court jurisdiction and clarified, at least in part, the court's 2011 decision in *Stern v. Marshall. Clark v. Rameker,* decided June 12, determined whether or not inherited IRA accounts are exempt from liquidation under Title 11 and applicable state law, thus clarifying an issue important both to the administration of bankruptcy cases and to estate planning.

Let's start with *Bellingham.* By way of background, the *Stern v. Marshall* decision featured a protracted legal battle between former Playboy model Anna Nicole Smith and her stepson. Ultimately, the battle was between a probate estate and a bankruptcy estate, starting with a skirmish between Smith (also known as Vickie Lynn Marshall) and stepson Pierce Marshall over the disposition of the estate of billionaire J. Howard Marshall. Smith also filed a bankruptcy proceeding.

Simultaneous proceedings ensued in probate court, where Pierce Marshall obtained a judgment against Smith, and in bankruptcy court, where Pierce filed a related claim in Smith's bankruptcy case, and Smith filed a counterclaim for tortious interference with her rights under the probate estate. The legal basis for Smith's counterclaims all arose entirely under state law, but the potential damages would inure directly to the benefit of the bankruptcy estate and Smith's creditors.

The *Stern* court held that while the bankruptcy court had statutory authority under Title 28 to enter final judgment on the counterclaim (because it was defined therein as a "core" proceeding involving potential assets of the bankruptcy estate), delegation of authority was unconstitutional because the bankruptcy court was an Article I court, rather than an Article III court, and the dispute involved purely private rights arising under state law, rather than public rights central to debtor-creditor relations.

Article III judges have lifetime tenure and salaries, which cannot be decreased (e.g., US District Court); Article I judges are appointed for fixed terms. Other provisions of Title 28 allow bankruptcy courts to make proposed findings of fact and rulings of law but not, absent the consent of the parties, to enter final judgment in matters "related to" but not "core" bankruptcy proceedings.

The *Stern* decision left bankruptcy courts wondering how to resolve certain "core" matters and whether or not, after *Stern*, it was even constitutional for parties to consent to the entry of final judgment by a bankruptcy court in "related to" matters.

In the *Bellingham* court's words, "…we did not address how courts should proceed when they encounter one of these Stern claims – a claim designated for final adjudication in the bankruptcy court but prohibited from proceeding that way as a constitutional matter."

The *Bellingham* decision sought to resolve this issue. The case involved fraudulent transfer claims arising from the debtor's pre-bankruptcy efforts to move assets from the soon-to-be debtor Bellingham Insurance to new company Executive Benefits Insurance Agency (EBIA). EBIA was not a creditor of Bellingham, and the claims against EBIA involved no public rights, merely standard fraudulent transfer issues.

The court held that when faced with "Stern" claims, bankruptcy courts should issue proposed findings of fact and rulings of law and send the matter for final adjudication to the US District Court (an Article III court), in effect treating the matters as if they were "related to" rather than "core." The court held the "severability" clause of Title 28 permitted the matters to be treated as if they were non-core, thus there was no gap in the statute.

The court ruled narrowly and did not address the issue of consent to jurisdiction in non-core matters, except to say that in this case, the parties had in fact had a de novo review by the District Court, so the issue was moot.

Although many bankruptcy courts had, during the years since Stern, promulgated local rules and procedures allowing *Stern* claims to proceed efficiently, the *Bellingham* decision allows these courts to resolve these claims in a predictable manner, without fear of rendering numerous unconstitutional decisions.

Clark v. Rameker

In *Clark*, the Court addressed whether or not inherited IRAs were "retirement funds" within the meaning of applicable provisions of state and federal laws exempting such funds from attachment or liquidation by a bankruptcy trustee. The court specifically addressed 11 USC Sections 522(b)(3)(C) and 522(d)(10)(E); in New Hampshire, RSA 511:2(XIX) also exempts IRA accounts.

The court noted that IRA-type accounts, once inherited, change their essential characteristics—no further funds need to be contributed, holders of the accounts may withdraw funds at any time and in fact must do so, and the entire account could be depleted and spent or transferred to another without restriction or penalty.

Once inherited, IRAs were no longer sums of money set aside for a future time when the individual account holder had stopped working. As a result, the court held these accounts no longer had the essential legal characteristics of "retirement funds" intended to assist with a debtor's fresh start following bankruptcy and could not be exempted.

This ruling clarifies an important exemption question and will likely affect individual estate planning in the future.

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