

Testimony of

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on behalf of the

NATIONAL BANKRUPTCY CONFERENCE

before the

Subcommittee on Courts, Commercial and Administrative Law

of the

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for Hearings on

**The Supreme Court's Decision in *Stern v. Marshall*:
Its Effects on Bankruptcy Administration and Possible
Congressional Responses**

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Good morning. My name is Patrick Vance and I am appearing here today on behalf of the National Bankruptcy Conference. By way of background, I am a partner in the New Orleans, Louisiana office of Jones, Walker, Waechter, Poitevent, Carrère and Denègre, where I head the firm's bankruptcy practice and I am the practice group leader for the Commercial Litigation practice group. I have been at Jones Walker for my entire 37 year career as a lawyer.

The National Bankruptcy Conference is grateful for the opportunity to participate in this hearing and to present its comments on the impact and effect on the bankruptcy system arising from the Supreme Court's *Stern v. Marshall* decision handed down last year.

The Supreme Court's decision – *Stern v. Marshall*, 131 S. Ct. 2594 (2011) – has created considerable consternation in the bankruptcy world. In a 5 – 4 decision, the Court found that the statutory grant of power to bankruptcy judges in 28 U.S.C. §157(b)(2)(C) to hear and determine core proceedings constituting “counterclaims by the estate against persons filing claims against the estate” exceeds the limits of Article III of the Constitution.

Although Chief Justice Roberts insisted that the holding is narrow, the near universal reaction among the bar and many courts is one of disbelief. The Court's rationale for its decision permits a reading that calls into question the constitutional validity of the bankruptcy court's authority over a wider range of core proceedings than the type of counterclaim that gave rise to the issue in *Stern*. For instance, *Stern* arguably affects avoidable preferences and fraudulent conveyances which constitute fertile areas for bankruptcy litigation.

Indeed, there are in excess of 500 reported decisions that cite *Stern*. Those lower court decisions indicate that some courts and parties are rushing to raise broader constitutional issues as they do not believe that *Stern* can be confined to an isolated, narrow issue. Some even argue that the effect of the *Stern* case is to return bankruptcy decision-making back to the bad old days

before the enactment of our modern bankruptcy code in 1978. Students of bankruptcy history worry that the bankruptcy system will return to those days when there was a lot of wasteful and expensive litigation sorting out whether the bankruptcy judge or referee was exercising summary or plenary jurisdiction.

If the Supreme Court's decisions on the contours of Article III and bankruptcy court powers were subject to easy synthesis, perhaps the post-*Stern* issues would not be so thorny and would provoke less litigation. The simplest solution is obvious, but has encountered stubborn resistance over the years. If bankruptcy courts were presided over by Article III judges, bankruptcy lawyers and judges could do their work efficiently without concern over the limitations that might affect the court's power to render final judgments.

The National Bankruptcy Conference has consistently recommended Article III status for bankruptcy courts. And incidentally, this was the view of the House of Representatives before enactment of the 1978 Bankruptcy Code. But, the history is known well. The Senate's view was to the contrary, and that view prevailed.

I have attached to my opening statement two reports written by the Court System and Bankruptcy Administration Committee of the National Bankruptcy Conference. The reports cover a lot of ground. The October 26, 2011 report is entitled The Scope and Implications of Stern v. Marshall. It reviews the tortured history of the decision, analyzes its scope and attempts to reconcile the decision with the Supreme Court's other Article III cases.

The report also addresses the validity of "consent" so as to permit a bankruptcy court to hear, determine, and enter a final judgment on a *Stern*-like claim – that is, one that is statutorily designated as "core" for which an Article III adjudication is otherwise required. A section of the report is a comparison of the bankruptcy court's powers to hear and decide disputes with the

Federal Magistrate Act (28 U.S.C. §636(c)(1)), the later having been upheld by virtually all of the courts of appeal. The comparison suggests that “consent” of litigants may well limit the effects of *Stern* on the regular work of the bankruptcy courts. If so, this would be in keeping with Chief Justice Roberts’ observation that the effect of the *Stern* decision should not change the division of labor between the district courts and bankruptcy courts.

So, how have the players in the system gone about trying to maintain as much of the status quo as possible? The May 7, 2012 report attached to this statement attempts to summarize those efforts. While the NBC has not yet, and may never, attempted to summarize and/or categorize the some 500 decisions which cite *Stern*, it does appear that the courts are attempting to read *Stern* narrowly. The report highlights eight decisions rendered by various courts of appeal and bankruptcy appellate panels.

Two other efforts which are underway are noted in the report. First, several judicial districts have enacted local rules that require the parties to state explicitly early on whether they will consent or not to the bankruptcy court’s rendition of a final judgment. Some of the referral orders attempt to avoid the head splitting *Stern* analysis and declare that if the district court in reviewing the work of the bankruptcy court concludes that an Article III court is necessary to render a final judgment, then the judgment of the bankruptcy court will be treated as “proposed” findings of fact and “proposed” conclusions of law.

And second, the Judicial Conference’s Advisory Committee on Bankruptcy Rules approved for publication at its June meeting proposed amendments to several Rules of Bankruptcy Procedure (Rules 7008, 7012, 7016, 9027 and 9033). These amendments were presented to the Committee on Rules of Practice and Procedure and will be published in August for public comment. However, those rules will likely not go into effect until December, 2014.

In the meantime, there are some clean up actions that Congress might consider with respect to 28 U.S.C. §157(b) and (c). Section 157(b)(2)(c) which was the focus of the *Stern* case should be revised. It would also appear that §157(c)(1) should be amended to include “core” matters that require an Article III court. This would clarify that absent consent, the bankruptcy court could at least hear the dispute and send proposed findings to the district court. Section 157(c)(2) should also include *Stern*-like “core” matters.

Since the full impact of *Stern* remains unclear, time and judicial decisions may dictate other statutory revisions. The only sure way to prevent repeated and costly litigation over these matters is to create Article III bankruptcy courts. But until that can be accomplished, revisions to section 157 or perhaps new local rules, revised reference orders and the proposed bankruptcy rules amendments can be pursued to keep the bankruptcy system working as efficiently as possible.

Once again, I would like to thank the Chair and the rest of the Subcommittee for inviting the National Bankruptcy Conference to testify in this important hearing. The Conference would be pleased to formulate drafting proposals and assist in technical matters if the Subcommittee would find that helpful.

NATIONAL BANKRUPTCY CONFERENCE

COMMITTEE ON COURT SYSTEM AND BANKRUPTCY ADMINISTRATION¹

“THE SCOPE AND IMPLICATIONS OF *STERN v. MARSHALL, 131 S. CT. 2594 (2011)*”

OCTOBER 26, 2011²

¹ Authored by Chair, Prof. S. Elizabeth Gibson, Michael St. Patrick Baxter, Prof. Randal C. Picker and R. Patrick Vance.

² The contents of this Report were presented at the 2011 Annual Meeting of the National Bankruptcy Conference, together with the recommendations of the Committee. This Report has neither been approved nor disapproved by the Conference.

In *Stern v. Marshall*, 131 S.Ct. 2594 (2011), the Supreme Court returned to the question of the scope of authority that bankruptcy courts can exercise consistent with the constraints of Article III of the U.S. Constitution. Article III vests the judicial power of the United States in courts where the judges enjoy certain constitutional protections designed to preserve their independence from the political branches and from democratic forces. Bankruptcy judges do not enjoy those protections. In *Stern*, in a 5-4 decision, the Court found that the statutory grant of power to bankruptcy judges in 28 USC § 157(b)(2)(C) to hear and determine core proceedings constituting “counterclaims by the estate against persons filing claims against the estate” exceeds the limits of Article III of the Constitution.

I. The Decision

Anna Nicole Smith (referred to in the Supreme Court opinion by her actual first name, “Vickie”) married J. Howard Marshall II roughly one year before his death. But even before her husband’s death, a fight broke out between Vickie and Marshall’s son, Pierce Marshall, over what would happen to the husband’s assets on his death. After his death, Vickie filed a bankruptcy petition, and Pierce Marshall in turn filed a complaint in the bankruptcy proceeding. Pierce believed that Vickie had defamed him in the fight over his father’s assets, and Pierce sought to have the defamation claim declared non-dischargeable. Pierce eventually filed a proof of claim in Vickie’s bankruptcy case relating to the alleged defamation. Vickie responded to that claim by filing a counterclaim for tortious interference in connection with her now-deceased husband’s assets.

The bankruptcy court resolved both Pierce’s original claim against Vickie and her counterclaim against him. Vickie won a summary judgment motion on the defamation claim and was awarded \$400 million in compensatory damages and \$25 million in punitive damages on her tortious interference claim. There were many other proceedings—including state proceedings and a prior trip to the U.S. Supreme Court—but eventually the outcome turned on Pierce’s challenge to the power of the bankruptcy court to decide Vickie’s counterclaim.

That was the question before the Supreme Court, and the initial question was statutory. The jurisdictional provision for bankruptcy cases and proceedings, 28 USC § 1334, distinguishes between bankruptcy cases and proceedings and then within proceedings, among proceedings “arising under title 11” or “arising in or related to cases under title 11.” That provision assigns jurisdictional power to district courts, not bankruptcy courts, but 28 USC § 157 sets forth the procedures under which district courts can assign matters within their jurisdiction under § 1334 to bankruptcy courts. Those provisions draw a sharp line between (1) what the statute defines as core proceedings arising under title 11 or arising in a case under title 11 and (2) proceedings that are non-core but otherwise related to a bankruptcy case. Matters that fall within the first statutory standard may be heard and determined by bankruptcy judges. The statute then offers a nonexclusive list of core proceedings, including the provision regarding counterclaims in § 157(b)(2)(C).

Pierce argued that under the statute a core proceeding need not necessarily be an arising-in or arising-under proceeding. Under that scheme, bankruptcy courts could hear and determine core proceedings that arose under title 11 or in a title 11 case, but not core proceedings that were

merely related to cases under title 11, such as, in Pierce's view, the counterclaim asserted by Vickie. The Court majority rejected that argument. The Court understood the statute to provide that core proceedings necessarily arise under title 11 or in cases under title 11, and thus the statute assigned to the bankruptcy court the power to decide Vickie's counterclaim. Pierce also raised a question about the extent to which § 157(b)(5)'s special rules for personal injury or wrongful death claims should apply in this situation, but the Court treated that provision as not jurisdictional and therefore subject to waiver. It concluded that Pierce had waived his claim to a district court trial under that provision.

That took the Court to the constitutional issue. The Court majority understood Article III to be critical in enacting our scheme of separation of powers among the judiciary, the legislature, and the executive. That in turn imposed sharp limits on the power of Congress to withdraw matters from resolution by Article III judges. As the Court put it: "When a suit is made of 'the stuff of the traditional actions at common law tried by the courts at Westminster in 1789,' *Northern Pipeline*, 458 U.S., at 90 (Rehnquist, J., concurring in judgment), and is brought within the bounds of federal jurisdiction, the responsibility for deciding that suit rests with Article III judges in Article III courts."

But at the same time, at least since *Northern Pipeline Constr. Co. v. Marathon Pipe Line Co.*, 458 U.S. 50 (1982), the Court has recognized a set of conflicts that Congress has the power to assign outside of the Article III judiciary for resolution. This is usually captured in the ill-defined "public rights" concept, but the core of that idea is that Congress enjoys flexibility in how to design the administration of a scheme when it creates new rights, even rights that just establish relationships among private parties. Disputes in those circumstances need not be assigned to Article III courts, and Congress can assign administration of those disputes to administrative agencies or what might be labeled as "courts" even if they don't enjoy Article III protections. This is critical, as much of the administrative apparatus that we associate with the modern federal government matches exactly this framework.

After a discussion of the cases on the scope of the public rights concept, the Court concluded that Vickie's counterclaim for tortious interference simply did not fall within the public rights doctrine. The action instead was a traditional, common law claim between two private parties: "What is plain here is that this case involves the most prototypical exercise of judicial power: the entry of a final, binding judgment by a court with broad substantive jurisdiction, on a common law cause of action, when the action neither derives from nor depends upon any agency regulatory regime. If such an exercise of judicial power may nonetheless be taken from the Article III Judiciary simply by deeming it part of some amorphous 'public right,' then Article III would be transformed from the guardian of individual liberty and separation of powers we have long recognized into mere wishful thinking."

The Court majority then turned to the cleanup of remaining issues. Pierce had filed a proof of claim in Vickie's bankruptcy proceeding, and the question was whether that filing created a power in the bankruptcy court to adjudicate Vickie's counterclaim for tortious interference. Two of the Court's prior decisions, namely *Katchen v. Landy*, 382 U.S. 323 (1966), and *Langenkamp v. Culp*, 498 U.S. 42 (1990) (per curiam), might be read to suggest that Pierce's proof of claim had that result, but the Court saw those cases as distinguishable. They addressed the proper location for adjudicating a bankruptcy preference claim, a classic example of a

separately created federal right. The Court also noted that under § 502(d) of the Bankruptcy Code, a creditor's claim can be disallowed as a result of the receipt of a preference. The Court found those preference claims to be quite different from the state law-based counterclaim asserted by Vickie that raised issues entirely different from Pierce's defamation claim. Finally, the Court rejected the idea that bankruptcy courts resolving counterclaims under § 157(b)(2)(C) could properly be viewed as adjuncts to Article III courts. With the power to enter final judgments on the counterclaims, subject to normal appellate review, they were in the eyes of the majority no more adjuncts of the district court than districts courts are adjuncts of the court of appeals.

In a short opinion, Justice Scalia concurred to emphasize his understanding of the public rights doctrine. In his view, the public rights doctrine encompasses disputes between the government and a second party and not disputes between two private parties.

Justice Breyer, joined by three other justices, dissented. He agreed with the majority's analysis on the statutory claim but disagreed with its constitutional analysis. The core of his analysis turned on what he understood to be the implications of *Crowell v. Benson*, 285 U.S. 22 (1932). Justice Breyer understood *Crowell* to provide the underpinning for the modern administrative state. One way to characterize the counterclaim provision in § 157(b) is precisely that it assigns the resolution of a private dispute to an administrative agency, namely the bankruptcy court. The majority opinion sidestepped *Crowell* in a footnote, but Justice Breyer feared that the majority's analysis put at risk the adjudication authority for private disputes currently assigned to the National Labor Relations Board and other federal agencies. Instead, Justice Breyer believed that the Court's inquiry should have focused on whether the congressional assignment of a particular dispute to a non-Article III actor seemed to pose an actual threat to Article III authority or independence. Absent that fear—and he didn't see the basis for that here—Justice Breyer would have found the assignment of authority to the bankruptcy court constitutional.

II. Scope of the Court's Decision

In his opinion for the Court, Chief Justice Roberts stressed the narrowness of the Court's holding and the limited practical impact of the decision. In response to arguments that the decision would "create significant delays and impose additional costs on the bankruptcy process," the Chief Justice wrote that the Court did not believe that "removal of counterclaims such as Vickie's from core bankruptcy jurisdiction meaningfully changes the division of labor in the current statute; we agree with the United States that the question presented here is a 'narrow' one."² The opinion went on to explain why it was important to adhere strictly to Article III's requirements even if the decision in this case "does not change all that much."³ And the concluding paragraph of the opinion stated the "one isolated respect" in which the Court concluded that the Bankruptcy Act of 1984 exceeded the limitations of Article III: "The

² 131 S. Ct. at 2619-20.

³ *Id.* at 2620.

Bankruptcy Court below lacked the constitutional authority to enter a final judgment on a state law counterclaim that is not resolved in the process of ruling on a creditor's proof of claim."⁴

If the Court's statement of the import of the decision is accepted at face value, it causes some disruption of the core-proceedings scheme established by § 157, but it does not require a major overhaul of the bankruptcy courts' exercise of jurisdiction like the one caused by *Northern Pipeline*. It means that a bankruptcy court cannot enter a final judgment on some counterclaims asserted by the estate against a creditor who files a proof of claim—at least if the parties do not consent to that exercise of authority by the bankruptcy court. But § 157's authorization for the exercise of jurisdiction by the bankruptcy court is otherwise unaffected. Under that reading, the only issues requiring resolution after *Stern* are the validity of party consent to a bankruptcy court's determination of a state law counterclaim and the procedure that bankruptcy courts should follow when they are unable to enter a final judgment on such a claim.

The Court's rationale for its decision, however, permits a reading that calls into question the constitutional validity of the bankruptcy courts' authority over a wider range of core proceedings than the type of counterclaim that gave rise to the issue in *Stern*. The majority's return to the categorical approach to Article III that a plurality followed in *Northern Pipeline* and a majority followed in *Granfinanciera, S.A. v. Nordberg*, 492 U.S. 33 (1989), as opposed to the more fluid approach it adopted in two intervening Article III decisions, provides a basis for challenging the constitutionality of the bankruptcy courts' authority to enter final judgments in certain other types of core proceedings. At its broadest, *Stern* might even be read to raise questions about the validity of much of the bankruptcy courts' authority over core proceedings. Although these constitutional questions regarding the 1984 congressional response to *Northern Pipeline* were raised twenty-two years ago by the *Granfinanciera* decision, they have largely been ignored until now. Lower court decisions in the wake of *Stern*, however, indicate that some courts and parties are no longer refraining from raising these broader constitutional issues and that they do not believe that *Stern* can be confined to an isolated, narrow issue. The discussion that follows in this Part summarizes the Supreme Court's recent Article III decisions and sets forth arguments that might be made for broader applications of *Stern*.

A. The case law background

The Court's opinion in *Stern* relied heavily on *Northern Pipeline* and *Granfinanciera*. The reasoning and language of those decisions, particularly the latter, provide the basis for a more expansive application of *Stern* than the Chief Justice's opinion acknowledged.

In *Northern Pipeline* a majority of the Court held that the statutory grant of bankruptcy jurisdiction under the 1978 Act, codified at 28 U.S.C. § 1471, was unconstitutional to the extent that it authorized bankruptcy judges, who lacked the attributes of Article III judges, to hear and decide state law contract claims, subject to traditional appellate review by an Article III court. Four members of the Court, in an opinion written by Justice Brennan, addressed the question broadly and concluded that "the broad grant of jurisdiction to the bankruptcy courts contained in . . . § 1471 . . . is unconstitutional."⁵ Two other members of the Court—Justices Rehnquist and

⁴ *Id.*

⁵ 458 U.S. 50, 87 (1982).

O'Connor—concurred in the judgment without attempting to synthesize the Court's Article III precedents or addressing exercises of jurisdiction by bankruptcy courts beyond the instance before them. Because they concluded that the grant of authority in question was not severable from the remainder of § 1471, those justices concurred in the judgment striking down the jurisdictional statute in its entirety.

The plurality opinion identified “three narrow situations” not subject to the constitutional command that the judicial power of the United States be vested in Article III courts: territorial courts, military courts, and legislative and administrative courts created to adjudicate cases involving public rights. Without definitively explaining the distinction between public and private rights, Justice Brennan wrote that “a matter of public rights must at a minimum arise ‘between the government and others.’”⁶ The liability of one individual to another, on the other hand, was said to be a matter of private rights. The first two exceptions were clearly inapplicable to the debtor in possession's adversary proceeding against Marathon, and the third was as well according to the plurality. The litigation was between individuals, and the plurality distinguished the “adjudication of state-created private rights, such as the right to recover contract damages that is at issue in this case” from “the restructuring of debtor-creditor relations, which is at the core of the federal bankruptcy power.” The latter, it said, “may well be a ‘public right.’”⁷

The Supreme Court issued two decisions a few years after *Northern Pipeline* that took a decidedly different approach to the Article III analysis. The majority opinion in both cases was written by Justice O'Connor. In *Thomas v. Union Carbide Agric. Prods. Co.*, 473 U.S. 568 (1985), the Court upheld the provision of a federal statute that authorized binding arbitration, subject to only limited judicial review, to resolve disputes among participants in a pesticide registration program. In contrast to Justice Brennan's *Northern Pipeline* opinion, Justice O'Connor wrote for the Court that “practical attention to substance rather than doctrinaire reliance on formal categories should inform application of Article III.”⁸ The Court then expanded its description of public rights from the one offered by the *Northern Pipeline* plurality. It rejected the argument that “the right to an Article III forum is absolute unless the Federal Government is a party of record.”⁹ Instead, the Court held, the Article III analysis must take into account “the origin of the right at issue [and] the concerns guiding the selection by Congress of a particular method for resolving disputes.”¹⁰

The following year Justice O'Connor's opinion for the Court in *Commodity Futures Trading Comm'n v. Schor*, 478 U.S. 833 (1986), again explicitly rejected a categorical Article III analysis. She wrote that when the Court determines whether Congress may authorize a non-Article III tribunal to exercise the judicial power of the United States, it “has declined to adopt formalistic and unbending rules.”¹¹ She then set out a multi-factored test for reviewing Article III challenges, noting that none of the factors “has been deemed to be determinative.” The Court,

⁶ *Id.* at 69.

⁷ *Id.* at 71.

⁸ 473 U.S. 568, 587 (1985).

⁹ *Id.* at 586.

¹⁰ *Id.* at 587.

¹¹ 478 U.S. 833, 851 (1986)

she wrote, weighs these factors “with an eye to the practical effect that the congressional action will have on the constitutionally assigned role of the federal judiciary.”¹² The Court upheld the authority of an administrative agency to determine a counterclaim arising under state law. Although the Court concluded that the claim was a private right, that characterization did not end the analysis. Justice O’Connor explained that “this Court has rejected any attempt to make determinative for Article III purposes the distinction between public and private rights.” She added that “there is no reason inherent in separation of powers principles to accord the state law character of a claim talismanic power in Article III inquiries.”¹³

Because the strict, categorical approach articulated in *Northern Pipeline* was embraced by only four members of the Court and was later twice rejected by a majority of its members, the Court’s discussion of Article III in the *Granfinanciera* opinion three years after *Schor* was especially surprising. The issue in *Granfinanciera* was whether there was a Seventh Amendment right to a jury trial of a fraudulent transfer action brought in a bankruptcy case. In answering that question in the affirmative, the Court—in an opinion written by Justice Brennan—addressed whether the claim involved public rights. It undertook that analysis because the Court had previously held that “[u]nless a legal cause of action involves ‘public rights,’ Congress may not deprive parties litigating over such a right of the Seventh Amendment’s guarantee of a jury trial.”¹⁴

In the public rights portion of the Court’s opinion, Justice Brennan expressly linked that aspect of the Seventh Amendment analysis with the method of analysis under Article III:

[O]ur decisions point to the conclusion that, if a statutory cause of action is legal in nature, the question whether the Seventh Amendment permits Congress to assign its adjudication to a tribunal that does not employ juries as factfinders requires the same answer as the question whether Article III allows Congress to assign adjudication of that cause of action to a non-Article III tribunal. For if a statutory cause of action . . . is not a “public right” for Article III purposes, then Congress may not assign its adjudication to a specialized non-Article III court lacking “the essential attributes of the judicial power.”¹⁵

Justice Brennan, now writing for a majority of the Court, thus returned to the categorical view that a private right—at least one created by statute—must be litigated in an Article III tribunal. The Court then concluded that “a bankruptcy trustee’s right to recover a fraudulent conveyance under 11 U.S.C. § 548(a)(2) seems to us more accurately described as a private rather than a public right as we have used those terms in our Article III decisions.”¹⁶ Thus, despite the classification of a fraudulent transfer action as a core proceeding under § 157(b)(2)(H), the Court stated, albeit in *dicta*, that non-Article III bankruptcy judges could not adjudicate such claims.

¹² *Id.*

¹³ *Id.* at 853.

¹⁴ 492 U.S. 33, 53 (1989).

¹⁵ *Id.*

¹⁶ *Id.* at 55.

In *Stern* the Court, admitting the obvious, stated that the Court's "discussion of the public rights exception since [*Northern Pipeline*] has not been entirely consistent."¹⁷ Recognizing that after *Northern Pipeline* the Court expanded the scope of public rights to matters in which the federal government is not a party, Chief Justice Roberts wrote that "it is still the case that the right is integrally related to particular federal government action." He explained that the Court continues to limit the public rights concept to cases in which the "claim at issue derives from a federal regulatory scheme, or in which resolution of the claim by an expert government agency is deemed essential to a limited regulatory objective within the agency's authority."¹⁸ He noted that the Court explained in *Granfinanciera* that if a statutory right does not belong to or is not asserted against the federal government and is not "closely intertwined with a federal regulatory program," it must be determined by an Article III court.¹⁹

The majority then concluded that the counterclaim asserted by Vickie did not fit within any of the formulations of the public rights doctrine. Although the Court acknowledged that under its recent cases the distinction between public and private rights was not always determinative, it contrasted an administrative agency's adjudication pursuant to a substantive regulatory scheme with "the entry of a final, binding judgment *by a court* . . . on a common law cause of action."²⁰ The latter, the Court concluded, could not be withdrawn from the Article III courts.

B. Arguments that the *Stern* rationale applies to core proceedings other than just state law counterclaims against creditors

Despite the Court's emphasis on the narrowness of its decision, its embrace of the absolute view that the determination of private rights must be left to Article III courts invites arguments that other types of core proceedings involve private rights that district judges must determine, at least if there is no valid consent to the entry of a judgment by a bankruptcy judge. Much of the uncertainty caused by *Stern* arises from the attempt to determine where the public-private rights line is properly drawn.

The majority opinion in *Stern* focused on the state-law basis for Vickie's counterclaim. It began by stating its conclusion that the bankruptcy court lacked constitutional authority "to enter[] final judgment on a common law tort claim."²¹ Similarly, the Court likened the case to *Northern Pipeline* because the bankruptcy court purported to resolve and enter a final judgment "on a state common law claim."²² Elsewhere the Court stressed that the counterclaim was "one under state common law between two private parties. It does not 'depend[] on the will of congress;' Congress has nothing to do with it."²³ And the Court distinguished the cases of *Katchen* and *Langenkamp* on the ground that those decisions involved the estate's attempt to

¹⁷ 131 S. Ct. at 2611.

¹⁸ *Id.* at 2613.

¹⁹ *Id.* at 2614.

²⁰ *Id.* at 2615.

²¹ *Id.* at 2601.

²² *Id.* at 2611.

²³ *Id.* at 2614.

recover assets by means of claims “created by federal bankruptcy law.” It described Vickie’s claim, in contrast, as “a state tort action that exists without regard to any bankruptcy proceeding.”²⁴

Read in isolation, those passages might suggest that *Stern* casts doubt on bankruptcy courts’ authority to determine all state law matters, not just counterclaims against creditors.²⁵ Such a broad reading, however, is unworkable. The focus of the decision was on common law claims that “simply attempt[] to augment the bankruptcy estate—the very type of claim that we held in *Northern Pipeline* and *Granfinanciera* must be decided by an Article III court.”²⁶ The opinion does not question bankruptcy courts’ authority to determine state law claims that “stem[] from the bankruptcy itself or would necessarily be resolved in the claims allowance process.”²⁷ Thus the Court seemed to accept the authority of bankruptcy courts to hear and determine state law claims against the estate and state law counterclaims to proofs of claim if they provide a basis for disallowance of the creditors’ claims or there is complete factual overlap of the legal and factual bases for the claims and the counterclaims.²⁸

If *Stern* is limited to state law counterclaims that are not fully resolved in the claims allowance process, it may not do major damage to the current operation of the bankruptcy system. Section 157, enacted in response to *Northern Pipeline*, already treats as noncore most state law claims that are brought to augment the estate. *Stern* went further and held that Congress erred in allowing the same type of claim to be determined by the bankruptcy court just because it is asserted as a counterclaim against a creditor who files a claim against the estate. So long as actual consent to a bankruptcy court’s determination of noncore and *Stern*-type claims is still permitted—an issue that is discussed in the next Part—the impact of the decision might be relatively mild.

Although *Stern* is not applicable to all state law matters that must be resolved in a bankruptcy case, its rationale is also probably not *limited* to issues of state law. The logic of the *Stern* opinion likely extends to counterclaims that rest on non-bankruptcy federal law. Despite the Court’s repeated references to the distinction between state common law claims and ones created by federal statute, at bottom the opinion rests on the proposition that claims pursued simply to augment the estate must be determined by an Article III court. The Court viewed counterclaims against creditors who have filed claims against the estate the same as “related-to” claims asserted against third-parties who do not seek to recover from the estate, so long as the resolution of the creditors’ claims will not necessarily resolve the counterclaims.²⁹ If a counterclaim is in pursuit of a debtor’s prepetition claim—and thus it does not “stem[] from the

²⁴ *Id.* at 2618.

²⁵ *Cf. Calvo v. HSBC Bank USA, N.A.*, 130 Cal. Rptr.3d 815, 819 n.2 (Cal. Ct. App. 2011) (citing *Stern* for the proposition that a bankruptcy court’s interpretation of state law is not entitled to the same respect and deference as that of a district court).

²⁶ 131 S. Ct. at 2616.

²⁷ *Id.* at 2618.

²⁸ *See id.* at 2616-17 (distinguishing and explaining *Katchen* and *Langenkamp* as cases in which the preference claim against the creditor was a basis for disallowance of the creditor’s claim and thus was part of the claims allowance/disallowance process).

²⁹ *See id.* at 2617 (explaining the resolution of Pierce’s claim did not determine the outcome of Vickie’s counterclaim, even though some issues overlapped).

bankruptcy itself”—it should not matter for Article III purposes whether the claim arises under state or federal law. Section 157(b)(3) so declares with respect to non-core proceedings,³⁰ and one can argue that after *Stern* the same is true for counterclaims that are statutorily designated as core.

The *Stern* opinion can be read as going even further and including core proceedings other than counterclaims within its sweep. It should be recalled that the Court in *Granfinanciera* said that Congress may not assign the determination of matters not involving public rights “to a specialized non-Article III court lacking ‘the essential attributes of the judicial power.’”³¹ In ruling on the Seventh Amendment issue at the heart of that case, the Court concluded that a fraudulent transfer action under § 548 of the Code does not involve public rights. Thus, according to the reasoning in *Granfinanciera*, upon which *Stern* relies, a fraudulent transfer action may not be determined by a non-Article III bankruptcy court, whether or not a jury trial is demanded—at least if there is no valid consent and the claim is not asserted as a basis for disallowing the defendant’s proof of claim. Thus, similar to the holding in *Stern* that the authority conferred by § 157(b)(2)(C) is unconstitutional, the argument can be made that the classification of all fraudulent conveyance actions as core proceedings under § 157(b)(2)(H) violates Article III of the Constitution.³² Indeed, the Court in *Stern* stated that it saw “no reason to treat Vickie’s counterclaim any differently from the fraudulent conveyance action in *Granfinanciera*.”³³

A similar argument might be made regarding preference actions. The Court throughout its *Granfinanciera* opinion equated fraudulent conveyance actions with preference actions. For example, in concluding that a fraudulent conveyance action is a legal rather than an equitable proceeding, the Court relied on *Schoenthal v. Irving Trust Co.*, 287 U.S. 92 (1932), in which it held that a preference action against a creditor who did not file a claim against the estate had to proceed as an action at law rather than in equity. The *Granfinanciera* Court concluded that the preference action in *Schoenthal* was “indistinguishable . . . in all relevant respects” from the fraudulent conveyance suit before it.³⁴ Later in the opinion the Court again relied on *Schoenthal* to conclude that the fraudulent conveyance suit involved private, not public, rights. It reasoned that such actions more closely resemble state law contract claims “brought to augment the bankruptcy estate than they do creditors’ hierarchically ordered claims to a pro rate share of the bankruptcy res.”³⁵ If *Stern*’s acceptance of the type of analysis adopted by the majority in *Granfinanciera* means that fraudulent conveyance actions involve private rights that must be determined by an Article III court, then the same is likely true for preference actions, despite their designation in § 157(b)(2)(F) as core proceedings.

³⁰ 28 U.S.C. § 157(b)(3) (“A determination that a proceeding is not a core proceeding shall not be made solely on the basis that its resolution may be affected by State law.”).

³¹ 492 U.S. at 53.

³² Under this reading of *Stern*, it would still be permissible under Article III for a bankruptcy court to hear and determine a fraudulent conveyance counterclaim against a creditor if disallowance of the creditor’s claim was sought under § 502(d).

³³ 131 S. Ct. at 2618.

³⁴ 492 U.S. at 48.

³⁵ *Id.* at 56.

Read most broadly, *Stern* could arguably call into question the constitutional validity of much of the bankruptcy courts' authority to hear and determine core proceedings. The decision pointed out that the Court has never determined whether any part of bankruptcy involves public rights. Explaining that the *Granfinanciera* Court had expressly refrained from "suggest[ing] that the restructuring of debtor-creditor relations is in fact a public right," the Court chose to follow the same approach in *Stern*.³⁶ Thus, the constitutional validity of the heart of the bankruptcy courts' decision-making authority has not been resolved.

Adding to the possible concern about the eventual fate of core jurisdiction is the distinction *Stern* draws between courts and administrative agencies. In response to arguments that the Court in *Thomas* and *Schor* had broadened the concept of public rights and had found the public-versus-private-rights distinction not to be determinative, the Court in *Stern* noted that those cases involved determinations by administrative agencies. It contrasted them with "the entry of a final, binding judgment by a court with broad substantive jurisdiction, on a common law cause of action, when the action neither derives from nor depends upon any agency regulatory scheme."³⁷ If the Court believes that Congress is given less flexibility to use non-Article III judges in the federal judiciary than in administrative agencies, that could suggest that when it comes to deciding whether any aspect of bankruptcy comes within the public rights exception, the Court might apply a narrow definition of public rights and strictly adhere to the requirement that private rights be determined by Article III courts.

One member of the Court, Justice Scalia, argued in both *Stern* and *Granfinanciera* that public rights are limited to matters in which the federal government is a party. He would require an Article III judge for all judicial determinations that do not fall within "a firmly established historical practice to the contrary"—such as territorial and military courts and "true 'public rights'" cases.³⁸ Insofar as bankruptcy is concerned, Justice Scalia left open the possibility that historical practice might allow non-Article III judges to "process claims against the bankruptcy estate,"³⁹ but he hinted at no other aspects of bankruptcy that might qualify for determination by non-Article III judges. Should a majority of the Court ever accept that view, much of the bankruptcy courts' authority over core proceedings could be found to be unconstitutional.

C. Factors cautioning against a broad reading of *Stern*

There are several reasons to refrain from assuming that the Court will follow the reasoning of *Stern* to its logical conclusion or that it will eventually decide that the restructuring of debtor-creditor relations does not involve public rights. First, the Chief Justice's emphasis on the narrowness of the decision cannot be ignored. Of course, in one sense a court never decides anything other than the issue before it; everything else is *dicta* that may later be disavowed. So it is possible that the Court was just pointing out the narrowness of the precise issue it had been asked to decide in that case. But the *Stern* opinion is particularly notable for its insistence on the limited impact of the decision. The majority seemed to go out of its way to avoid the appearance of paving the way for a more sweeping invalidation of the bankruptcy courts' authority to enter

³⁶ See 131 S. Ct. at 2614 n.7.

³⁷ *Id.* at 2615.

³⁸ *Id.* at 2621 (Scalia, J., concurring).

³⁹ *Id.*

final judgments in bankruptcy proceedings.⁴⁰ The fact that the invalidation of this one aspect of the bankruptcy court's authority over core proceedings was rendered by a 5-4 decision even raises the possibility that the Chief Justice's assurance of the narrow scope of the decision was necessary to obtain a majority vote.

Second, the confused state of the Court's Article III jurisprudence provides a basis for the Court to depart from the reasoning of *Stern* in the next bankruptcy case. The Court's articulation of the principles governing the use of non-Article III decisionmakers has not proceeded in a straight-line fashion. Among the issues on which there is confusion in the recent precedents are the following important questions:

- what is the meaning of "public rights;"⁴¹
- must all private rights be determined by an Article III judge;⁴²
- what is the significance for the Article III analysis of the state or federal nature of a claim;⁴³ and
- does the analysis differ for the use of non-Article III judges by administrative agencies and by the federal judiciary?⁴⁴

A future Court can pick and choose among the precedents to reach an outcome other than the one suggested by *Stern*. Furthermore, to the extent that the Article III analysis of fraudulent conveyances and preferences rests on the *Granfinanciera* opinion, that decision can later be distinguished as one interpreting the Seventh Amendment, not Article III. In *Granfinanciera* the Court was particular about confining its public rights analysis to the Seventh Amendment question that was before the Court.⁴⁵ It proclaimed that "[t]he sole issue before [the Court was] whether the Seventh Amendment confer[red] on petitioners a right to a jury trial." The Court

⁴⁰ See, e.g., *id.* at 2620 ("We conclude today that Congress, in one isolated respect, exceeded that limitation [imposed by Article III] in the Bankruptcy Act of 1984.").

⁴¹ *Id.* at 2611 ("[O]ur discussion of the public rights exception since [*Northern Pipeline*] has not been entirely consistent, and the exception has been the subject of some debate . . ."). Compare *Northern Pipeline*, 458 U.S. at 2870 (plurality opinion) ("[A] matter of public rights must at a minimum arise 'between the government and others'"); and *Stern*, 131 S. Ct. at 2620 (Scalia, J., concurring) (same); with *Granfinanciera*, 492 U.S. at 54 ("[T]he Federal Government need not be a party for a case to revolve around 'public rights'").

⁴² Compare *Granfinanciera*, 492 U.S. at 54-55 ("If a statutory right is not closely intertwined with a federal regulatory program Congress has power to enact, and if that right neither belongs to nor exists against the Federal Government, then it must be adjudicated by an Article III court."); with *Schor*, 478 U.S. at 853 ("[T]his Court has rejected any attempt to make determinative for Article III purposes the distinction between public rights and private rights . . .").

⁴³ Compare *Schor*, 478 U.S. at 853 ("[T]here is no reason inherent in separation of powers principles to accord the state law character of a claim talismanic power in Article III inquires."); with *Stern*, 131 S. Ct. at 2600-01 (Article III was violated because the bankruptcy court "exercised the judicial power of the United States by entering final judgment on a common law tort claim").

⁴⁴ Compare *Stern*, 131 S. Ct. at 2615 (noting that a case involving the entry of a final judgment by a court on a common law cause of action is "markedly distinct from agency cases discussing the public rights exception"); with *Schor*, 478 U.S. at 847-856 (agency case relying repeatedly on *Northern Pipeline*).

⁴⁵ See *Granfinanciera*, 492 U.S. at 50-53.

declined to decide whether such an adjudication would “comport[] with Article III when non-Article III judges preside[d] over the actions.”⁴⁶

In a future case in which Court is asked to declare that another exercise of authority by a bankruptcy court violates Article III, the Court may be more concerned about the practical impact of its decision on the federal judiciary. Further limitations on the authority of bankruptcy judges—and perhaps magistrate judges as well⁴⁷—will have a major impact on the workload of federal district judges, particularly if the Article III problem cannot be overcome by the parties’ consent. Chief Justice Roberts, acting not just as interpreter of the Constitution but also as head of the federal judiciary, may be reluctant to render a decision that will overburden the district courts and underutilize the existing numbers of bankruptcy and magistrate judges. Although he wrote in *Stern* 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,”⁴⁸ he did so in the context of a ruling that he considered “not [to] change all that much.”⁴⁹ If faced with a decision that is likely to “create significant delays and impose additional costs on the bankruptcy process” and on federal court litigation generally,⁵⁰ the Chief Justice and some other members of the *Stern* majority may be more likely to follow the Court’s admonition in *Schor* to avoid the use of “formalistic and unbending rules . . . [that] might unduly constrict Congress’ ability to take needed and innovative action pursuant to its Article I powers.”⁵¹

As for the possible invalidation of core jurisdiction generally, it is true that the Court in *Stern* declined to declare the restructuring of the debtor-creditor relationship a public right, but its holding hinged on this assumption. The Court repeatedly stressed the relational distance between Vickie’s private right counterclaim and the creditor claim allowance process.⁵² This suggests that the claims allowance process, at a minimum, is closely related to a public right determinable by bankruptcy courts.⁵³

⁴⁶ *Id.* at 50.

⁴⁷ See *Technical Automation Servs. Corp. v. Liberty Surplus Ins. Corp.*, No. 10-20640 (5th Cir. Sept. 9, 2011) (ordering briefing on applicability of *Stern* to magistrate judges).

⁴⁸ 131 S. Ct. at 2619 (quoting *INS v. Chadha*, 462 U.S. 919, 944 (1983)).

⁴⁹ *Id.* at 2620.

⁵⁰ *Id.* at 2619.

⁵¹ 478 U.S. at 851.

⁵² See 131 S. Ct. at 2611 (“Here Vickie’s claim is a state law action independent of the federal bankruptcy law and not necessarily resolvable by a ruling on the creditor’s proof of claim in bankruptcy.”); *id.* at 2617 (“[T]here was never any reason to believe that the process of adjudicating Pierce’s proof of claim would necessarily resolve Vickie’s counterclaim”); *id.* at 2620 (bankruptcy court lacks “the constitutional authority to enter a final judgment on a state law counterclaim that is not resolved in the process of ruling on a creditor’s proof of claim.”).

⁵³ The Court rejected Pierce’s argument that under § 157(b)(5) his defamation claim against the bankruptcy estate was a personal injury tort claim that the district court had to try. It concluded that the statutory provision was not a jurisdictional restriction and thus could be and in fact was forfeited by Pierce. *Id.* at 2606. Had the Court questioned the bankruptcy court’s authority under Article III to resolve Pierce’s claim, it likely would have discussed whether Pierce’s consent to the bankruptcy court’s determination of his claim was sufficient to overcome any Article III violation. See discussion in Part III *infra*.

III. The Validity of Consent after *Stern*

A. Introduction

The Supreme Court has 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.⁵⁴ The latter safeguard is achieved by mandating lifetime appointments and salary protections for Article III judges.

Similar to other individual constitutional rights, the protection for litigants in Article III may be waived.⁵⁵ By contrast, the institutional interest cannot be dispensed with as freely.⁵⁶ Neither an individual nor Congress may easily divest the judiciary of its entitlement to exercise “the judicial Power of the United States.” Congress, as a coordinate branch of government, is generally barred from “withdraw[ing] from judicial cognizance any matter which, from its nature, is the subject of a suit at the common law, or in equity, or admiralty.”⁵⁷ Similarly, an individual may not, by waiver or consent, automatically siphon jurisdiction from Article III courts into non-Article III tribunals without impinging the judiciary’s independence and structural integrity.⁵⁸ Thus, even with party consent, judicial determination of claims by non-Article III courts must have separate and substantial constitutional support to justify the institutional strain.

One of the questions lingering after *Stern* is whether the parties’ consent permits a bankruptcy court to hear, determine, and enter a final judgment on a *Stern*-type claim—that is, one that is statutorily designated as “core” but for which an Article III adjudication is otherwise required. The answer to that question will also determine the constitutionality of § 157(c)(2), which authorizes bankruptcy courts to hear, determine, and enter a final judgment in a related-to proceeding with the consent of all of the parties to the proceeding. The discussion in this Part proceeds on the assumption that the parties expressly consent to the entry of a final judgment by the bankruptcy court.⁵⁹

⁵⁴ *Stern*, 131 S. Ct. at 2609; *Schor*, 478 U.S. at 848.

⁵⁵ *Schor*, 478 U.S. at 848-49 (citing *Boykin v. Alabama*, 395 U.S. 238 (1969); *Duncan v. Louisiana*, 391 U.S. 145 (1968)).

⁵⁶ *See id.* at 850-851.

⁵⁷ *See Stern*, 131 S. Ct. at 2609.

⁵⁸ *See Schor*, 478 U.S. at 850-51 (“the parties cannot by consent cure the constitutional difficulty for the same reason that the parties by consent cannot confer on federal courts subject-matter jurisdiction beyond the limitations imposed by Article III”).

⁵⁹ *See* F.R. Bankr. P. 7008(a) (“In an adversary proceeding before a bankruptcy judge, the complaint, counterclaim, cross-claim, or third-party complaint shall contain a statement that the proceeding is core or non-core and, if non-core, that the pleader does or does not consent to entry of final orders or judgment by the bankruptcy judge.”); F.R. Bankr. 7012(b) (“A responsive pleading shall admit or deny an allegation that the proceeding is core or non-core. If the response is that the proceeding is non-core, it shall include a statement that the party does or does not consent to entry of final orders or judgment by the bankruptcy judge. In non-core proceedings final orders and judgments shall not be entered on the bankruptcy judge’s order except with the express consent of the parties.”)

B. Consent to non-Article III adjudication

The Court in *Stern* concluded that Pierce consented to the determination of his own claim by the bankruptcy court. However, the Court found that “Pierce did not truly consent to resolution of Vickie’s [counter]claim in the bankruptcy court proceedings.”⁶⁰ As a result, consent was inapposite to the Court’s determination of whether Vickie’s counterclaim complied with Article III. The *Stern* dissent and at least one bankruptcy court since *Stern* suggested that the addition of the parties’ consent could preserve a bankruptcy court’s power to enter a final judgment on a private right claim.⁶¹ This premise depends in large part on the interpretation of *Schor*.

The Court in *Schor* recognized five factors, including consent, that should be considered in determining whether the authorization of adjudication by a non-Article III judge “impermissibly threatens the institutional integrity of the Judicial Branch.” The Court said that none of these factors “has been deemed determinative.”⁶² Thus, consent to private right judgments in the bankruptcy court is not a constitutional cure in and of itself.

The *Stern* majority and dissent interpreted those factors differently. The *Stern* dissent, drawing closely from the language of *Schor*, named the factors to be: “(1) the nature of the claim to be adjudicated [e.g. public or private right]; (2) the nature of the non-Article III tribunal; (3) the extent to which Article III courts exercise control over the proceeding; (4) the presence or absence of the parties’ consent; and (5) the nature and importance of the legislative purpose served by the grant of adjudicatory authority to a tribunal with judges who lack Article III’s tenure and compensation protections.”⁶³

By contrast, the *Stern* majority found that the *Schor* Court accepted non-Article III resolution of a state law counterclaim only after finding: (1) “the public right claim and the private right counterclaim concerned a single dispute”; (2) the non-Article III tribunal’s authority encompassed only “a narrow class of common law claims in a particularized area of law”; (3) “the area of law in question was governed by a specific and limited federal regulatory scheme as to which the tribunal had obvious expertise”; (4) the parties consented to resolve the matter before the tribunal; and (5) orders of the tribunal were “enforceable only by order of the district court.”⁶⁴ While the majority’s reading of *Schor* is narrower than that of the dissent (and arguably more limited than the *Schor* decision itself), this interpretation is controlling, and the Court’s application of *Schor* to the facts of *Stern* is authoritative for now.

The majority found that Vickie’s counterclaim failed to satisfy the *Schor* factors in all respects. First, Pierce’s claim for defamation and Vickie’s counterclaim for tortious interference

⁶⁰ *Stern*, 131 S. Ct. at 2614.

⁶¹ See *id.* at 2628 (Breyer, J., dissenting) (“[N]on-Article III adjudication may be appropriate when both parties consent”); *In re Teleservices Grp., Inc.*, 2011 WL 3610050, at *14 (Bankr. W.D. Mich. 2011) (stating the belief that consent would allow the court to render final judgment on a private right claim after *Stern*).

⁶² *Schor*, 478 U.S. at 851.

⁶³ *Stern*, 131 S. Ct. at 2625-26 (Breyer, J., dissenting).

⁶⁴ *Id.* at 2613 (internal citations and quotation marks omitted).

with gift did not form “a single dispute.” While there may have been “some overlap” between the claims, the Court acknowledged that the two actions involved distinct factual and legal determinations. Second, the Court found that bankruptcy courts’ authority to decide counterclaims was not limited to “a narrow class of common law claims in a particularized area of law.” Instead, the courts’ statutory authority encompassed any sort of claim, common law or otherwise, that a trustee or debtor could bring against a suing creditor. Third, the majority recognized that common law actions were in no way “governed by a specific and limited federal regulatory scheme,” and further, bankruptcy courts did not have any “obvious expertise” in the area involved. The Court said that the “experts” of common law in the federal system are Article III judges, not bankruptcy adjudicators. The Court also noted Pierce’s lack of consent to the bankruptcy court’s determination of Vickie’s counterclaim. Finally, the majority made clear that the bankruptcy court’s resolution of the counterclaim was not “enforceable only by order of the district court”; rather, the decision represented “the entry of a final, binding judgment by a court with broad substantive jurisdiction”—an essential attribute of Article III judicial power. Thus, none of the *Schor* factors, as interpreted by the majority, was satisfied in *Stern*.⁶⁵ As a result, even if Pierce had consented to resolution of Vickie’s counterclaim, that assent would have represented only one of five (absent) factors, and, in particular, a factor that the *Schor* Court made clear would not cure the constitutional issue independently.

On the other hand, the Court’s treatment of Pierce’s § 157(b)(5) argument might provide some indication of the Court’s willingness to accept party consent as a basis for a bankruptcy court’s entry of a final judgment in a non-core proceeding—or one rendered the equivalent of non-core by the *Stern* decision. The Court rejected Pierce’s 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 Pierce had consented to the bankruptcy court’s resolution of his defamation claim and had thereby forfeited any objection under that provision. In reaching this conclusion, the Court referred with seeming approval to § 157(c)(2), under which it said “parties may consent to the entry of final judgment by [a] bankruptcy judge in [a] non-core case.” It stated that “Pierce does not explain why [§ 157(b)(5)’s] statutory limitation may not be similarly waived.”⁶⁶ If the Court harbors any doubts about the constitutional efficacy of waiver under § 157(c)(2), its response to Pierce’s argument did not reveal it.

C. Sections 157(c)(2) and 636(c)(1): important or tenuous analogues?

The constitutionality of the analogous system of the exercise of consent jurisdiction by federal magistrate judges as upheld by the appellate courts possibly provides some insight into a path that the Court might take if a challenge is made to § 157(c)(2) or consent with respect to a *Stern*-type claim. A comparison can be drawn between § 157(c)(2) and the consent provision for magistrate judges as a means of supporting the constitutional legitimacy of the former. Indeed, § 157(c)(2) is very similar to 28 U.S.C. § 636(c)(1) (The Federal Magistrate Act). For bankruptcy courts, § 157(c)(2) provides that, “[n]otwithstanding the provisions of paragraph (1) of this subsection, the district court, with the consent of all the parties to the proceeding, may refer a proceeding related to a case under title 11 to a bankruptcy judge to hear and determine

⁶⁵ See *id.* at 2613-17.

⁶⁶ *Id.* at 2607.

and to enter appropriate orders and judgments, subject to review under section 158 of this title.” For magistrate judges, § 636(c)(1) provides, in part, that a federal magistrate may “[u]pon the consent of the parties...conduct any or all proceedings in a jury or nonjury civil matter and order the entry of judgment in the case, when specially designated to exercise such jurisdiction by the district court or courts he serves.”

Nearly every court of appeals in the nation has held § 636(c)(1) to be constitutional. The sole outlier declined to take up the issue directly, but commented favorably on the decisions of its sister circuits.⁶⁷ As the Supreme Court has avoided direct consideration of § 636(c)(1), these appellate decisions carry increased precedential weight. *Cf. Gomez v. United States*, 490 U.S. 858 (1989); *Peretz v. United States*, 501 U.S. 923 (1991) (refraining from deciding the constitutionality of § 636(c)(1)).

Whether this impressive array of decisions will go unchallenged in light of the *Stern* decision is unlikely. As recently as September 9, 2011, the Fifth Circuit ordered the parties in a pending case to submit briefs addressing whether the *Stern* decision “applies to magistrate judges, which, like bankruptcy judges, are not Article III judges, and whether, under *Stern*, a magistrate judge can enter a final judgment in a case tried to a magistrate judge by consent under 28 U.S.C. § 636(c) where jurisdiction is based on diversity of citizenship and state law provides the rule of decision.” *Technical Automation Services Corp. v. Liberty Surplus Insurance Corporation*, No. 10-20640.

Among the circuit court rulings, the common justification for the constitutionality of § 636(c)(1) is the presence of consent from the parties *and* the degree of control retained by Article III judges over non-Article III magistrates. The seminal opinion of the series belongs to the Ninth Circuit in its decision, *Pacemaker Diagnostic Clinic, Inc. v. Instromedix, Inc.*, authored by then-Judge, now Justice Kennedy.⁶⁸ In *Pacemaker*, the court acknowledged that § 636(c) authorized the issuance of final judgments over civil matters by non-Article III officials. The court also assumed that no public rights exception applied under the circumstances. The question for the court was whether the individual and institutional rights implicated by Article III were compromised by § 636(c). After recognizing that the personal protections of Article III could be waived by consent, the court addressed the institutional interest implicated by separation of powers. As interpreted by the court, the standard for determining whether one branch of government has encroached upon the independence of another is whether the action in question “prevents or substantially impairs performance by the branch of its essential role in the constitutional system.” In terms of statutory grants affecting Article III power, the court reasoned

⁶⁷ See *Goldstein v. Kelleher*, 728 F.2d 32 (1st Cir. 1984), *cert. denied*, 469 U.S. 852 (1984); *Collins v. Foreman*, 729 F.2d 108 (2d Cir. 1984), *cert. denied*, 469 U.S. 870 (1984); *Wharton-Thomas v. United States*, 721 F.2d 922 (3d Cir. 1983); *Gairola v. Virginia Dep’t of Gen. Servs.*, 753 F.2d 1281 (4th Cir. 1985); *Puryear v. Ede’s Ltd.*, 731 F.2d 1153 (5th Cir. 1984); *Bell & Beckwith v. United States*, 766 F.2d 910 (6th Cir. 1985); *Geras v. Lafayette Display Fixtures, Inc.*, 742 F.2d 1037 (7th Cir. 1984); *Lehman Bros. Kuhn Loeb, Inc. v. Clark Oil & Refining Corp.*, 739 F.2d 1313 (8th Cir. 1984) (en banc), *cert. denied*, 469 U.S. 1158 (1985); *Pacemaker Diagnostic Clinic, Inc. v. Instromedix, Inc.*, 725 F.2d 537 (9th Cir. 1984) (en banc) (Kennedy, J.), *cert. denied*, 469 U.S. 824 (1984); *Sinclair v. Wainwright*, 814 F.2d 1516 (11th Cir. 1987); *Fields v. Washington Metro. Area Transit Auth.*, 743 F.2d 890 (D.C. Cir. 1984); *D.L. Auld Co. v. Chroma Graphics Corp.*, 753 F.2d 1029 (Fed. Cir. 1985), *cert. denied*, 474 U.S. 825 (1985); *cf. United States v. Dobby*, 751 F.2d 1140 (10th Cir. 1985) (upholding of the constitutionality of § 636(a)(3) rather than § 636(c)(1) but commenting favorably on *Collins* and *Pacemaker*), *cert. denied*, 474 U.S. 818 (1985).

⁶⁸ See 725 F.2d at 537; see also *United States v. Johnston*, 258 F.3d 361, 368 (5th Cir. 2001) (attesting to the preeminence of the *Pacemaker* analysis among the series of cases).

that if the “constitutional role of the judiciary is to be maintained, there must be both the appearance and the reality of control by Article III judges over the interpretation, declaration, and application of federal law.”⁶⁹

For § 636(c)(1), the *Pacemaker* court found that the degree of judicial control was constitutionally sufficient because the statute vested “the Article III judiciary with extensive administrative control over the management, composition, and operation of the magistrate system.” To support this conclusion, the court noted four manifestations of Article III control: (1) the power of referral and withdrawal; (2) the exercise of appointment and removal; (3) the determination of the number of judicial offices; and (4) the availability of appellate review.⁷⁰ In terms of referral, the court explained that § 636(c) allowed parties to consent to magistrate jurisdiction only when an Article III judge of the district court “specially designated” that the magistrate be able to hear the case. The district court also retained the power to withdraw *sua sponte* its jurisdictional grant from the magistrate at any time for “good cause.” Concerning appointment and removal, the *Pacemaker* court acknowledged that Article III judges controlled the selection and retention of their non-Article III counterparts; specifically, the district court was vested with the authority to appoint magistrates to office and remove them for performance and fitness violations. The court also noted that the Judicial Conference of the United States (composed of Article III judges) was empowered to determine the number of magistrate judgeships for each federal district, warding against the creation of so many magistrate positions by a political branch that substantive judicial control was lost. Finally, the court noted that Article III review of magistrates’ decisions was available, of right, to litigants at the district court level. For the *Pacemaker* court, these elements of control adequately insulated the judiciary from the intrusions of other branches such that the separation of powers mandated by Article III was satisfied.

So how does the bankruptcy consent system fare under a similar analysis? There are many similarities between § 636(c)(1) and § 157(c)(2). Most, but not all, of the control mechanisms associated with the magistrate system are present with the bankruptcy scheme. In terms of delegation by Article III judges, consent to the jurisdiction of a bankruptcy court plainly requires the referral of the district court. *See* 28 U.S.C. § 157(c)(2) (“the district court... *may refer...*”). The power to cancel the referral also lies with the district court, which is able to act upon its own motion for good cause. *See* 28 U.S.C. § 157(d).

With regard to the appointment and removal of bankruptcy judges, the authority remains with the Article III judiciary; the only difference between bankruptcy and magistrate judges is that the court of appeals, rather than the district court bench, appoints bankruptcy judges, and the circuit judicial council (made up of circuit and district court judges), rather than the district court bench, may remove bankruptcy judges from office during their terms. *Compare* 28 U.S.C. § 152(a)(1) & (e), *with* 28 U.S.C. § 631(a) & (i). Additionally, the judgments of bankruptcy courts are directly appealable to an Article III court in the same fashion as magistrate judgments, although in circuits with BAPs, a party has to make an election to retain district court review. *Compare* 28 U.S.C. § 158(a) & (c)(1), *with* 28 U.S.C. § 636(c)(3).

⁶⁹ 725 F.2d. at 544.

⁷⁰ *See id.* at 540, 544-46.

A variance exists with the final element of Article III control: with magistrate judges, the Judicial Conference of the United States makes the final determination of the number of magistrate positions; with the bankruptcy court, the Judicial Conference makes recommendations to Congress, which then sets the number of judgeships. *Compare* 28 U.S.C. § 152(b)(2) & (3), *with* 28 U.S.C. § 631(a).

Excluding this last variation, Article III control of the bankruptcy system is nearly identical to that of the magistrate system.⁷¹ As a result, a case can be made that § 157(c)(2) passes constitutional muster if the same analysis utilized in upholding the Federal Magistrate Act is applied. Indeed, the analysis in *Pacemaker* has remained virtually unchallenged for over two decades.⁷² The question, then, is the extent to which the *Pacemaker* framework is compatible with the rationales of *Stern* and *Schor*, and, if incompatible, how willing the Supreme Court will be to upset the settled jurisprudence of its subordinate courts.

D. Section 157(c)(2): the prognosis

In *Stern* the Supreme Court issued a narrow interpretation of the *Schor* factors and described them as being absent from the case. The *Stern* dissent interpreted *Schor* differently and found that many of the factors were actually satisfied. While *Pacemaker* was never mentioned explicitly in either opinion, its “Article III control analysis” is present in both opinions and in the *Schor* opinion as well; however, treatment of this analysis varies considerably.⁷³ *Schor* did not adopt the control analysis by name, but it did consider *the extent to which judicial power is reserved to Article III courts* as a factor.⁷⁴ This difference in phraseology did not deter the *Stern* dissent from interpreting the above *Schor* factor as “the extent to which Article III courts *exercise control* over the proceeding.”⁷⁵ The *Stern* dissent explained that elements of Article III control over bankruptcy courts bolstered the constitutional legitimacy of bankruptcy judgments. Then, in much the same fashion as *Pacemaker*, the dissent cited the control elements as including the power of Article III judges to appoint and remove bankruptcy judges, the district court’s referral system (including the power to withdraw a case on the court’s motion), and the right of litigants to appeal bankruptcy determinations to the district court.

If the *Stern* Court’s “isolated” holding is taken at face value, then it is clear that the Court is addressing Congress’s action in taking away the Article III courts’ power to adjudicate a limited set of claims. To hold § 157(c)(2) unconstitutional, on the other hand, would go far beyond the holding in *Stern* and reduce the authority and efficiency of bankruptcy judges substantially. It would also call into question the constitutionality of the magistrate consent system by analogy. Given the similarities between §§ 636(c)(1) and 157(c)(2), the Court would

⁷¹ The similarities are particularly interesting given that circuit courts of the *Pacemaker* era drew contrast between the magistrate system and the system of the Bankruptcy Act of 1978 to lend constitutional support to the former. *See, e.g., Wharton-Thomas*, 721 F.2d at 926-27. The 1984 restructuring of the bankruptcy courts certainly echoed the configuration of the magistrate system. *Compare* 28 U.S.C.A. § 636(b), *with* 28 U.S.C.A. § 157(c).

⁷² *See Safety Harbor Resort and Spa*, No. 8:10-bk-25886-MGW, 2011 WL 3841599, at *12 (Bankr. M.D. Fla. Aug. 30, 2011) (commenting that no court has addressed the constitutionality of § 157(c)(2), but the statute would likely be constitutional in light of courts’ favorable treatment of the analogous magistrate statute).

⁷³ *Cf.* 131 S. Ct. at 2614-19, 2625-29; *Schor*, 478 U.S. at 851-59.

⁷⁴ *Compare Pacemaker*, 725 F.2d at 539-46, *with Schor*, 478 U.S. at 850-851.

⁷⁵ *See Stern*, 131 S. Ct. at 2626 (Breyer, J., dissenting) (emphasis added).

be hard pressed to distinguish the latter if it seeks to preserve the former. As mentioned, the only substantive difference between the two systems is whether the Judicial Conference of the United States or Congress decides the number of non-Article III judgeships associated with the courts; otherwise, the remaining suite of Article III controls are present for both schemes.

To the extent that external judicial factors affect the disposition of the Court, it should be apparent that striking down § 157(c)(2) will have an adverse effect on judicial economy. An invalid § 157(c)(2) will curtail the authority of bankruptcy judges and, by analogy, undermine the authority of magistrates to enter final judgments (whether litigants were to later challenge the constitutionality of the judgments or whether magistrates were to preemptively refer matters back to the district court for final determination to avoid the issue). This would decrease the number of cases susceptible to non-Article III disposition and place considerable strain on the district court judges who would be required to assume jurisdiction over cases previously handled by bankruptcy and magistrate courts. Even so, as the courts have said, both in upholding or rejecting congressional action that sends traditional Article III powers to other tribunals, “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.”⁷⁶

IV. Procedural Options for *Stern*-type Claims

This Part addresses procedural options available to bankruptcy courts and parties confronted with a claim similar to the state-law counterclaim at issue in *Stern* (“*Stern*-type claim”). It proceeds on two assumptions:

1. A bankruptcy court has before it a *Stern*-type claim, *i.e.*, the claim is defined by 28 U.S.C. § 157(b)(2) as “core,” but it is unconstitutional for the bankruptcy court to enter final judgment on the claim without the parties’ consent.⁷⁷
2. At least one party does not consent to the bankruptcy court hearing and determining the claim by entering final judgment pursuant to § 157(c)(2) (or, as is discussed in Part III, consent is deemed ineffective to authorize the bankruptcy court to enter final judgment).

The procedures available to bankruptcy courts and parties confronted with *Stern*-type claims depend on the consideration of three issues: (1) subject matter jurisdiction, (2) consent and forfeiture of statutory rights, and (3) the existence (or non-existence) of a “gap” in § 157, or, stated otherwise, the existence of a third type of proceeding that is statutorily “core” but constitutionally must be treated “non-core.” As a preliminary but necessary matter, this Part first addresses these fundamental issues.

First, *Stern* clarified bankruptcy courts’ constitutional power, not their subject matter jurisdiction. *Stern* did not alter any federal court’s subject matter jurisdiction to hear any case or claim. As relevant here, subject matter jurisdiction lies in the district court for all claims,

⁷⁶ *Bowsher v Synar*, 478 U.S. 714, 736 (1986).

⁷⁷ “Final judgment” refers to a judgment that is entered by the bankruptcy court clerk, requires no further action to have legal effect, and is appealable only under normal appellate review standards.

including *Stern*-type claims.⁷⁸ Section 151 grants bankruptcy courts power to “exercise” certain “authority” conferred upon district courts by title 28, but bankruptcy courts are nowhere granted their own independent subject matter jurisdiction.⁷⁹ *Stern* discussed this critical distinction at length,⁸⁰ and expressly clarified that § 157 is not jurisdictional.⁸¹ *Stern* addressed two sides of the same constitutional issue: (1) Congress’s constitutional authority to vest certain power to enter final judgments in bankruptcy courts, and (2) a party’s constitutional right to have a final judgment entered by a state or federal court other than a non-Article III bankruptcy court.⁸²

This distinction is critical because it highlights the implications of consent and forfeiture, which survive *Stern*. Parties and courts cannot create, consent to, forfeit objections to, or waive subject matter jurisdiction, but parties can waive other statutory and individual constitutional rights by consent or forfeiture.⁸³ Indeed, the *Stern* Court held that Pierce both consented to and forfeited his objection under § 157(b)(5) to the bankruptcy court’s authority to enter final judgment on his state-law defamation claim.⁸⁴ But Pierce objected from the outset to the bankruptcy court’s authority to enter final judgment on Vickie’s state-law counterclaim.⁸⁵ Pierce thus preserved his right to assert on appeal the objection the *Stern* Court affirmed regarding the bankruptcy court’s constitutional power to enter final judgment on Vickie’s counterclaim.⁸⁶

Stern necessarily confirms that a party that consents to, or does not object to, a bankruptcy court’s exercise of § 157 powers will forfeit at least the objection that the court exceeded the statutory grant of authority in § 157. This is unexceptional because subject matter jurisdiction does not rest in the bankruptcy court and is not created by § 157. It rests in the district court and is created by § 1334. *Stern* forecloses any argument that *Stern*-type claims raise issues of bankruptcy courts’ subject matter jurisdiction.⁸⁷

⁷⁸ See 28 U.S.C. § 1334(a)-(b).

⁷⁹ Bankruptcy courts do not have their own independent subject matter jurisdiction, because they are “units” of the district court. See 28 U.S.C. § 151. The *Stern* majority did not say that bankruptcy courts are *never* “adjuncts” of the district court. Rather, the *Stern* majority made clear that, when exercising the authority conferred by §§ 151 and 157 to enter final judgments subject only to normal standards of appellate review, bankruptcy courts are not mere adjuncts of the district court. See *Stern*, 131 S. Ct. at 2611 (“The judicial powers the courts exercise *in cases such as this* remain the same, and a court exercising such broad powers is no mere adjunct of anyone.”) (emphasis added); *id.* at 2612 n.6; *id.* at 2619 (discussing a bankruptcy court’s final-judgment power before observing: “*Given that authority*, a bankruptcy court can no more be deemed a mere ‘adjunct’ of the district court than a district court can be deemed such an ‘adjunct’ of the court of appeals.”) (emphasis added).

⁸⁰ See *Stern*, 131 S. Ct. at 2606–08.

⁸¹ *Id.* at 2607 (“Section 157 allocates the authority to enter final judgment between the bankruptcy court and the district court. That allocation does not implicate questions of subject matter jurisdiction.”). Note that this portion of *Stern* received unanimous agreement of the Court’s members. See *id.* at 2622 (Breyer, J., dissenting) (agreeing with majority’s statutory analysis and disagreeing only with majority’s constitutional analysis).

⁸² *Id.* at 2607 (majority opinion).

⁸³ See *id.* at 2606, 2608.

⁸⁴ See *id.* at 2608 (Pierce “consented to” the bankruptcy court’s “resolution of his defamation claim (and forfeited any argument to the contrary)”).

⁸⁵ See *id.* at 2601–02.

⁸⁶ *Id.*

⁸⁷ The bankruptcy court in *Samson v. Blixseth* (*In re Blixseth*), No. 10–00088, 2011 WL 3274042, at *10 (Bankr. D. Mont. Aug. 1, 2011), proceeded from the flawed premise that *Stern* addressed “the constitutionality of th[e] Court’s subject matter jurisdiction.” As discussed below, this flawed premise may have prevented the *Blixseth* court from considering the permissibility of parties consenting to (or forfeiting the right to later object to) its entry of proposed findings of fact and

Finally, *Stern* provides strong authority for the proposition that it should not be read as creating any “gap” in, i.e., a third kind of “proceeding” not addressed by, § 157.⁸⁸ *Stern*’s unanimous statutory interpretation of § 157 clearly concluded that there remain only two kinds of proceedings: “core” proceedings that arise “in” a bankruptcy case or “under” title 11, and “non-core” proceedings that are “related to” a bankruptcy case.⁸⁹ The majority indicates its intention merely to “remov[e]” *Stern*-type claims “from core bankruptcy jurisdiction” and redistribute the authority to enter final judgment on such claims to other courts, whether state courts or Article III federal courts:

Pierce has not argued that the bankruptcy courts “are barred from ‘hearing’ all counterclaims” or proposing findings of fact and conclusions of law on those matters, but rather that it must be the district court that “finally decide[s]” them. Brief for Respondent 61. We do not think the removal of counterclaims such as Vickie’s from core bankruptcy jurisdiction meaningfully changes the division of labor in the current statute⁹⁰

The majority thus at least implicitly (and arguably expressly) endorsed Pierce’s argument that *Stern*-type claims could be treated as “non-core” despite their statutory classification as “core”—that is, the bankruptcy court could hear the claim and propose findings of fact and conclusions of law so long as the district court entered final judgment.⁹¹ This is not surprising because, once a district court enters final judgment on a *Stern*-type claim, (1) any objection based upon subject matter jurisdiction will be meritless (or at least cured), and (2) any objection to statutory defects arising from the bankruptcy court hearing and submitting proposed findings of fact and conclusions of law on a “core” proceeding will have been forfeited. The lesson of *Stern* is that a party wishing to object to the bankruptcy court hearing a claim and submitting proposed findings of fact and conclusions of law pursuant to § 157(c)(1) must object (or take other action described below) before the bankruptcy court hears the claim.

If a timely objection is raised, bankruptcy courts confronted with *Stern*-type claims have three procedural options:

1. Proceed pursuant to § 157(c)(1) to hear the claim and submit proposed findings of fact and conclusions of law to the district court.
2. Order the parties to file motions to withdraw the reference so the claim can be heard and determined in the district court.

conclusions of law on the *Stern*-type claim before it.

⁸⁸ See *Stern*, 131 S. Ct. at 2604–05 (holding § 157(b)(1) “is ambiguous” and thus required an authoritative interpretation).

⁸⁹ See *id.* at 2605 (“Two options. The statute does not suggest that any other distinctions need be made.”).

⁹⁰ *Id.* at 2620.

⁹¹ Indeed, the *Stern* majority “affirmed” the judgment of the court of appeals, which did not disapprove (on either statutory or constitutional grounds) the district court’s entry of final judgment on Vickie’s counterclaim after reviewing *de novo* what the district court treated as the bankruptcy court’s proposed findings of fact and conclusions of law. See *Stern*, 131 S. Ct. at 2620; *id.* at 2602–03 (noting that the court of appeals held that the district court’s final judgment should have afforded preclusive effect to the Texas court’s determination of relevant factual and legal issues on Vickie’s counterclaim). Neither the Supreme Court nor the court of appeals held that it was reversible error for the district court to treat the bankruptcy court’s judgment as proposed findings of fact and conclusions of law, which it reviewed *de novo*.

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3. Abstain from hearing and determining the claim in favor of a state (or other appropriate) court hearing the claim.

District courts may enter revised standing orders directing bankruptcy courts in the district to follow any of these options. The following discussion proceeds on the assumption that there is no such standing order.

1. Proceed pursuant to § 157(c)(1)

The bankruptcy court may proceed pursuant to § 157(c)(1) to hear the claim and submit proposed findings of fact and conclusions of law to the district court.⁹² As a matter of best practices, it may be prudent for a bankruptcy court to require the parties to a *Stern*-type claim to agree (*i.e.*, forfeit any objections) to following this procedure.⁹³ If any party does not agree, the court may avoid prolonged litigation over the court's statutory power to hear but not determine a *Stern*-type claim by simply proceeding to the second option.

2. Withdrawal of the reference

The second option is for the bankruptcy court to order the parties to file motions in the district court for withdrawal of the reference so that the proceeding may be heard and determined in the district court.⁹⁴ This is the procedure the court required in *Samson v. Blixseth (In re Blixseth)*.⁹⁵ The *Blixseth* court determined that “a bankruptcy court has no statutory authority to render findings of fact and conclusions of law for core proceedings that it may not constitutionally hear.”⁹⁶ It bears noting that the *Blixseth* court (1) begins its discussion of *Stern* on the false premise that *Stern* addresses bankruptcy courts’ “subject matter jurisdiction,”⁹⁷ and (2) overstates the holding in *Stern*, which, as discussed above, did not hold that bankruptcy courts could not hear—but only that they could not determine—*Stern*-type claims. Although directing parties to move for withdrawal of the reference is one option, it is not required by *Stern*.

Indeed, a district court could conceivably deny the motion to withdraw the reference and direct the matter back to the bankruptcy court for hearing and submission of proposed findings of fact and conclusions of law. Section 151 may provide sufficient authority for the district court to

⁹² See, e.g., *Stoebner v. PNY Techs., Inc. (In re Polaroid Corp.)*, 451 B.R. 493, 498 (Bankr. D. Minn. 2011) (noting that, unless parties consent to the court entering final judgment on a *Stern*-type claim, the court will proceed pursuant to § 157(c)(1)).

⁹³ Note that this option is distinct from the parties consenting to the bankruptcy court hearing and determining the *Stern*-type claim pursuant to § 157(c)(2). As noted, this discussion assumes the parties have not so consented. A party may rationally decline consent to the bankruptcy court's entry of final judgment on the claim but agree (by forfeiting any objection) to the court's submission of proposed findings of fact and conclusions of law. Under the latter option, each party preserves a “second bite at the apple” on *de novo* review before the district court.

⁹⁴ See § 157(d); Fed. R. Bankr. P. 5011(a). As some commentators point out, such a motion does not stay proceedings in the bankruptcy court. See Fed. R. Bankr. P. 5011(c). As a practical matter, however, a bankruptcy court could (and likely would) simply stay (or grant a party's motion to stay) the proceedings until the district court decides the motion to withdraw the reference.

⁹⁵ *Samson v. Blixseth (In re Blixseth)*, No. 10-00088, 2011 WL 3274042 (Bankr. D. Mont. Aug. 1, 2011).

⁹⁶ *Id.* at *12 (emphasis added); see also *id.* (“Since this Court may not constitutionally hear the fraudulent conveyance claim as a core proceeding, and this Court does not have statutory authority to hear it as a non-core proceeding, it may in no case hear the claim.”) (emphases added).

⁹⁷ *Id.* at *10; see *supra* n.87.

do this: “Each bankruptcy judge . . . may exercise the authority conferred under this chapter with respect to any action, suit, or proceeding and may preside alone . . . except as otherwise provided by law or by rule or *order of the district court*.”⁹⁸

3. Abstention

The third option is for the bankruptcy court to abstain from hearing and determining the *Stern*-type claim in favor of a state court (or other appropriate court).⁹⁹ In *Christian v. Kim (In re Soo Bin Kim)*, the court held that if, in the process of determining the dischargeability of a claim, the court had to liquidate the claim or otherwise make a determination that the state probate court should make, the “court will abstain from considering those issues, in favor of the state probate court.”¹⁰⁰ But the court declined to read *Stern* as divesting the court of authority to hear any aspect of the dischargeability issue just because it related to an underlying state-law claim. There should be little question that a court that has no constitutional authority to determine a claim may abstain from hearing the claim “in the interest of justice.”¹⁰¹

Ultimately, district courts may choose to issue new standing orders addressing how bankruptcy courts should proceed when they determine, pursuant to § 157(b)(3), that they are confronted with a *Stern*-type claim. The most direct, and least disruptive, option in this respect would appear to be for a district court to enter a standing order requiring its bankruptcy courts to proceed pursuant to § 157(c)(1) *without* seeking the parties’ agreement. This would also provide a catalyst for obtaining a binding judicial ruling clarifying the permissibility of this option. A party that objects to being compelled to proceed pursuant to § 157(c)(1) would have grounds for seeking certification of a direct appeal to the court of appeals pursuant to § 158(d)(2), which the party could pursue immediately upon the bankruptcy court’s denial of its motion to dismiss or the district court’s denial of its motion to withdraw the reference based upon the district court’s standing order. Such a direct appeal would result in a decision that would guide all district courts in that circuit. It would also provide an opportunity for the Supreme Court to clarify that it interprets § 157(c)(1) to permit *Stern*-type claims to be determined by district courts following hearing and submission of findings of fact and conclusions of law by bankruptcy courts.

⁹⁸ § 151 (emphasis added).

⁹⁹ See § 1334(c).

¹⁰⁰ *Christian v. Kim (In re Soo Bin Kim)*, No. 11–5020–C, 2011 WL 2708985, at *2 (Bankr. W.D. Tex. July 11, 2011).

¹⁰¹ See § 1334(c)(1).

NATIONAL BANKRUPTCY CONFERENCE

COMMITTEE ON COURT SYSTEM AND BANKRUPTCY ADMINISTRATION¹

UPDATE ON “THE SCOPE AND IMPLICATIONS OF *STERN v. MARSHALL, 131 S. CT. 2594 (2011)*”

May 7, 2012 Midyear Meeting²

¹ Authored by Chair, Prof. S. Elizabeth Gibson and R. Patrick Vance.

² The contents of this Report were presented at the 2012 Midyear Meeting of the National Bankruptcy Conference. It has been edited to reflect subsequent developments as of July 16, 2012. This Report has neither been approved nor disapproved by the Conference.

At the Conference's annual meeting in November, the Courts Committee presented a report on the Supreme Court's decision in *Stern v. Marshall*, 131 S. Ct. 2594 (2011). The Court, in a 5-4 decision, held that the statutory grant of power to bankruptcy judges in 28 USC § 157(b)(2)(C) to hear and determine core proceedings constituting "counterclaims by the estate against persons filing claims against the estate" exceeds the limits of Article III of the Constitution—at least with respect to the entry of "a final judgment on a state law counterclaim that is not resolved in the process of ruling on a creditor's proof of claim." The Court's opinion, however, left the scope and implications of the decision uncertain. The Committee's fall report discussed arguments for both broad and narrow readings of the decision, considered whether constitutional issues could be eliminated by the parties' consent to the entry of a judgment by the bankruptcy judge, and addressed procedural options for handling *Stern-like* claims.

In the intervening six months, courts and rulemakers have been faced with all of these issues and have responded in a variety of ways. The scope of the *Stern* decision—specifically, whether other core proceedings suffer from the same constitutional infirmity—and the validity of consent as a cure for the constitutional problem remain issues subject to debate and conflicting views. Progress is starting to be made, however, on the procedural front. Some federal district courts have amended their standing orders of reference to specify how *Stern-like* proceedings should be handled. Local bankruptcy rule amendments have also been proposed in some districts to require parties to state at the outset of a proceeding whether they consent to the bankruptcy judge's entry of a final judgment or, in one district, whether they demand adjudication in the district court. Meanwhile, the Advisory Committee on Bankruptcy Rules is proposing amendments to five national bankruptcy rules in response to *Stern*.

This report provides an overview of these recent developments. The Courts Committee is not recommending any Conference action at this time. If, however, national bankruptcy rule amendments are published in August, the Conference may want to consider at the annual meeting in the fall whether it wants to submit any comments on them.

CASE LAW DEVELOPMENTS IN RESPONSE TO *STERN* v. *MARSHALL*

A Westlaw search in late June revealed that 506 cases have cited *Stern* so far, 180 of which examined or discussed it and 77 of which distinguished or declined to extend it. A full review of that case law is beyond the scope of this report. But summaries of the few court of appeals decisions that have considered *Stern* in any significant way follow.

1. *Ortiz v. Aurora Health Care, Inc. (In re Ortiz)*, 665 F.3d 906 (7th Cir. 2011). Two debtor class actions were filed in the bankruptcy court against Aurora, which had filed proofs of claim in these and several thousand other bankruptcy cases over a period of several years. The class actions asserted that Aurora had violated Wisconsin medical privacy law by attaching unredacted medical records to its proofs of claim. The bankruptcy court granted summary judgment for Aurora, and the debtors were permitted to take a direct appeal to the Seventh Circuit.

The court of appeals dismissed the appeals for lack of appellate jurisdiction. In reaching this decision, the court considered the impact of *Stern* on the bankruptcy court's authority. Because the court of appeals treated the class actions as "counterclaims by the estate against persons filing claims against the estate," it concluded that they came within core jurisdiction under 28 U.S.C. § 157(b)(2)(C). But based on *Stern*, the court of appeals held that the

bankruptcy court lacked constitutional authority to enter a final judgment on these state law counterclaims.

The court then considered how that conclusion affected its jurisdiction. It reasoned that the bankruptcy court's entry of summary judgment could not be treated as proposed findings of fact and conclusions of law for the following reason:

For the bankruptcy judge's orders to function as proposed findings of fact or conclusions of law under 28 U.S.C. § 157(c)(1), we would have to hold that the debtors' complaints were "not a core proceeding" but are "otherwise related to a case under title 11." *Id.* As we just concluded, the debtors' claims qualify as core proceedings and therefore do not fit under § 157(c)(1).

Id. at 915. Thus the court appeared to adopt the view that *Stern* creates a statutory gap: § 157(c)(1) does not authorize a bankruptcy judge to enter proposed findings of fact and conclusions of law in proceedings that are designated as core under § 157(b)(2), even though the Constitution does not permit the bankruptcy judge to enter a final judgment. Those *Stern-like* proceedings are therefore left in no-man's land.

Despite the Seventh Circuit's statement about the inapplicability of § 157(c)(1), it went on to conclude that a court of appeals lacks jurisdiction to exercise direct review over a bankruptcy court's proposed findings of fact and conclusions of law. So even if the bankruptcy court's ruling could be treated as proposed findings and conclusions, the appeal would still have had to be dismissed for lack of appellate jurisdiction.

2. *Pfizer Inc. v. Law Offices of Peter G. Angelos (In re Quigley Co.)*, 2012 WL 1171848 (2d Cir. Apr. 10, 2012). Stressing that the *Stern* holding "was a narrow one," the Second Circuit held that *Stern* was inapplicable in the case before it. The question was whether the bankruptcy court had authority to stay litigation against the debtor's parent during the pendency of the bankruptcy case. The court of appeals explained that

[e]njoining litigation to protect bankruptcy estates during the pendency of bankruptcy proceedings, unlike the entry of the final tort judgment at issue in *Stern*, has historically been the province of the bankruptcy courts. Accordingly, the bankruptcy court was well within constitutional bounds when it exercised jurisdiction to enjoin the Angelos suits.

Id. at *6 (citation omitted).

3. *DiVittorio v. HSBC Bank USA, NA (In re DiVittorio)*, 670 F.3d 273 (1st Cir. 2012).

The First Circuit held that *Stern* was inapplicable in this case. First quoting the Supreme Court's statement in *Stern* that Congress had exceeded the Constitution "in one isolated respect," the court of appeals held that the bankruptcy court's resolution of an issue of state law was necessary to determine if the bank was entitled to relief from the automatic stay.

4. *Technical Automation Servs. Corp. v. Liberty Surplus Ins. Corp.*, 673 F.3d 399 (5th Cir. 2012). In this non-bankruptcy case, the Fifth Circuit, after requesting supplemental briefing on the issue, held that the authority of magistrate judges to enter final judgments on state law counterclaims with the consent of the parties was not rendered unconstitutional by *Stern*. Central to the court's holding was the fact that the Fifth Circuit, prior to *Stern*, had upheld the constitutionality of this authority. The court said that it could not overturn that precedent "absent an intervening change in the law, such as by a statutory amendment, or the Supreme Court or by our *en banc* court." And to conclude that a Supreme Court decision had changed the law, the court had to find that it "unequivocally" overturned the circuit precedent. *Id.* at 405.

The court was unable to conclude that *Stern* met that test with respect to the authority of magistrate judges—even though it stated that "the similarities between bankruptcy judges and magistrate judges suggest that the Court's analysis in *Stern* could be extended to this case." It noted in particular the Supreme Court's repeated statements in *Stern* that its holding was narrow. Somewhat sadly, it seems, the court concluded:

Notwithstanding that this constitutional question may be seen in a different light post *Stern*, we will follow our precedent and continue to hold, until such time as the Supreme Court or our court *en banc* overrules our precedent, that federal magistrate judges have the constitutional authority to enter final judgments on state-law counterclaims.

Id. at 407.

5. *Executive Benefits Ins. Agency v. Arkison (In re Bellingham Ins. Agency, Inc.)*, 661 F.3d 476 (9th Cir. 2011). This is the case in which the Ninth Circuit requested briefs by “any amicus curiae” on the following questions: Does *Stern* “prohibit bankruptcy courts from entering a final, binding judgment on an action to avoid a fraudulent conveyance? If so, may the bankruptcy court hear the proceeding and submit a report and recommendation to a federal district court in lieu of entering a final judgment?” At least 17 amicus briefs were filed in response to the request. The court has not yet issued a decision in the case.

The following are several cases decided by Bankruptcy Appellate Panels:

6. *In re Deitz*, 2012 Bankr. LEXIS 1968 (B.A.P. 9th Cir. Apr. 23, 2012). Before the United States Bankruptcy Appellate Panel for the Ninth Circuit (“BAP”) was an appeal by the Chapter 7 debtor of the bankruptcy court’s judgment awarding damages to Wayne and Patricia Ford (the “Fords”) and “declaring the debt represented by the judgment excepted from discharge under § 523.” The debtor was a general contractor in the Fresno area who had agreed to build the Fords a house that would comply with the specification for the Americans with Disabilities Act and which would comply with the Veterans Administration standards for providing financial support for homeowners. Although the Fords paid Deitz an amount of money above the contracted for rate, Deitz never completed building the house. Deitz filed a Chapter 7 petition and listed the Fords as creditors holding a claim in an unknown amount. The Fords commenced an adversary proceeding in which they alleged, among other things, that the claims arising from

the construction of the house should be excepted from discharge. The bankruptcy court entered a money judgment in favor of the Fords and ordered the judgment excepted from discharge from Deitz's bankruptcy case pursuant to § 523. In re Deitz, 2012 Bankr. LEXIS 1968, at *1–9 (B.A.P. 9th Cir. Apr. 23, 2012).

The debtor challenged the constitutional authority of the bankruptcy court to enter a final judgment on the adversary proceeding, depending on Stern. Id. at *9. The BAP noted that the debtor had conceded that the bankruptcy court had subject matter jurisdiction and that there was no dispute that the action was core. Id. The BAP stated that even though the Court in Stern stated that its decision was meant to be narrow, the debtor relied on Stern to launch a frontal attack on the bankruptcy court's authority to enter final judgment in "a prototypical bankruptcy context, a dischargeability action." Id. at *14. The BAP stated that it agreed with the conclusion of a bankruptcy court that had stated "there can be little doubt that [a bankruptcy court], as an Article I tribunal, has the constitutional authority to hear and finally determine what claims are non-dischargeable in a bankruptcy case" because the determination of the scope of the debtor's discharge is a fundamental part of the bankruptcy process. Id. at *19–21 (citing Farooqi v. Carroll (In re Carroll), 464 B.R. 293 (Bankr. N.D. Tex. 2011)).

In addition, the debtor challenged the constitutional power of the bankruptcy court to liquidate the amount of a discharge claim. Id. at *21. The BAP stated that the debtor had failed to show any support for this contention in case law and that the decisions following Stern indicated that the bankruptcy court did in fact have the power to liquidate the amount of such a discharge claim. Id. at *21–21. The BAP also noted that the Ninth Circuit had precedent that a bankruptcy court may enter a monetary judgment in a disputed state law claim in the course of

determining that the debt is nondischargeable and that nothing in Stern indicated that this practice needed change. Id. at *24–31.

Thus, the BAP held that the bankruptcy court had the constitutional authority to enter a final judgment determining both the amount of the Fords' damages claims against the debtor and the determination that those claims were excepted from discharge. Id. at *31–32.

7. *CirTran Corp. v. Advanced Beauty Solutions, LLC (In re Advanced Beauty Solutions, LLC)*, 2012 Bankr. LEXIS 666 (B.A.P. 9th Cir. Feb. 8, 2012). Before the United States Bankruptcy Appellate Panel for the Ninth Circuit (the "Court") was an appeal by CirTran Corporation ("CirTran") of a bankruptcy court's order denying CirTran's "Motion to Declare Judgment Fully Satisfied or Alternatively to Recoup Mutual Debts"(the "Motion") in its ongoing litigation with the chapter 11 debtor. In addition to challenging the merits of the bankruptcy court's decision, CirTran argued, for the first time, that the bankruptcy court lacked subject matter jurisdiction to enter the underlying judgment in favor of the debtor and that, based upon Stern, the Court should vacate the judgment and order the court to dismiss the adversary proceeding. The Stern decision, which was entered on June 23, 2011, was handed down after the bankruptcy court's order regarding the Motion was entered on April 28, 2011. CirTran Corp. v. Advanced Beauty Solutions, LLC (In re Advanced Beauty Solutions, LLC), 2012 Bankr. LEXIS 666, at *1–2, *13–4 (B.A.P. 9th Cir. Feb. 8, 2012).

The Court stated that it need not determine whether or not the constitutional issue addressed in Stern is implicated because CirTran's challenge to the bankruptcy court's jurisdiction was "made far too late in the game." Id. at *18. CirTran's opening brief in the appeal, which was filed shortly after the Stern decision, was the first instance in which CirTran challenged the court's subject matter jurisdiction. Id. at *17–8. The Court stated that the

Supreme Court in Stern noted that a constitutional right may be forfeited by not making a timely assertion of the right and that CirTran should have raised the issue before the appeal. Id. at *20–1. Therefore, the Court declined to consider CirTran’s attack on the bankruptcy court’s subject matter jurisdiction. Id. at *26.

8. *Badami v. Sears (In re AFY, Inc.)*, 2012 Bankr. LEXIS 47 (B.A.P. 8th Cir. Jan. 13, 2012). Before the United States Bankruptcy Appellate Panel for the Eighth Circuit was an appeal by Robert A. Sears from a bankruptcy court order finding that the bankruptcy estate of the debtor was contractually and equitably entitled to receive the cash value of a life insurance policy, owned by Sears and paid for by the debtor, to reimburse the debtor for policy premiums paid. Badami v. Sears (In re AFY, Inc.), 2012 Bankr. LEXIS 47, at *1 (B.A.P. 8th Cir. Jan. 13, 2012). Sears argued that the bankruptcy court lacked subject matter jurisdiction under Stern. Id. at *8. The appellate panel stated that Sears’ argument represented a basic misunderstanding of both bankruptcy jurisdiction and Stern. Id. The appellate panel recast Sears’ argument and instead sought to determine whether Congress’ grant of authority to bankruptcy courts of core matters affecting the administration of the estate, such as those at issue, was unconstitutional. Id. at *11. The appellate court stated that “the Supreme court itself has cautioned that its holding [in Stern] is a narrow one”, only affecting counterclaims to the extent such counterclaims arose under state or nonbankruptcy law. Id. at *12. Therefore, the appellate panel rejected Sears’s argument and held that it would not be unconstitutional for the bankruptcy judge to determine the matter. Id. at *12–13.

LOCAL RULES AND ORDERS IN RESPONSE TO STERN V. MARSHALL

In an effort to bridge the gap between *Stern v. Marshall* and the adoption of expected amendments to the Federal Rules of Bankruptcy Procedure, local rules and orders have been

enacted and/or proposed by a number of district and bankruptcy courts. The rules and orders take several different approaches to the issues created by *Stern*.

I. Reference Orders: Southern District of New York, Delaware, Ohio and Florida

Orders addressing the reference of bankruptcy cases and proceedings from the district court to the bankruptcy court so that the division of labor between those courts is minimally impacted by *Stern* appear to be the most popular path taken. 28 U.S.C. § 157(a). The orders accomplish this task by:

- (1) providing that if a bankruptcy or district judge determines that the entry of a final order or judgment would not be consistent with Article III of the United States Constitution (*e.g.* similar to a *Stern-like* counterclaim), the bankruptcy judge shall hear the matter and submit proposed findings of fact and conclusions of law to the district court; and
- (2) providing that the district court may treat any order of the bankruptcy court as proposed findings of fact and conclusion of law if it concludes that an Article III court order is required.

The Southern District of New York amended its Standing Order of Reference (12 MISC 00032) on January 31, 2012 to broaden the scope of reference of 28 U.S.C. § 157(a) as follows:

If a bankruptcy judge or district judge determines that entry of a final order or judgment by a bankruptcy judge would not be consistent with Article III of the United States Constitution in a particular proceeding referred under this order and determined to be a core matter, the bankruptcy judge shall, unless otherwise ordered by the district court, hear the proceeding and submit proposed findings of fact and conclusions of law to the district court. The district court may treat any order of the bankruptcy court as proposed findings of fact and conclusions of law in the event the district court concludes that the bankruptcy judge could not have entered a final order or judgment consistent with Article III of the United States Constitution.

The emphasis of this Order is to focus on the constitutional issue raised by *Stern*, rather than the core/non-core distinction set out in 28 U.S.C. § 157(b) and (c).

The Districts of Delaware (order entered February 29, 2012), Northern District of Ohio (General Order No. 2012-7) and Middle District of Florida (No. 12-MISC-6:12-MC-26-ORL-22) have adopted the same language as the Southern District of New York in their respective reference order amendments. The Middle District of Florida has added the requirement that:

proposed findings of fact and conclusions of law to the district court [shall be] made in compliance with Fed.R.Civ.P. 52(a)(1) in the form of findings and conclusions stated on the record or in an opinion or memorandum of decision.

By letter dated February 7, 2012, Martin J. Bienenstock wrote to the Chief Judge of the Southern District of New York, Loretta A. Preska. He requested that the following language – “or a litigant is entitled to a jury trial under the Seventh Amendment” – be added to the phrase – “unless otherwise ordered by the court.” He argues that “absent the amendment, the New Standing Order creates the need for a litigant to run to the district court to revoke the reference or to stay the bankruptcy court from proceeding with a nonjury trial so that it can comply with the New Standing Order by proposing findings of fact.”

Judge Preska responded on February 23, 2012 that the “Amended Order does not contemplate any change from prior statutory or local procedures with respect to core matters in which jury trials may be required.” Accordingly, she declined Mr. Bienenstock’s proposed amendment.

II. Proposed Reference Order: Massachusetts

The District Court for the District of Massachusetts issued a Public Notice on April 6, 2012 Regarding Proposed New Rule 206. The Notice requires comments to be submitted by May 25, 2012.

The Notice advises that the primary purpose of the New Rule “is to require litigants to exhaust the bankruptcy process before proceeding to the district court. The rule as proposed is

consistent with Title 28 U.S.C. § 157 and preserves the process of adjudication between the district court judges and the bankruptcy judges, as intended by the Bankruptcy Amendment Act of 1984.”

The Proposed New Rule in large part tracks the Southern District of New York Reference Order, but adds the following language:

The district judge shall make a de novo review upon the record or, after additional evidence, of any portion of the bankruptcy judge’s findings of fact or conclusions of law to which specific written objection has been made in accordance with the federal and local rules of bankruptcy procedure. The district judge may accept, reject, or modify the proposed findings of fact or conclusions of law, receive further evidence, or recommit the matter to the bankruptcy judge with instructions.

III. Withdrawal of the Reference: Texas

The Southern District of Texas entered an Order on November 29, 2011 *In the Matter of Bankruptcy Jurisdiction: Authority of Bankruptcy Judges to Enter Final Orders* (General Order No. 2011-12). Its Order sets out deadlines for parties to move to withdraw the reference in both adversary proceedings and contested matters. The bankruptcy judge is entitled to, but not mandated, to make a recommendation to the district court concerning the appropriateness of the proposed withdrawal of the reference. However, the failure to move to withdraw the reference does not appear to create consent to the bankruptcy judge’s entry of a final order where an Article III judge is required.

- (1) In an adversary proceeding, a party should move to withdraw the reference within 90 days of the complaint or notice of removal.
- (2) In a contested matter, a party should move to withdraw the reference within 21 days of the pleading initiating the contested matter.
- (3) Motions to withdraw the reference must be first submitted to the bankruptcy judge for a recommendation to the district court.

(4) Before the bankruptcy judge, on appeal, or both, a party may challenge the bankruptcy judge's authority at any time. A party's not having moved to withdraw the reference within these times does not waive a party's right to challenge the bankruptcy judge's authority.

(5) The general right of a party in interest to move to withdraw an adversary proceeding or contested matter to the district court remains.

(6) The bankruptcy judge or district judge may raise the issue of the bankruptcy judge's authority at any time and on their own initiative.

IV. Local Rule Amendments

(a) Local Rule 7008-1

The Bankruptcy Court for the Eastern District of Washington adopted as of May 7, 2012 local bankruptcy rule – 7008-1. The effect of the rule is that a litigant who believes it is entitled to an Article III court adjudication in an adversary proceeding must make a demand for judgment by the District Court in initial pleadings. Failure to do so operates as a waiver. The local rule also provides a procedure to object to the demand.

Right to Judgment by the United States District Court

(a) Right Preserved

In any adversary proceeding filed in the bankruptcy court, the right to judgment by the district court established by Article III of the Constitution is preserved to the parties.

(b) Demand

To demand judgment by the district court on any claim in an adversary proceeding:

(1) a plaintiff, or a defendant filing a counterclaim, must state the demand in the allegation of jurisdiction, required by FRBP 7008 in the initial pleading asserting the claim; and

(2) any answering party must state the demand in the

initial answer to the pleading asserting the claim.

Any pleading that includes a demand for judgment by the district court must note the demand in the caption.

(c) Waiver

A party waives judgment by the district court unless a demand is made as specified in paragraph (b). A demand by a plaintiff or defendant filing a counterclaim may be withdrawn only if the other parties consent.

(d) Objection to a Demand

Any party may, by motion, object to a demand for judgment by the district court on any claim on the grounds (1) that the claim is not one as to which there is a right to judgment by the district court under Article III of the Constitution, or (2) that the election was not made as specified in paragraph (b). The bankruptcy court may also raise an objection independently.

A motion objecting to a demand for judgment by the district court shall be filed with the clerk of the bankruptcy court no later than 14 days following the demand for judgment made under paragraph (b). Any objection or other response documents shall be filed and served no later than 21 days after service of the motion. Reply documents, if any, shall be filed and served no later than 7 days after service of any response.

(e) Transmittal of Documents to District Court

After expiration of the time for filing documents as provided in subsection (d) of this rule, the clerk of the bankruptcy court shall transmit the motion and all related documents to the district court. The transmittal may include comments by the bankruptcy judge, including an analysis of the demand for judgment and the impact of the adversary proceeding upon the underlying bankruptcy case. The motion shall be assigned to a district court judge in the normal course. The moving party shall note the matter for hearing in accordance with LR 7.1(h) of the Local Rules of the United States District Court.

All further documents related to the motion shall be filed with the clerk of the district court. Unless otherwise ordered by the bankruptcy court or district court, parties shall continue to file with the bankruptcy court all documents relating to other matters in the

adversary proceeding with the clerk of the bankruptcy court.

(b) Proposed Notice in Adversary Proceedings

The Northern District of California has proposed a rule that requires a Notice Regarding Final Adjudication and Consent to be filed with initial pleadings. The litigants must indicate whether it consents to final adjudication by the bankruptcy judge of non-core matters and core matter which may require an Article III court adjudication.

(a) In every adversary proceeding, in addition to the statements in the pleadings as required by Bankruptcy Rules 7008(a) and 7012(b), each party shall file a separate document with its initial pleading (the complaint, counter-claim, cross-claim, third party complaint, answer or other responsive pleading) entitled Notice Regarding Final Adjudication and Consent. The Notice Regarding Final Adjudication and Consent shall include:

(1) A repetition of the statements required by Fed. R. Bankr. P. 7008(a) and 7012(b), including whether, if the matter is non-core, the party does or does not consent to entry of final orders or judgments by a bankruptcy judge;

(2) A statement whether the matter is one that, although core, may not be adjudicated to final judgment by a bankruptcy judge without consent, and whether such consent is given by the party submitting the statement.

(b) The bankruptcy court may, at any time prior to trial, enter an order determining whether a final adjudication of the adversary proceeding may only be made by the district court or whether such final adjudication may be made by the bankruptcy judge. If the matter is core, but the bankruptcy judge determines that final adjudication must be made by a district judge, the procedures set forth in Bankruptcy Rule 9033 will apply notwithstanding the Rules reference to non-core proceeding.

(c) Recent Rules Regarding Declaration of Consent

The Bankruptcy Court for the Southern District of New York adopted on April 16, 2012 several local rules to address *Stern-like* core matters:

Rule 7008-1. Statement Regarding Consent to Entry of Orders or Judgment

in Core Proceeding.

In an adversary proceeding before a bankruptcy judge, in addition to statements required by Rule 7008(a) of the Federal Rules of Bankruptcy Procedure, if the complaint, counterclaim, crossclaim, or third-party complaint contains a statement that the proceeding or any part of it is core, it shall contain a statement that the pleader does or does not consent to the entry of final orders or judgment by the bankruptcy judge if it is determined that the bankruptcy judge, absent consent of the parties, cannot enter final orders or judgment consistent with Article III of the United States Constitution.

The Southern District of New York also adopted a local rule that requires a declaration in the response to initial pleadings of the litigant's position with respect to consent.

Rule 7012-1. Statement in Responsive Pleading Regarding Consent to Entry of Orders or Judgment in Core Proceeding.

In addition to statements required by Rule 7012(b) of the Federal Rules of Bankruptcy Procedure, if a responsive pleading states that the proceeding or any part of it is core, it also shall contain a statement that the pleader does or does not consent to the entry of final orders or judgment by the bankruptcy judge if it is determined that the bankruptcy judge, absent consent of the parties, cannot enter final orders or judgment consistent with Article III of the United States Constitution.

Similarly with respect to Removal, the Southern District of New York adopted changes to Local Rule 9027 which requires litigants in both the initial and responsive pleadings to expressly state whether they consent to the bankruptcy court's final adjudication of the matter.

Rule 9027-1. Statement in Notice of Removal Regarding Consent to Entry of Orders or Judgment in Core Proceeding.

If, pursuant to Rule 9027(a)(1) of the Federal Rules of Bankruptcy Procedure, a notice of removal states that upon removal of the claim or cause of action the proceeding or any part of it is core, the notice shall also state that the party removing the proceeding does or does not consent to the entry of final orders or judgment by the bankruptcy judge if it is determined that the bankruptcy judge, absent consent of the parties, cannot enter final orders or judgment consistent with Article III of the United States Constitution.

Rule 9027-2. Statement in Regarding Consent to Entry of Orders or Judgment in Core Proceeding.

If a statement filed pursuant to Rule 9027(e)(3) by a party who filed a pleading in connection with a removed claim or cause of action, other than the party filing the notice of removal, states that the proceeding or any part of it is core, the party shall also state that the party does or does not consent to the entry of final orders or judgment by the bankruptcy judge if it is determined that the bankruptcy judge, absent consent of the parties, cannot enter final orders or judgment consistent with Article III of the United States Constitution.

Finally, the Southern District of New York's Local Rule 9033-1 expressly grants to the bankruptcy court the power to submit proposed findings of fact and conclusions of law to the district court in "core constitutional" matters as determined by the bankruptcy court itself. The rule addresses the argument that 28 U.S.C. § 157(c)(1) is not available for "core constitutional" matters.

Rule 9033-1. Proposed Findings and Conclusions in Certain Core Proceedings.

If the Court determines that it cannot enter a final order or judgment consistent with Article III of the United States Constitution in a particular proceeding referred to the Court and designated as core under section 157(b) of title 28, and the Court hears the proceeding, Rule 9033(a), (b), and (c) of the Federal Rules of Bankruptcy Procedure shall apply as if it is a non-core proceeding.

PROPOSED BANKRUPTCY RULE AMENDMENTS

At its March 2012 meeting, the Advisory Committee on Bankruptcy Rules approved preliminary drafts of rule amendments in response to *Stern*. These amendments were presented to the Committee on Rules of Practice and Procedure ("the Standing Committee") at its June meeting and were approved for publication. The proposed amendments to Rules 7008, 7012, 7016, 9027, and 9033 will be published in August for public comment. Comments on these

proposed amendments will be due sometime in February 2013. If the amendments are eventually approved by the Rules Committee, the Standing Committee, the Judicial Conference, and the Supreme Court, they will go into effect on December 1, 2014, unless Congress takes action to the contrary.

The Rules Committee's proposed response to *Stern* is to delete references in the rules to "core" and "non-core" proceedings, require parties in all adversary proceedings to state whether they consent to the bankruptcy court's entry of a final judgment or order, and provide a procedure for the bankruptcy court to determine and announce the action it will take in a proceeding. This approach is intended to avoid the ambiguity created by *Stern* about whether the terms "core" and "non-core" refer to statutory designations or constitutional authority. By requiring all pleadings to state whether the party consents to the entry of a final judgment or order by the bankruptcy court, the proposed rules leave to judicial resolution whether a proceeding is one in which the bankruptcy court has constitutional authority to make a final determination. The rules therefore do not attempt to define which matters are constitutionally core, what action a bankruptcy court may take in a *Stern-like* proceeding, or whether consent of all the parties permits the bankruptcy court to enter a final judgment in a non-core proceeding.

Here are brief descriptions of the proposed amendments:

Rule 7008(a) – A complaint, counterclaim, cross-claim, or third-party complaint would have to contain "a statement that the pleader does or does not consent to entry of final orders or judgment by the bankruptcy court." No longer would the pleading have to state whether a proceeding is core or non-core, and the consent statement would not be limited to non-core proceedings.

Rule 7012(b) – A similar statement regarding consent would be required in all responsive pleadings. The current provision in the rule that in “non-core proceedings, final orders and judgments shall not be entered on the bankruptcy judge’s order except with the express consent of the parties” would be deleted.

Rule 7016 – A new subdivision would be added that would require the bankruptcy court to determine on its own motion or that of a party “whether to hear and determine the proceeding, issue proposed findings of fact and conclusions of law, or take some other action.” This provision would allow a party to seek a ruling early in a proceeding about the scope of authority the bankruptcy court intends to exercise.

Rule 9027 – All notices of removal would have to contain a consent statement like the one required of pleadings in an adversary proceeding, and no longer would the notice have to state whether the removed proceeding is core or non-core. Following removal, any non-removing party that had already filed its pleading in the non-bankruptcy court would have to file a similar statement regarding consent.

Rule 9033(a) – This provision would be revised to address only the named topic of the subdivision—service. It would provide that in a proceeding in which the bankruptcy court issues proposed findings of fact and conclusions of law, the clerk is required to serve them on the parties. The amendment would delete the existing provision that “[i]n non-core proceedings heard pursuant to 28 U.S.C. § 157(c)(1), the bankruptcy judge shall file proposed findings of fact and conclusions of law.” The rule would therefore leave to the district court’s order of reference and judicial interpretation of *Stern* what authority the bankruptcy court can exercise in a *Stern-like* proceeding.

NATIONAL BANKRUPTCY CONFERENCE

A non-profit, non-partisan, self-supporting organization of approximately sixty lawyers, law professors and bankruptcy judges who are leading scholars and practitioners in the field of bankruptcy law. Its primary purpose is to advise Congress on the operation of bankruptcy and related laws and any proposed changes to those laws.

History. The National Bankruptcy Conference (NBC) was formed from a nucleus of the nation's leading bankruptcy scholars and practitioners, who gathered informally in the 1930's at the request of Congress to assist in the drafting of major Depression-era bankruptcy law amendments, ultimately resulting in the Chandler Act of 1938. The NBC was formalized in the 1940's and has been a resource to Congress on every significant piece of bankruptcy legislation since that time. Members of the NBC formed the core of the Commission on the Bankruptcy Laws of the United States, which in 1973 proposed the overhaul of our bankruptcy laws that led to enactment of the Bankruptcy Code in 1978, and were heavily involved in the work of the National Bankruptcy Review Commission (NBRC), whose 1997 report initiated the process that led to significant amendments to the Bankruptcy Code in 2005.

Current Members. Membership in the NBC is by invitation only. Among the NBC's 60 active members are leading bankruptcy scholars at major law schools, as well as current and former judges from eleven different judicial districts and practitioners from leading law firms throughout the country who have been involved in most of the major corporate reorganization cases of the last three decades. The NBC includes leading consumer bankruptcy experts and experts on commercial, employment, pension, mass tort and tax related bankruptcy issues. It also includes former members of the congressional staff who participated in drafting the Bankruptcy Code as originally passed in 1978 and former members and staff of the NBRC. The current members of the NBC and their affiliations are set forth on the second page of this fact sheet.

Policy Positions. The Conference regularly takes substantive positions on issues implicating bankruptcy law and policy. It does not, however, take positions on behalf of any organization or interest group. Instead, the NBC seeks to reach a consensus of its members - who represent a broad spectrum of political and economic perspectives - based on their knowledge and experience as practitioners, judges and scholars. The Conference's positions are considered in light of the stated goals of our bankruptcy system: debtor rehabilitation, equal treatment of similarly situated creditors, preservation of jobs, prevention of fraud and abuse, and economical insolvency administration. Conferees are always mindful of their mutual pledge to "leave their clients at the door" when they participate in the deliberations of the Conference.

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