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

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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."<sup>2</sup> 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."<sup>3</sup> 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

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<sup>2</sup> 131 S. Ct. at 2619-20.

<sup>3</sup> *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.”<sup>4</sup>

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.”<sup>5</sup> Two other members of the Court—Justices Rehnquist and

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<sup>4</sup> *Id.*

<sup>5</sup> 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.’”<sup>6</sup> 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.’”<sup>7</sup>

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.”<sup>8</sup> 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.”<sup>9</sup> 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.”<sup>10</sup>

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.”<sup>11</sup> 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,

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<sup>6</sup> *Id.* at 69.

<sup>7</sup> *Id.* at 71.

<sup>8</sup> 473 U.S. 568, 587 (1985).

<sup>9</sup> *Id.* at 586.

<sup>10</sup> *Id.* at 587.

<sup>11</sup> 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.”<sup>12</sup> 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.”<sup>13</sup>

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.”<sup>14</sup>

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.”<sup>15</sup>

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.”<sup>16</sup> 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.

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<sup>12</sup> *Id.*

<sup>13</sup> *Id.* at 853.

<sup>14</sup> 492 U.S. 33, 53 (1989).

<sup>15</sup> *Id.*

<sup>16</sup> *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.”<sup>17</sup> 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.”<sup>18</sup> 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.<sup>19</sup>

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.”<sup>20</sup> 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.”<sup>21</sup> 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.”<sup>22</sup> 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.”<sup>23</sup> And the Court distinguished the cases of *Katchen* and *Langenkamp* on the ground that those decisions involved the estate’s attempt to

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<sup>17</sup> 131 S. Ct. at 2611.

<sup>18</sup> *Id.* at 2613.

<sup>19</sup> *Id.* at 2614.

<sup>20</sup> *Id.* at 2615.

<sup>21</sup> *Id.* at 2601.

<sup>22</sup> *Id.* at 2611.

<sup>23</sup> *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.”<sup>24</sup>

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.<sup>25</sup> Such a broad reading, however, is unsupportable. 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.”<sup>26</sup> 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.”<sup>27</sup> 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.<sup>28</sup>

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.<sup>29</sup> If a counterclaim is in pursuit of a debtor’s prepetition claim—and thus it does not “stem[] from the

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<sup>24</sup> *Id.* at 2618.

<sup>25</sup> *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).

<sup>26</sup> 131 S. Ct. at 2616.

<sup>27</sup> *Id.* at 2618.

<sup>28</sup> *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).

<sup>29</sup> *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,<sup>30</sup> 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.’”<sup>31</sup> 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.<sup>32</sup> 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*.”<sup>33</sup>

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.<sup>34</sup> 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.”<sup>35</sup> 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.

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<sup>30</sup> 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.”).

<sup>31</sup> 492 U.S. at 53.

<sup>32</sup> 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).

<sup>33</sup> 131 S. Ct. at 2618.

<sup>34</sup> 492 U.S. at 48.

<sup>35</sup> *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*.<sup>36</sup> 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.”<sup>37</sup> 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.<sup>38</sup> 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,”<sup>39</sup> 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

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<sup>36</sup> See 131 S. Ct. at 2614 n.7.

<sup>37</sup> *Id.* at 2615.

<sup>38</sup> *Id.* at 2621 (Scalia, J., concurring).

<sup>39</sup> *Id.*

final judgments in bankruptcy proceedings.<sup>40</sup> 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;”<sup>41</sup>
- must all private rights be determined by an Article III judge;<sup>42</sup>
- what is the significance for the Article III analysis of the state or federal nature of a claim;<sup>43</sup> and
- does the analysis differ for the use of non-Article III judges by administrative agencies and by the federal judiciary?<sup>44</sup>

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.<sup>45</sup> 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

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<sup>40</sup> 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.”).

<sup>41</sup> *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’”).

<sup>42</sup> 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 . . .”).

<sup>43</sup> 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”).

<sup>44</sup> 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*).

<sup>45</sup> 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.”<sup>46</sup>

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 well<sup>47</sup>—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,”<sup>48</sup> he did so in the context of a ruling that he considered “not [to] change all that much.”<sup>49</sup> 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,<sup>50</sup> 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.”<sup>51</sup>

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.<sup>52</sup> This suggests that the claims allowance process, at a minimum, is closely related to a public right determinable by bankruptcy courts.<sup>53</sup>

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<sup>46</sup> *Id.* at 50.

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

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

<sup>49</sup> *Id.* at 2620.

<sup>50</sup> *Id.* at 2619.

<sup>51</sup> 478 U.S. at 851.

<sup>52</sup> 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.”).

<sup>53</sup> 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.<sup>54</sup> 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.<sup>55</sup> By contrast, the institutional interest cannot be dispensed with as freely.<sup>56</sup> 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.”<sup>57</sup> 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.<sup>58</sup> 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.<sup>59</sup>

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<sup>54</sup> *Stern*, 131 S. Ct. at 2609; *Schor*, 478 U.S. at 848.

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

<sup>56</sup> *See id.* at 850-851.

<sup>57</sup> *See Stern*, 131 S. Ct. at 2609.

<sup>58</sup> *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”).

<sup>59</sup> *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.”<sup>60</sup> 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.<sup>61</sup> 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.”<sup>62</sup> 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.”<sup>63</sup>

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.”<sup>64</sup> 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 with gift did not form “a single dispute.” While there may have been “some overlap” between

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<sup>60</sup> *Stern*, 131 S. Ct. at 2614.

<sup>61</sup> *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*).

<sup>62</sup> *Schor*, 478 U.S. at 851.

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

<sup>64</sup> *Id.* at 2613 (internal citations and quotation marks omitted).

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*.<sup>65</sup> 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."<sup>66</sup> 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 and to enter appropriate orders and judgments, subject to review under section 158 of this title."

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<sup>65</sup> See *id.* at 2613-17.

<sup>66</sup> *Id.* at 2607.

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.<sup>67</sup> 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.<sup>68</sup> 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 that if the “constitutional role of the judiciary is to be maintained, there must be both the

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<sup>67</sup> 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. Dobey*, 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).

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

appearance and the reality of control by Article III judges over the interpretation, declaration, and application of federal law.”<sup>69</sup>

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.<sup>70</sup> 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).

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<sup>69</sup> 725 F.2d. at 544.

<sup>70</sup> *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.<sup>71</sup> 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.<sup>72</sup> 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.<sup>73</sup> *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.<sup>74</sup> 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.”<sup>75</sup> 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

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<sup>71</sup> 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).

<sup>72</sup> *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).

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

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

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

system by analogy. Given the similarities between §§ 636(c)(1) and 157(c)(2), the Court would 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.”<sup>76</sup>

#### **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.<sup>77</sup>
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

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<sup>76</sup> *Bowsher v Synar*, 478 U.S. 714, 736 (1986).

<sup>77</sup> “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.

claim. As relevant here, subject matter jurisdiction lies in the district court for all claims, including *Stern*-type claims.<sup>78</sup> 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.<sup>79</sup> *Stern* discussed this critical distinction at length,<sup>80</sup> and expressly clarified that § 157 is not jurisdictional.<sup>81</sup> *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.<sup>82</sup>

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.<sup>83</sup> 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.<sup>84</sup> But Pierce objected from the outset to the bankruptcy court’s authority to enter final judgment on Vickie’s state-law counterclaim.<sup>85</sup> 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.<sup>86</sup>

*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.<sup>87</sup>

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<sup>78</sup> See 28 U.S.C. § 1334(a)-(b).

<sup>79</sup> 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).

<sup>80</sup> See *Stern*, 131 S. Ct. at 2606–08.

<sup>81</sup> *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).

<sup>82</sup> *Id.* at 2607 (majority opinion).

<sup>83</sup> See *id.* at 2606, 2608.

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

<sup>85</sup> See *id.* at 2601–02.

<sup>86</sup> *Id.*

<sup>87</sup> 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

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.<sup>88</sup> *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.<sup>89</sup> 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 statute . . . .<sup>90</sup>

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.<sup>91</sup> 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.

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jurisdiction.” As discussed below, this flawed premise may have prevented the *Blixeth* 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 conclusions of law on the *Stern*-type claim before it.

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

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

<sup>90</sup> *Id.* at 2620.

<sup>91</sup> 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*.

2. Order the parties to file motions to withdraw the reference so the claim can be heard and determined in the district court.
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.<sup>92</sup> 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.<sup>93</sup> 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.<sup>94</sup> This is the procedure the court required in *Samson v. Blixseth (In re Blixseth)*.<sup>95</sup> 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*.”<sup>96</sup> 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,”<sup>97</sup> 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*.

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<sup>92</sup> 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)).

<sup>93</sup> 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.

<sup>94</sup> 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.

<sup>95</sup> *Samson v. Blixseth (In re Blixseth)*, No. 10–00088, 2011 WL 3274042 (Bankr. D. Mont. Aug. 1, 2011).

<sup>96</sup> *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).

<sup>97</sup> *Id.* at \*10; see *supra* n.87.

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 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*.”<sup>98</sup>

### 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).<sup>99</sup> 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.”<sup>100</sup> 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.”<sup>101</sup>

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.

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<sup>98</sup> § 151 (emphasis added).

<sup>99</sup> See § 1334(c).

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

<sup>101</sup> See § 1334(c)(1).