Executive Benefits Insurance Agency v. Arkison:

Does Party Consent Render Bankruptcy Court Adjudication Constitutionally Valid?

Report of the National Bankruptcy Conference

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The Supreme Court's grant of a writ of certiorari in Executive Benefits Insurance Agency v. Arkison, 133 S. Ct. 2880 (2013), presents the Court with the opportunity to resolve issues that lower courts and lawyers have been grappling with in the aftermath of Stern v. Marshall, 131 S. Ct. 2594 (2011).[1] The certiorari petition presented the following questions:

1. Does Article III of the Constitution permit bankruptcy courts to exercise the judicial power of the United States on the basis of party consent, and, if so, can that consent be implied by the party's conduct even though the statutory scheme provides no notice that consent is required?

2. May a bankruptcy judge submit proposed findings of fact and conclusions of law to the district court for de novo review in a proceeding that is designated as "core" under 28 U.S.C. § 157(b)(2)?

This paper analyzes the first of these issues—the constitutional effectiveness of party consent to adjudication by a non-Article III bankruptcy judge. Its goal is to examine how the Supreme Court's precedents should guide the Court's analysis of that issue and to highlight the significance of the issue to the operation of the bankruptcy system.

I. The Decision Below

The chapter 7 trustee in the bankruptcy case of Bellingham Insurance Agency, Inc., brought an adversary proceeding against Executive Benefits Insurance Agency ("EBIA") based on state- and federal-law fraudulent conveyance, preference, and successor liability claims. The bankruptcy court granted summary judgment in favor of the trustee, concluding that EBIA had received fraudulent transfers and was a "mere successor" of the debtor, liable for its debts. *See* Executive Benefits Ins. Agency, Inc. v. Arkinson (*In re* Bellingham Ins. Agency, Inc.), 702 F.3d 553, 557 (9th Cir. 2012).

EBIA appealed to the district court, which affirmed the grant of summary judgment on both grounds. On EBIA's further appeal to the Ninth Circuit, EBIA raised for the first time—just before oral argument—the objection that under Stern v. Marshall the bankruptcy judge lacked authority to enter a final judgment on the fraudulent conveyance claims. *Id.* The court of appeals agreed that, because the trustee's fraudulent conveyance claims are not matters of "public rights," they must generally be decided by Article III courts. *Id.* at 562.

The Ninth Circuit also addressed what it considered to be a "subsidiary issue"—whether bankruptcy judges may hear fraudulent conveyance claims and prepare recommendations for de novo review by district courts. The court of appeals concluded that bankruptcy courts have this authority, despite the absence of any explicit statutory authorization to do so in core proceedings. The court reasoned that the authorization in § 157(b)(1) to hear and determine fraudulent

[1]The National Bankruptcy Conference has previously prepared papers on the unanswered issues *Stern* raised and how courts and rulemakers have responded. *See, e.g.*, http://www.nationalbankruptcyconference.org/reports.cfm. Some portions of those papers are incorporated here.

conveyance proceedings includes the "more modest power" to issue proposed findings of fact and conclusions of law. *Id.* at 565.

Finally, the Ninth Circuit held that EBIA's right to have an Article III court decide the fraudulent conveyance claims was waivable and had in fact been waived. The court reasoned that if "consent permits a non-Article III judge to decide finally a noncore proceeding, then it surely permits the same judge to decide a core proceeding in which he would, absent consent, be disentitled to enter final judgment." *Id.* at 567. The court held that EBIA had waived its right to an Article III court by abandoning its motion for the district court to withdraw the reference and by not raising a constitutional objection to the bankruptcy court's entry of final judgment until the eve of oral argument in the Ninth Circuit. *Id.* at 568.

II. The Exercise of Bankruptcy Jurisdiction in the Aftermath of *Stern*

In bankruptcy cases, 28 U.S.C. § 157 allocates decision-making power over adversary proceedings and contested matters to both the district court and the bankruptcy judges within the district. Upon referral by the district court, the statute authorizes bankruptcy judges to "hear and determine" core proceedings, subject to ordinary appellate review. § 157(b)(1). For noncore proceedings, bankruptcy judges may only hear the proceeding and submit proposed findings of fact and conclusions of law to the district court for de novo review. § 157(c)(1). If, however, all the parties to the proceeding consent, the bankruptcy judge may hear and determine a noncore proceeding, including entering a final order or judgment, subject to ordinary appellate review. § 157(c)(2).

Stern v. Marshall, the most recent Supreme Court decision dealing with issues arising from the two-tier allocation of bankruptcy decision-making power, involved an adversary proceeding by a creditor to declare his defamation claim nondischargeable and a counterclaim by the debtor's estate for tortious interference with her expectancy. The Court held that although there was statutory authority for the bankruptcy judge to decide the counterclaim—since it was listed as a core proceeding under § 157(b)(2)(C)—there was no constitutional authority for the bankruptcy judge to do so because an Article III court was required. 131 S. Ct. at 2608. The Court stated that there would be constitutional authority for the bankruptcy court to determine the counterclaim only if the counterclaim stemmed from the bankruptcy case itself or "would necessarily be resolved in the claims allowance process." *Id.* at 2618. The Court held that this test was not met. *Id.* at 2611, 2617. At the end of its opinion, the Court stressed that the issue decided was a "narrow" one that did "not change all that much," *id.* at 2620, brushing aside the dissent's argument that the decision would lead to unnecessary cost and delay and open a Pandora's box of allocation issues in bankruptcy cases. *See id.* at 2630 (Breyer, J., dissenting).

The National Bankruptcy Conference believes that it is important that, in the two-tier system of bankruptcy adjudication, the rules for determining the proper court should be clear and should not lead to litigation, maneuvering, and gaming as to decision-making authority. Such practices not only delay a final resolution of the merits of a proceeding, but also greatly increase the cost of bankruptcy administration, thereby harming creditors seeking to maximize the estate. Uncertain rules that provoke disputes over proper forum and decision-making issues are in effect a tax on creditors of an insolvent estate.

Although the *Stern* Court said its decision was "narrow," experience since *Stern* has indicated that it is neither easy of application nor self-defining. One court of appeals recently described the Court's reasoning in *Stern* as "sweeping." Frazin v. Hayes & Boone, L.L.P. (*In re* Frazin), 732 F.3d 313, 318-19 (5th Cir. 2013). Litigants in bankruptcy proceedings have availed themselves of the *Stern* decision as a new and powerful weapon of uncertain scope, which has led to a proliferation of challenges to bankruptcy judges' decision-making authority.[2] When there are multiple claims in the same proceeding, parties have challenged whether some of them fall outside the scope of the bankruptcy court's authority based on a strict application of *Stern*'s "necessary for resolution" test, arguing that, while transactionally related to a creditor's claim, these claims involve somewhat different (although possibly overlapping) facts and circumstances. In proceedings that, unlike *Stern*, do not involve a counterclaim against a creditor, parties have argued that the underlying rationale of the decision extends to other types of proceedings that are statutorily designated as core.

Efforts of litigants to game the system and delay a decision on the merits are legion. There are over two thousand decisions accessible on Westlaw that cite *Stern*, and undoubtedly many more bench rulings and unpublished opinions that raise *Stern* issues. In almost every chapter 11 case of any size, parties may use *Stern* for any number of purposes:

- to limit the power and authority of the bankruptcy court at the outset of a proceeding;

- to raise questions about what the bankruptcy court can and cannot decide and how it must go about exercising its authority;

- to separate litigated cases by issue so that the bankruptcy court must sit in different capacities in the same matter;

- to remove the case from the bankruptcy court on some or all issues by various procedural options, such as motions to withdraw the reference, dismiss, remand to a state court, compel arbitration, or abstain;

- to limit the role of the bankruptcy court mid-proceeding, such as by withdrawal of the reference of some issues, providing that the reference will be withdrawn at a specified stage of the case, or limiting the bankruptcy court's power to decide dispositive motions; and

- to challenge for the first time on appeal the bankruptcy court's authority to enter an adverse judgment.

The uncertainties of application have been compounded by uncertainty regarding how the doctrines of consent and waiver apply to *Stern* issues.

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[2] *See* Finley v. Carrington Mortgage Servs., LLC, 2012 WL 6610194 (N.D. Ala. Dec. 17, 2012) ("Unfortunately, *Stern* has become the refuge for strategic-minded defendants who have sought to use [it] to prolong and/or obfuscate litigation. It has developed into the mantra of every litigant who, for strategic or tactical reasons, would rather litigate somewhere other than the bankruptcy court.") (internal quotation marks and citations omitted).

III. Consent to Bankruptcy and Magistrate Judge Adjudication—Prior Supreme Court Support

Arkison squarely presents the Supreme Court with a principle that the Court has cited without questioning in past cases but has not directly addressed: that parties who have a constitutional right to an Article III determination of a bankruptcy proceeding may, by consenting to a determination by a bankruptcy judge, eliminate any constitutional infirmity—in other words, that the right to an Article III adjudication in a bankruptcy proceeding is waivable.[3]

There is a long history of applying notions of consent and waiver to determine whether various proceedings can be heard and decided in the bankruptcy court. Long before the 1978 Bankruptcy Code, the Supreme Court held that the right to an Article III judge in non-summary proceedings in the bankruptcy court could be waived by litigants. MacDonald v. Plymouth County Trust Co., 286 U.S. 263, 267 (1932). And § 2a(7) of the Bankruptcy Act of 1898, as amended in 1952, provided that the failure to object to the summary jurisdiction of a bankruptcy court was "deemed" to constitute consent to the court's jurisdiction. Law of July 27, 1952, Pub. L. No. 456, 66 Stat. 420-21.

The Court has similarly suggested approval of consent under the bankruptcy adjudicative scheme introduced by the 1978 Act and revised in 1984. Beginning with Northern Pipeline Construction Co. v. Marathon Pipe Line Co., 458 U.S. 50 (1982), the Court—or in some cases individual justices—have attached significance to the fact that an objecting party failed to consent to the bankruptcy judge's entry of a final judgment. These statements implied that, had the parties consented, the outcome would have been different:

- "[T]he Court's holding is limited to the proposition stated by Justice Rehnquist in his concurrence in the judgment—that a 'traditional' state common-law action, not made subject to a federal rule of decision, and related only peripherally to an adjudication of bankruptcy under federal law, must, *absent the consent of the litigants*, be heard by an 'Art. III court' if it is to be heard by any court or agency of the United States." *Northern Pipeline*, *id.* at 92 (Burger, C.J., dissenting) (emphasis added).

[3] In this context, consent and waiver are opposite sides of the same coin. By waiving a right to an Article III forum, a party consents to adjudication by a non-Article III decision maker, and *vice versa*. *See* Sheridan v. Michels (*In re* Sheridan), 362 F.3d 96, 113 n.20 (1st Cir. 2004) (Lynch, J., dissenting) (collecting cases). On the other hand, waiver and forfeiture are different. "A waived claim or defense is one that a party has knowingly and intelligently relinquished; a forfeited plea is one that a party has merely failed to preserve." Wood v. Milyard, 132 S. Ct. 1826, 1832 n.4 (2012) (citing Kontrick v. Ryan, 540 U.S. 443, 458 n.13 (2004); United States v. Olano, 507 U.S. 725, 733 (1993)). It can sometimes be difficult to distinguish implied consent from forfeiture, however. One court has recently stated a rule for finding implied consent: "[O]nce a party is alerted, or is held to be alerted, to the potential risks of failing to raise the issue of the tribunal's authority, there is a rebuttable presumption that such failure to act was intentional, and that further purposeful proceeding in the forum indicates consent." Hasse v. Rainsdon (*In re* Pringle), 495 B.R. 447, 461 (B.A.P. 9th Cir. 2013). Although the issue was not raised by the petition for certiorari in *Arkison*, it is possible that the Court will choose to decide both (1) whether EBIA either impliedly consented to adjudication in the bankruptcy court or forfeited its objection to that court's entry of a final judgment and (2) whether that distinction matters for Article III purposes.

- "[C]ases such as these would have to be heard by Art. III judges or by state courts—*unless the defendant consents to suit before the bankruptcy judge*—just as they were before the 1978 Act was adopted." *Id.* at 95 (White, J., dissenting) (emphasis added).

- "The Court's holding in [*Northern Pipeline*] establishes only that Congress may not vest in a non-Article III court the power to adjudicate, render final judgment, and issue binding orders in a traditional contract action arising under state law, *without consent of the litigants*, and subject only to ordinary appellate review." Thomas v. Union Carbide Agric. Prods. Co., 473 U.S. 568, 584 (1985) (emphasis added).

- "Indeed, the relevance of concepts of waiver to Article III challenges is demonstrated by our decision in *Northern Pipeline*, in which the absence of consent to an initial adjudication before a non-Article III tribunal was relied on as a significant factor in determining that Article III forbade such adjudication." Commodity Futures Trading Comm'n v. Schor, 478 U.S. 833, 849 (1986).

Most recently, the Court in *Stern* referred to the consent provision of § 157(c)(2) with approval. 131 S. Ct. at 2607. The Court rejected the argument that § 157(b)(5) deprived the bankruptcy court of jurisdiction to try a personal injury tort claim. Finding the provision for a district court trial to be non-jurisdictional, the Court concluded that the claimant, Pierce, had consented to the bankruptcy court's resolution of his defamation claim and had thereby waived any objection under that provision. In reaching this conclusion, the Court referred to § 157(c)(2), under which it said "parties may consent to the entry of final judgment by [a] bankruptcy judge in [a] noncore case." It stated that "Pierce does not explain why [§ 157(b)(5)'s] statutory limitation may not be similarly waived." In citing § 157(c)(2), the Court expressed no doubts about the constitutional validity of the waiver it provides for.

In at least two other decisions, the Court has recognized that, when consent is required, parties may implicitly consent to adjudication by a non-Article III decision maker. In Commodity Futures Trading Commission v. Schor, the Court stated that "[e]ven were there no evidence of an express waiver here," Schor's litigation conduct "constituted an effective waiver." 478 U.S. at 849. The Court reasoned that, by deciding to seek relief before the CFTC rather than in a district court, Schor "effectively agreed to an adjudication by the CFTC of the entire controversy," including the common law counterclaim asserted against him. *Id.* at 850. And in Roell v. Withrow, 538 U.S. 580 (2003), the Court held that parties by their litigation conduct had given implied consent to adjudication by a magistrate judge. Notwithstanding a requirement of advance, written consent imposed by statute and rule,[4] the Court held that the parties "'clearly implied their consent' by their decision to appear before the Magistrate Judge, without expressing any reservation, after being notified of their right to refuse and after being told that

[4] Section 636(c)(2) requires parties to "communicate[]" to the clerk of court whether they consent to have a magistrate judge adjudicate their civil proceeding, and Fed. R. Civ. P. 73(b) provides that, to "signify their consent, the parties must jointly or separately file a statement consenting to the referral." The Court in *Roell* noted, however, that § 636(c)(1)—"the font of a magistrate judge's authority"—speaks only of the "'the consent of the parties,' without qualification as to form," in contrast to other statutory provisions governing magistrate judges that require a "specific written request." *Id.* at 587. The statute governing bankruptcy judges' authority to hear and determine noncore proceedings, § 157(c)(2), likewise refers just to "the consent of all the parties to a proceeding."

[the magistrate judge] intended to exercise case-dispositive authority." *Id.* at 586. The Court reasoned that rejection of a bright-line requirement of express consent served to "check[] the risk of gamesmanship by depriving parties of the luxury of waiting for the outcome before denying the magistrate judge's authority. Judicial efficiency is served; the Article III right is substantially honored." *Id.* at 590.

III. Commodity Futures Trading Comm'n v. Schor

The Supreme Court directly addressed the constitutional effect of consent to non-Article III adjudication in *Schor*. That decision, which involved adjudication of a common law counterclaim by an administrative agency, provides a framework for assessing the effect of consent in *Arkison*. In *Schor* the Supreme Court explained that the purpose of Article III, § 1 is twofold: first, it serves the institutional interest of separation of powers by creating an independent judiciary; second, it preserves the individual liberty of litigants to go before judges who are insulated from the pressures exerted by other branches of government. 478 U.S. at 848. These safeguards are achieved by mandating lifetime appointments and salary protections for Article III judges.

Schor held that, similar to other individual constitutional rights, the protection for litigants in Article III adjudication may be waived. *Id.* at 848-49. In contrast, it concluded that "[t]o the extent that th[e] structural principle is implicated in a given case, the parties cannot by consent cure the constitutional difficulty." *Id.* at 850-51.

The Court's formulation therefore requires a constitutional analysis even if the parties consent to adjudication by a non-Article III judge. Although *Schor* says that the Article III, § 1 "serves to protect primarily personal, rather than structural, interests," *id.* at 848, the Court's dual-function analysis requires examination of whether a particular legislative scheme implicates the structural principle of separation of powers. *Schor* provides the analysis required to make that determination.

The Court set out the three factors listed below as ones to be weighed in "determining the extent to which a given congressional decision to authorize the adjudication of Article III business in a non-Article III tribunal impermissibly threatens the institutional integrity of the Judicial Branch." *Id.* at 851. None of these factors is determinative; instead, the Court instructed that the analysis must focus on "the practical effect that the congressional action will have on the constitutionally assigned role of the federal judiciary." *Id.*

- **The extent to which the essential attributes of judicial power are reserved to Article III courts.** In applying this factor in *Schor*, the Court looked at the extent to which the statutory scheme deviated from the traditional agency model. This examination included the scope of the authority given the agency, the means of enforcement of the agency's order, and the standard of judicial review. *Id.* at 851-53.

- **The origins and importance of the right to be adjudicated.** Here the Court considered whether the claim at issue was a public or private right and whether it was governed by state or federal law. Although *Schor* involved a private right under state law, the Court found the nature of the claim not to be dispositive for Article III purposes. Instead, the

Court took into account the fact that "the decision to invoke this forum is left entirely to the parties and the power of the federal judiciary to take jurisdiction of these matters is unaffected." *Id.* at 855.

- **The concerns that drove Congress to depart from the requirements of Article III.** In applying this factor, the Court found it significant that Congress's "primary focus was on making effective a specific and limited federal regulatory scheme" and that the conferral of authority on the agency to hear a common law counterclaim was limited to what was necessary to achieve that goal. As a result, the Court concluded that any intrusion on the federal judiciary was *de minimis*. *Id.* at 856.

While *Schor* did not set forth a mechanical test that is easily applied by plugging factors into a settled formula, it did signal the need to consider the issue pragmatically. The Court stated that "due regard must be given in each case to the unique aspects of the congressional plan at issue and its practical consequences in light of the larger concerns that underlie Article III." *Id.* at 857. Ultimately, the Court concluded that the legislative scheme at issue raised "no questions about the aggrandizement of congressional power at the expense of a coordinate branch" and "no genuine threat" to the separation of powers. *Id.* at 856-57. The parties' consent, therefore, to adjudication by the administrative agency was effective to eliminate any constitutional concern under Article III.

IV. Application of *Schor* Analysis to Bankruptcy Judges

In order to apply *Schor* to determine whether party consent eliminates constitutional questions about adjudication by bankruptcy judges, the entire statutory scheme of 28 U.S.C. §§ 151-158 has to be considered. Congress enacted these provisions in 1984 in response to *Northern Pipeline*, in which the Supreme Court—without a majority rationale—struck down the statutory scheme for the exercise of bankruptcy jurisdiction enacted by Congress in the Bankruptcy Reform Act of 1978. As expressed in the plurality opinion written by Justice Brennan, by assigning to bankruptcy judges the jurisdiction granted in 28 U.S.C. § 1471, Congress violated Article III because the bankruptcy courts as then constituted were neither legislative courts nor adjuncts of the district court. 458 U.S. 50, 76, 87 (1982). In concluding that the contract action before the Court did not constitute a "public right" that a legislative court might adjudicate, Justice Brennan stated:

> [T]he restructuring of debtor-creditor relations, which is at the core of the federal bankruptcy power, must be distinguished from the adjudication of state-created private rights, such as the right to recover contract damages that is at issue in this case. The former may well be a "public right," but the latter obviously is not.

Id. at 71.[5]

[5] Concurring in the judgment in an opinion joined by Justice O'Connor, Justice Rehnquist objected to the breadth of the plurality opinion. He wrote, however, that he did agree that "[n]one of the cases has gone so far as to sanction the type of adjudication to which Marathon will be subjected *against its will* under the provisions of the 1978 Act." 458 U.S. at 91 (Rehnquist, J., concurring) (emphasis added). He also agreed that, given the scope of appellate review of bankruptcy court decisions, bankruptcy courts were not adjuncts of the district courts. Because the grant

Congress responded to *Northern Pipeline* by largely keeping intact the scope of bankruptcy subject-matter jurisdiction, but by limiting the authority of bankruptcy judges to exercise that jurisdiction. It enacted 28 U.S.C. § 151, which declares that bankruptcy judges in each district "constitute a unit of the district court" and that they are judicial officers of the district court. The statute authorizes bankruptcy judges to "exercise the authority conferred under this chapter . . . , except as otherwise provided by law or by rule or order of the district court." Section 152 provides for the appointment of bankruptcy judges for fourteen-year terms by the court of appeals for the circuit in which the district is located.

In an effort to comply with the principles announced in *Northern Pipeline*, Congress enacted § 157, which governs the authority of bankruptcy judges. This statute's structure reflects the reasoning of Justice Brennan's plurality opinion. Subsection (a) authorizes district courts to refer "any or all" bankruptcy cases and proceedings to the bankruptcy judges for the district. What the bankruptcy judge is permitted to do after referral depends on the nature of the proceeding involved.

Drawing from Justice Brennan's language about matters at the "core of the federal bankruptcy power," subsection (b) authorizes bankruptcy judges to "hear and determine all cases under title 11 and all core proceedings." 28 U.S.C. § 157(b)(1). Bankruptcy judges may enter appropriate orders and judgments, subject to appeal under ordinary standards of review. Although the statute does not define "core proceedings," it equates them with proceedings arising under title 11 or arising in a case under title 11, and it provides a nonexclusive list of core proceedings. It is apparent that Congress deemed core proceedings to be public rights that bankruptcy courts could adjudicate as legislative courts.

Subsection (c) governs bankruptcy proceedings that are not core proceedings. This category includes claims like the one at issue in *Northern Pipeline*. Because noncore proceedings do not involve public rights, Congress limited the role of bankruptcy judges to serving as adjuncts of the district court—*unless* the parties consent to the entry of judgment by the bankruptcy judge. In the absence of consent, bankruptcy judges may only hear the proceeding and submit proposed findings of fact and conclusions of law to the district court for de novo review.

When the entirety of this legislative scheme for bankruptcy adjudication is taken into account, the analysis prescribed by *Schor* leads to the conclusion that party consent eliminates constitutional objections to the entry of a judgment by a bankruptcy judge. The first factor *Schor* considered was the extent to which the essential attributes of judicial power are reserved to Article III courts. In responding to *Northern Pipeline*, Congress left the judicial power in the ultimate control of the Article III courts:

- Courts of appeals appoint bankruptcy judges as judicial officers of the district court. § 152(a)(2).

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of authority to bankruptcy judges to hear the type of claim at issue in the case before the Court was not readily severable from the remaining grant of authority under 28 U.S.C. § 1471, Justices Rehnquist and O'Connor concurred in the judgment that the grant of jurisdiction to bankruptcy courts in § 1471 was unconstitutional. *Id.* at 91-92.

- District courts choose whether to refer bankruptcy cases and proceedings to the bankruptcy court, and they can withdraw that reference in particular cases or proceedings for cause, regardless of the preferences of the parties. § 157(a), (d).

- District courts by order or rule can limit the authority conferred by statute on bankruptcy judges. Thus, the Article III courts, not Congress, have the final say about the scope of bankruptcy judges' authority. § 151.

- Except where Congress declared a matter to involve a public right at the core of bankruptcy or where the parties otherwise consent, bankruptcy judges may only submit proposed findings of fact or conclusions of law, with a judgment or order entered by the district court following de novo review of the bankruptcy judge's recommendation. § 157(c)(1).

The second *Schor* factor is the origin and importance of the right to be adjudicated. Bankruptcy proceedings involve a broad range of issues, some arising under federal bankruptcy law or other federal law, others arising under state statutory or common law. The adjudicative scheme is therefore unlike the agency model considered in *Schor* in which the non-Article III decision maker was for the most part given authority to determine only a narrow range of issues in a specialized area. Nevertheless, the Court indicated that the nature of the claim, though relevant, is not dispositive in determining the effect of consent to non-Article III adjudication.

The final *Schor* factor—the concerns that drove Congress to depart from the requirements of Article III—is especially significant here. In reconstructing the bankruptcy adjudicative scheme after *Northern Pipeline*, Congress sought to maintain an effective bankruptcy system with specialized courts capable of handling the bankruptcy caseload in a timely manner, while at the same time leaving sufficient power in the Article III courts to preserve judicial independence. The plurality opinion in *Northern Pipeline* had indicated that matters at the core of the bankruptcy process might well be subject to determination by non-Article III judges—a conclusion clearly shared by the dissenting justices. Congress attempted to identify those proceedings, while giving bankruptcy judges only the authority of an adjunct to the district court with respect to the others. Although *Stern* determined that Congress's judgment was wrong in one type of core proceeding that should have been designated as noncore, that conclusion does not suggest that Congress was attempting to augment its authority at the expense of the judiciary or to diminish the authority of the Article III courts.

V. Split in the Circuits Regarding Consent to Bankruptcy Judge Adjudication

Since *Stern*, four courts of appeals have addressed the question of whether parties may effectively consent to a bankruptcy judge entering judgment on a matter of private right. As recited above, the Ninth Circuit decision in *Arkison* held that the appellant consented to a determination by the bankruptcy judge and thereby waived any constitutional objection. Executive Benefits Ins. Agency, Inc. v. Arkinson (*In re* Bellingham Ins. Agency, Inc.), 702 F.3d 553, 567-70 (9th Cir. 2012). The three other courts of appeals held that party consent did not eliminate an Article III objection to bankruptcy court adjudication or prevent a party from raising the issue for the first time on appeal. BP RE, L.P. v. RML Waxahachie Dodge, L.L.C. (*In re* BP

RE, L.P.), 2013 WL 5975030 (5th Cir. Nov. 11, 2013); Frazin v. Haynes & Boone, L.L.P. (*In re* Frazin), 732 F.3d 313, 320 n.3 (5th Cir. 2013); Wellness Int'l Network Ltd. v. Sharif, 727 F.3d 721, 767-773 (7th Cir. 2013); Waldman v. Stone, 698 F.3d 910, 917-918 (6th Cir. 2012), *cert. denied*, 133 S.Ct. 1604 (2013). All of the decisions cited *Schor*, but the courts' analyses differed greatly.

The Fifth, Sixth, and Ninth Circuits based their conclusions on brief analyses of *Schor*. In *Arkison* the Ninth Circuit upheld consent after noting that *Schor* held that Article III, § 1 serves to protect primarily personal interests and that that protection is subject to waiver. It then concluded in a footnote that no structural interests are implicated by the adjudicative scheme for bankruptcy judges: "[T]he allocation of authority between bankruptcy courts and district courts does not implicate structural interests, because bankruptcy judges are 'officer[s] of the district court' and are appointed by the Courts of Appeals." 702 F.3d at 567 n.9.

The Fifth and Sixth Circuits reached the opposite conclusion with equally brief applications of *Schor*. The Sixth Circuit in *Waldman* stated that allowing judicial power to be shifted from Article III judges to judges who lack the constitutional protections causes "the Judicial Branch [to be] weaker and less independent than it is supposed to be." The court then concluded that "Waldman's objection thus implicates not only his personal rights, but also the structural principle advanced by Article III. And that principle is not Waldman's to waive." 698 F.3d at 918. [6]

The Fifth Circuit in *Frazin* held that under *Schor* consent cannot cure constitutional difficulties if the separation of powers is implicated in a given case. It then relied on *Stern* for the conclusion that the entry of a final judgment by a bankruptcy court on certain state law counterclaims does implicate separation of powers. 732 F.3d at 320 n.3. [7] In the subsequent *BP RE* decision, the Fifth Circuit applied the same reasoning to a noncore proceeding in which the parties had consented to bankruptcy adjudication. It relied on *Waldman* and *Frazin* to conclude that, while the parties' consent gave the bankruptcy court statutory authority to enter a judgment in a noncore proceeding under § 157(c)(2), under *Stern* the bankruptcy court lacked constitutional authority to do so. The court found persuasive the reasoning of *Waldman* that "parties cannot consent to [a] circumvention of Article III that impinges on the structural interests of the Judicial Branch." 2013 WL 5975030 at *6. It concluded that *Schor* did not

[6] In *Waldman* a chapter 11 debtor in possession brought an adversary proceeding against his principal creditor for fraud, seeking disallowance of the creditor's claims and an award of actual and punitive damages. The Sixth Circuit held that the bankruptcy court properly exercised authority to disallow the claims, but that it lacked constitutional authority to hear and determine the claims for damages arising from the fraud. The creditor did not raise the constitutional argument until he appealed to the Sixth Circuit.

[7] In *Frazin* two law firms that had been hired as special counsel to pursue state court litigation on behalf of the chapter 13 debtor filed fee applications in the bankruptcy court at the conclusion of the litigation. In response, the debtor asserted counterclaims against them that alleged negligence, violations of the state Deceptive Trade Practices Act, and breach of fiduciary duty. The bankruptcy court awarded the law firms the fees requested and entered judgment against the debtor on his counterclaims. Although the debtor had filed his claims against the law firms in the bankruptcy court and did not question—until in the Fifth Circuit—its authority to decide them, the Fifth Circuit held that under *Stern* the bankruptcy court lacked authority to make the legal determinations underlying the DTPA counterclaim. The court reasoned that, unlike the other counterclaims and the factual underpinnings of this claim, the legal conclusions regarding the DTPA claim were not necessary to resolve in ruling on the fee applications.

require a contrary result because "[a]llowing bankruptcy courts to enter final judgments on state-law claims that are not necessary to address the bankruptcy issues confers the 'essential attributes of judicial power' on non-Article III courts." *Id.* at *7.[8]

The Seventh Circuit's decision in *Wellness International* was based on a more detailed examination of *Schor*.[9] The court noted that *Schor* presented the "practical problem . . . of separating out the waivable personal safeguard from the nonwaivable structural safeguard." 727 F.3d at 769. It then looked to *Schor* for the analysis to resolve this problem and discussed the factors the Court relied on in that case. The Seventh Circuit concluded that the authority given the bankruptcy judge under § 157(b) is distinguishable from the statutory scheme upheld in *Schor*, using reasoning similar to the Fifth Circuit's in *Frazin*:

> [U]nlike *Schor*, where party consent was permissible because the statutory scheme at issue did not implicate structural concerns, the Supreme Court has already held that the statutory scheme granting bankruptcy judges authority to enter final judgment in core proceedings *does* implicate structural concerns where the core proceeding at issue is the "stuff of the traditional actions at common law tried by the courts at Westminster in 1789."

Id. at 771 (quoting *Stern*, 131 S. Ct. at 2609) (internal quotation marks deleted). In reaching this conclusion, however, the court failed to note (1) that *Stern* decided the Article III issue in a case in which the objecting party had *not* consented to have the counterclaim that was asserted against him decided by the bankruptcy judge, *see Stern*, 131 S. Ct. at 2607, and (2) that *Schor* held consent to be effective precisely as to a private cause of action of the sort tried at common law, *see Schor*, 478 U.S. at 854-55.

The Seventh Circuit went on to hold that "under current law a litigant may not waive an Article III, § 1 objection to a bankruptcy court's entry of final judgment in a core proceeding." *Id.* at 773. In reaching this conclusion, the Seventh Circuit focused narrowly on the authority granted by § 157(b)(2), rather than examining the entire statutory scheme for bankruptcy adjudication that Congress enacted to comply with the constitutional principles articulated in *Northern Pipeline*. The court distinguished consent in the case before it from the consent

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[8] In *BP RE* the bankruptcy court entered a final judgment denying relief in the chapter 11 debtor in possession's adversary proceeding that asserted tort and contract claims against several entities. The debtor alleged in the complaint that the proceeding was noncore, and it filed a statement consenting to the entry of a judgment by the bankruptcy court. The debtor later demanded a jury trial. The bankruptcy court denied the jury demand as untimely, after which the debtor moved for withdrawal of the reference and stated that it did not consent to the bankruptcy court's entry of a judgment. The district court denied the withdrawal motion. The debtor argued in the Fifth Circuit that it had withdrawn its consent to bankruptcy court adjudication and that the bankruptcy court lacked authority to enter a final judgment. The court determined that the debtor had expressly consented to the entry of a final judgment by the bankruptcy court and refused to accept its later attempt to withdraw consent. It nevertheless held that consent was ineffective to give the bankruptcy court constitutional authority to enter a final judgment.

[9] In *Wellness International* a creditor brought an adversary proceeding against the chapter 7 debtor seeking denial of the discharge on four grounds and a declaratory judgment that a trust was the debtor's alter ego. As a sanction for the debtor's failure to comply in multiple respects with an order compelling discovery, the bankruptcy court entered a default judgment in favor of the creditor on all five counts of its complaint. On appeal, the district court rejected the debtor's *Stern* objection—raised for the first time after briefs were filed in that court—as untimely. The Seventh Circuit held that the bankruptcy court had authority to enter a final judgment on the objection-to-discharge counts, but that it lacked constitutional authority to enter a final judgment on the alter ego claim.

provisions of both § 157(c)(2) for bankruptcy judges in noncore proceedings and § 636(c)(1) for magistrate judges in civil proceedings. Absent consent, those statutes authorize non-Article III judges only to submit proposed findings of fact and conclusions of law. In contrast, the court said, "Congress has vested bankruptcy judges with authority to enter final orders and judgments in core proceedings subject only to review by the district court under traditional appellate standards." *Id.* at 772. Because of the more limited conferral of authority under §§ 157(c)(2) and 636(c)(1), the Seventh Circuit said, without deciding the issue, that those statutes may "allow[] room for notions of consent and waiver," unlike § 157(b)(2). *Id.* The court did not, however, explain how it could be consistent with Article III for parties to consent to bankruptcy judges deciding a traditional common law adversary proceeding, such as *Northern Pipeline*, but not a common law proceeding more closely tied to a bankruptcy matter, such as a proceeding seeking nondischargeability of a debt or the disallowance of a claim (the context of the relief sought in *Waldman*).[10]

VI. The Practical Effect of the Decision Regarding Consent

There is undoubtedly some tension between the pragmatic approach the Court took in *Schor* and the more categorical analysis of *Stern*. *Schor* stressed the need to consider "the practical effect that the congressional action will have on the constitutionally assigned role of the federal judiciary," 478 U.S. at 851, and to give due regard to "the unique aspects of the congressional plan at issue and its practical consequences in light of the larger concerns that underlie Article III." *Id.* at 857. *Stern*, on the other hand, stated that "'the fact that a given law or procedure is efficient, convenient, and useful in facilitating functions of government, standing alone, will not save it if it is contrary to the Constitution.'" 131 S. Ct. at 2619 (quoting INS v. Chadha, 462 U.S. 919, 944 (1983)). The *Stern* Court, however, even as it stated that practicality could not be the sole basis for determining how to enforce Article III, immediately followed that statement with assurance that its decision was a narrow one that would not "meaningfully change[] the division of labor in the current statute." *Id.* at 2620.

A decision that party consent—whether express or implied—never allows bankruptcy courts to determine *Stern*-type claims would have a large and negative impact on the operation of the bankruptcy system. First, and most importantly, it would treat a *Stern* objection like an objection to subject matter jurisdiction, allowing it to remain alive throughout the initial determination of the case and all appeals. This opportunity to hold back an objection to the bankruptcy court's exercise of jurisdiction would allow parties to engage in sandbagging—litigating proceedings in the bankruptcy court as long as rulings were favorable to the party, but appealing an unfavorable judgment on grounds that could have been raised, but were not, at an

[10] In a subsequent bankruptcy decision, the Seventh Circuit stated that "It is established that parties may consent to the entry of final decision by a magistrate judge under 28 U.S.C. § 636(c), followed by an appeal that bypasses the district court, even though a magistrate judge lacks Article III tenure." Peterson v. Somers Dublin Ltd., 729 F.3d 741, 746 (7th Cir. 2013). The *Peterson* court also noted that *Wellness International* presented only the issue of the possible forfeiture of the right to an Article III judge due to party inaction and not the effect of affirmative consent to non-Article III adjudication by all of the parties. *Id.* at 747. Therefore, the court stated, "[W]e think the effect of an express and mutual waiver [remains] open in this circuit." *Id.*

early stage of the litigation. The Supreme Court in *Stern* noted that the "consequences of a litigant 'sandbagging' the court . . . can be . . . particularly severe." 131 S. Ct. at 2609. [11]

Second, with the possible exception of clearly core bankruptcy matters, such as the determination of claims and dischargeability, elimination of the effectiveness of consent would lead to bankruptcy courts exercising authority cautiously and defensively. They would be more likely to render proposed findings and conclusions, rather than enter a final judgment, in proceedings asserting any claim that might come within *Stern*, even if all parties initially participated in the proceeding without objection. Indeed, although the Court held that *Stern* did not apply to counterclaims that "would necessarily be resolved in the claims allowance process" and referred to its holding as "narrow," 131 S. Ct. at 2618, 2620, lower court decisions have interpreted *Stern* as "broad in scope" and "sweeping" and implied that *Stern* might be applied on an issue-by-issue basis in various adversary proceedings and contested matters. *See* Frazin v. Hayes & Boone, L.L.P. (*In re* Frazin), 732 F.3d 313, 318-19, 323-24 (5th Cir. 2013). As the combined result of a broad application of *Stern* by some courts of appeals and the elimination of consent as a curative, bankruptcy courts could be reluctant to enter judgments and orders in a variety of proceedings that were routinely resolved by bankruptcy courts prior to *Stern*. Similarly, when issues over which the bankruptcy courts clearly had authority arose in cases where there were also *Stern* issues, bankruptcy courts might proceed as if *Stern* applied to the entire matter, with findings and conclusions on all issues, which would require the district court to make wholly unnecessary de novo determinations.

Third, if the Court were to determine in *Arkison* that parties may not validly waive the right to Article III adjudication of proceedings that § 157(b)(2) lists as core but that fall outside of the bankruptcy court's constitutional authority to determine, it is hard to see how the consent provision of § 157(c)(2) would be constitutionally valid for proceedings not listed as core. In *Stern* the Court said that its ruling resulted in "the removal of counterclaims such as [the one at issue] from core bankruptcy jurisdiction." 131 S. Ct. at 2620. As a result, *Stern*-type claims and claims treated as noncore by § 157 are constitutionally one and the same, so a holding that a bankruptcy court may not determine the former with the consent of the parties would apply equally to the latter, thus rendering § 157(c)(2) unconstitutional. *See* BP RE, L.P. v. RML Waxahachie Dodge, L.L.C. (*In re* BP RE, L.P.), 2013 WL 5975030 at *9 (5th Cir. Nov. 11, 2013) ("Under *Stern*'s reasoning . . . , the core/non-core contention urges a distinction without a difference for purposes of Article III.") (internal quotation marks and citation deleted).

[11] Orderly and efficient bankruptcy procedures require that *Stern* issues be raised and decided at the outset of proceedings in the bankruptcy court. Accordingly, the National Bankruptcy Conference advocates application of the doctrines of actual and implied consent to *Stern*-governed matters, which application would minimize the uncertainties of *Stern* by allowing resolution of the bankruptcy court's authority at an early stage of proceedings. The Judicial Conference of the United States has approved amendments to the Bankruptcy Rules that would require parties to all adversary proceedings in bankruptcy cases—whether statutorily core or noncore—to state in their initial pleading whether they do or do not consent to the entry of a final order or judgment by the bankruptcy court. *See* Report of Proceedings of the Judicial Conference of the United States, September 19, 2013 at xxx (not yet issued). In light of the pending *Arkison* case, however, the Judicial Conference deferred forwarding the amendments to the Supreme Court until after the case is decided.

Disallowing consent would mean that *Stern*-type claims and noncore proceedings could no longer be finally resolved by bankruptcy courts. Instead, those courts could only hear the proceedings and make proposed findings of fact and conclusions of law, subject to de novo review in the district court.[12] This result would have a very detrimental impact on the efficient administration of bankruptcy cases. In consumer cases, claims litigation would become more time consuming and expensive as related counterclaims against creditors would have to be resolved in the district court. Trustee avoidance actions would be greatly delayed, perhaps so much so that trustees would forego pursuing the recovery of assets that would otherwise be available for distribution to creditors. In the case of claims alleged to be nondischargeable, debtors and creditors would often face two trials—one in the bankruptcy court to determine whether the claim is excepted from discharge and, if determined to be so, a second trial in the district court or a state court to liquidate the claim and enter a judgment against the debtor. Confirmation of chapter 13 plans would be delayed, awaiting the resolution by other courts of litigation to determine objections and counterclaims asserted in response to creditors' claims or to recover assets to fund the plan. All of these delays would occur despite the parties' willingness to resolve the matters more expeditiously in the bankruptcy court.

The same is true for business cases. Arguably under the rationale of *Stern*, even with the parties' express consent or active participation without objection, bankruptcy courts in chapter 11 cases would not be able to issue (1) financing order provisions concerning the validity under state law of debts and liens; (2) sale order provisions granting broad protective relief against future claims and ordering a sale free and clear of all interests; or (3) plan confirmation orders approving settlements of common law claims, granting third party injunctions, or granting channeling orders. Lest these consequences seem fanciful, it should be recalled that following *Northern Pipeline* parties to many significant bankruptcy transactions insisted on so-called "comfort orders" from the district courts, and a similar result might occur in many situations where parties currently rely on the doctrines of consent and mootness to protect them against appeals and collateral attack. The elimination of consent as a basis for bankruptcy court adjudication of private rights, coupled with the uncertain scope of *Stern*, would undermine parties' willingness to rely on the validity of bankruptcy court orders. As a result, the resolution of complex chapter 11 cases might be delayed while critical matters remained pending in the district court.

Fourth, eliminating bankruptcy courts' authority to determine matters with the consent of the parties would significantly increase the workload of district courts. The most recent Annual Report of the Director of the Administrative Office of the U.S. Courts indicates that 1,261,140

[12] Section 157(b)(1)'s conferral of authority on bankruptcy courts to "hear and determine" core proceedings includes the lesser authority to hear such proceedings and submit proposed findings of fact and conclusions of law to the district court. *See Stern*, 131 S. Ct. at 2602 (noting that the district court treated the bankruptcy court's judgment as "'proposed[,] rather than final'"). Because § 151 provides that the district court "by rule or order" may limit the authority conferred under that chapter on the bankruptcy courts, a district court can clarify in its standing order of reference that the bankruptcy court may only submit proposed findings of fact and conclusions of law if entry of a final judgment or order would not be consistent with Article III. *See, e.g.*, Amended Standing Order of Reference, 12 MISC 00032 (S.D.N.Y. Feb. 1, 2012).

bankruptcy cases[13] and 53,931 adversary proceedings[14] were filed during the 12-month period ending on September 30, 2012. Although the number of adversary proceedings includes ones that bankruptcy courts would still have constitutional authority to adjudicate, data gathered by the American Bar Association and included in its *amicus* brief filed in *Arkison* give a partial indication of the impact that eliminating party consent to bankruptcy court adjudication could have on district courts. The ABA's count of fraudulent conveyance, preference, and state-law-based adversary proceedings filed during the four-year period ending on June 30, 2013, in a sample district in each circuit showed that requiring their determination by the district court would increase the district court's caseload by anywhere from 4.35% to 213%.[15]

The increased burden on district courts would be compounded by the likely effect that a decision invalidating consent in bankruptcy noncore proceedings would have on magistrate judge authority. As pointed out in an earlier Conference paper, the legislative scheme for the appointment of bankruptcy judges and their exercise of noncore jurisdiction closely tracks the scheme for the appointment of magistrate judges and their exercise of jurisdiction in civil actions.[16] *See* 28 U.S.C. §§ 631, 636(b), (c). Although the statutory provision allowing a magistrate judge to "conduct any or all proceedings in a jury or nonjury civil action" with the consent of the parties has been upheld by eleven courts of appeals, the *Stern* decision led the Fifth Circuit to question whether that authority is still valid. Technical Automation Servs. Corp. v. Liberty Surplus Ins. Corp., 673 F.3d 399 (5th Cir. 2012). The court stated that "the similarities between bankruptcy judges and magistrate judges suggest that the Court's analysis in *Stern* could be extended to this case," but it concluded that *Stern* did not unequivocally overturn the circuit precedent upholding the constitutionality of § 636(c)(1), thus leaving it still binding on the panel. *Id.* at 405.

In sum, eliminating the authority of bankruptcy judges to exercise jurisdiction over *Stern*-type claims and noncore proceedings with the consent of the parties would greatly burden the operation of the bankruptcy system.[17] Delays in resolving bankruptcy cases would occur while adversary proceedings or some claims within them awaited resolution in districts courts.

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[13] *See* U.S. Bankruptcy Courts—Bankruptcy Cases Commenced, Terminated, and Pending During the 12 Month Periods Ending September 30, 2011 and 2012, http://www.uscourts.gov/uscourts/Statistics/JudicialBusiness/2012/appendices/F00Sep12.pdf.

[14] *See* U.S. Bankruptcy Courts—Adversary Proceedings Commenced, Terminated, and Pending During the 12 Month Periods Ending September 30, 2011 and 2012, http://www.uscourts.gov/uscourts/Statistics/JudicialBusiness/2012/appendices/F08Sep12.pdf.

[15] *See http://www.americanbar.org/content/dam/aba/publications/supreme_court_preview/briefs-v3/12-1200_resp_amcu_aba.authcheckdam.pdf* (pp.20-24).

[16] http://www.nationalbankruptcyconference.org/pubs/nbc%20courts%20committee%20stern%20report1211.pdf at 15-19.

[17] It would also be ironic not to permit parties to consent to adjudication by a "judicial officer of the district court," given the Supreme Court's vigorous enforcement of contract provisions requiring the resolution of disputes by non-judicial arbitrators whose decisions are subject to minimal judicial review. *See, e.g.*, CompuCredit Corp. v. Greenwood, 132 S. Ct. 665 (2012); Shearson/American Express Inc. v. McMahon, 482 U.S. 220 (1987).

Already overburdened district courts would necessarily place a lower priority on resolving bankruptcy cases than on handling their criminal dockets, and some might seek refuge by abstaining to allow state courts to resolve bankruptcy-related state law claims. Closely related claims would thus end up being resolved in a piecemeal fashion, with bankruptcy courts resolving the ones that constituted core proceedings while district or state courts resolved the noncore ones. Costly litigation would continue over how much authority a bankruptcy judge could exercise, and parties would be able to raise these issues for the first time on appeal, even after actively participating without objection in the bankruptcy court proceeding.

This picture of a bankruptcy system without an option for party consent to the exercise by bankruptcy courts of noncore jurisdiction is reminiscent of the jurisdictional situation that Congress sought to repair when it enacted the Bankruptcy Reform Act of 1978. A major reason for the expansion of bankruptcy subject matter jurisdiction and the expansion of bankruptcy judges' authority was to eliminate the costs and delay that resulted from a bifurcated jurisdictional scheme. *See, e.g.*, H. REP. NO. 595, 95th Cong., 1st Sess. 445 (1977) ("Actions that formerly had to be tried in State court or in Federal district court, at great cost and delay to the estate, may now be tried in the bankruptcy courts."). After *Northern Pipeline* struck down the 1978 jurisdictional scheme, the 1984 Act's authorization for bankruptcy judges—upon referral from the district courts—to resolve core proceedings and, with the consent of the parties, noncore proceedings allowed the bankruptcy system to continue operating with as much efficiency as possible.

Stern has already reduced the scope of core jurisdiction to an uncertain degree, but disallowing party consent as a basis for bankruptcy courts to resolve noncore proceedings would be neither "narrow" nor limited to "one isolated" aspect of the statutory scheme. Far from confirming *Stern* as a decision that "does not change all that much," s*ee Stern*, 131 S. Ct. at 2620, disallowing consent to final adjudication by the bankruptcy court would be a stunning and costly alteration of bankruptcy procedure.

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