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CORE CONTRADICTIONS: *STERN'S* IMPACT IN THE SEVENTH CIRCUIT & *ORTIZ V. AURORA HEALTH CARE, INC.*

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Introduction

This outline discusses certain implications of *Stern v. Marshall*[1] as expressed in (among others) the decision of the United States Court of Appeals for the Seventh Circuit, *Ortiz v. Aurora Health Care, Inc.*[2] In *Stern,* the United States Supreme Court held that a bankruptcy court lacked the Constitutional authority to adjudicate finally a debtor's "tortious interference with gift" counterclaim to a defamation claim (asserted in a proof of claim filed in the bankruptcy court). In *Ortiz,* the Seventh Circuit extended *Stern* to affirmative claims that an estate might hold against creditors (not merely asserted as counterclaims): "[B]ankruptcy judges lack authority under Article III of the Constitution to enter final judgments on claims that constitute 'the stuff of the traditional actions at common law tried by the courts at Westminster in 1789.'"[3]

Courts and commentators have expressed concern about and frustration with *Stern* and *Ortiz.* Indeed, an entire issue of the American Bankruptcy Law Journal (ABLJ), perhaps the leading publication among bankruptcy scholars and practitioners, was recently devoted to the issues they raise.[4]

While there are different views about the scope and effect of these cases (and their progeny), it would appear that at minimum they have destabilized the way that lawyers and observers understand the division of labor between bankruptcy courts and other courts. As Judge J. Rich Leonard, Editor-in-Chief of the ABLJ, observed in his introduction to its symposium: "[M]y first response [to *Stern*] was that if a case did not involve a debtor-brought, state-law counterclaim that was not adjudicated in the process of determining the claim, *Stern* was irrelevant. But obviously, the disconnect between the final comforting words [of the *Stern* majority opinion] and the logic that the [C]ourt employed pushes in other directions."[5] As Judge Leonard notes, in the last half of 2011 alone, "228 opinions at all levels of courts" were published attempting to "digest [*Stern's*] full implications."[6] *Ortiz,* issued by the Seventh Circuit December 30, 2011, is one of those cases, and perhaps the most important to date.

This outline briefly recounts *Stern* and *Ortiz,* then explores why there is such a "disconnect" between the language of *Stern* and the results it appears to have produced, most notably in *Ortiz.* We argue that *Stern*'s disconnect derives, in part, from three sets of contradictions embedded in the opinion, and three very different conceptualizations of bankruptcy court authority associated with those contradictions. The contradictions of *Stern,* and its competing conceptualizations of bankruptcy court power, have been embedded in

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[1] 131 S Ct. 2594 (2011).

[2] 665 F.3d 906 (2011).

[3] Id. at 908-908 (quoting *Stern,* 131 S Ct. at 2609).

[4] It was originally (and perhaps ironically) organized as a discussion of the 30th anniversary of *Marathon v. Northern Pipeline*, the last major Supreme Court case upsetting Congress' design for bankruptcy court jurisdiction *See Marathon at 30: A Symposium Issue*, 86 AM. BANKR. L. J. *passim* (2012).

[5] Id. at 2.

[6] Id.

our various bankruptcy systems since enactment of the first bankruptcy law in 1800.[7] They thus cannot be easily resolved. The most we can hope to do in this outline is to identify problem areas and provide some practical guidance, in the form of hypotheticals and practice pointers, where we think the underlying logic of *Stern* may produce challenges and opportunities for bankruptcy practitioners and observers.

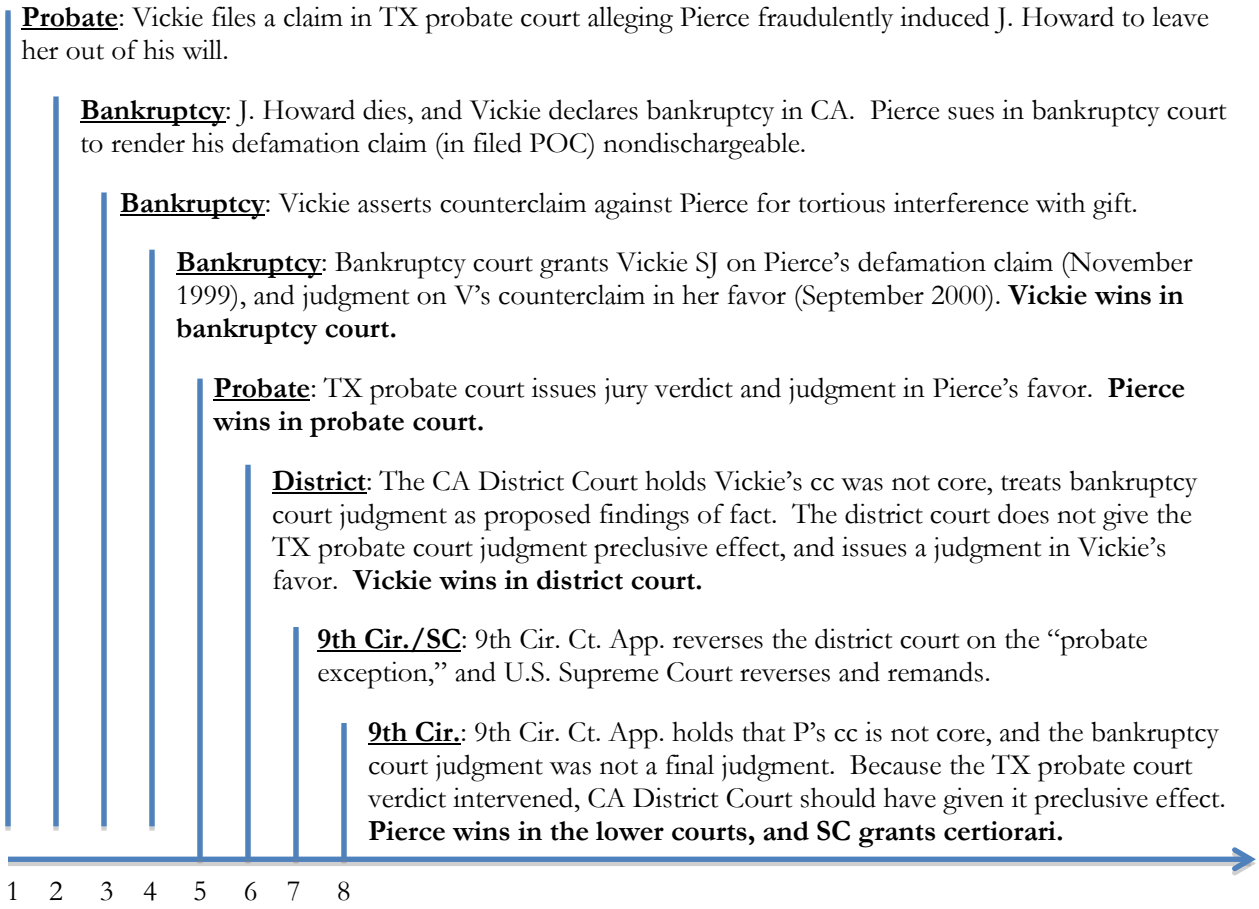
1. Background

1.1 *Stern v. Marshall*, 131 S. Ct. 2594 (2011): Debtor Vickie Lynn Marshall (better known as Anna Nicole Smith) commenced a bankruptcy case in the United States Bankruptcy Court for the Central District Court of California, as she was not included in the will of her octogenarian husband, J. Howard Marshall. The husband's son, Pierce, filed a proof of claim in Vickie's bankruptcy case asserting that Vickie had defamed him by alleging that he fraudulently gained control of his father's assets. Vickie filed a counterclaim (arguably compulsory) for tortious interference with the gift she expected from J. Howard. The bankruptcy court granted Vickie summary judgment on Pierce's defamation claim, and issued a judgment on Vickie's counterclaim in her favor.[8]

[7] *See* Jonathan C. Lipson, *Debt and Democracy: Towards a Constitutional Theory of Bankruptcy*, 83 NOTRE DAME L. REV. 101 (2008).

[8] *Stern*, 131 S. Ct. at 2601.

Figure 1: Stern Procedural History



1.1.2 *Holding*: The bankruptcy court lacked authority under Article III of the Constitution to enter a final judgment on Vickie's counterclaim. Although the bankruptcy court had *statutory* authority (under 28 U.S.C. § 157(b)(2)(C)) it lacked *constitutional* authority to do so: it could not enter final judgment on Vickie's counterclaim.[9] "Bankruptcy judges lack authority under Article III of the Constitution to enter final judgments on claims that constitute 'the stuff of the traditional actions at common law tried by the courts at Westminster in 1789.'"[10]

- "Vickie's counterclaim cannot be deemed a matter of 'public right' that can be decided outside the Judicial Branch" as the case does not fall within "any of the various formulations of the concept that appear in this Court's opinions."[11]

[9] *Id.* at 2608.

[10] *Id.* at 2609.

[11] *Id.* at 2611.

- The process of adjudicating Pierce's proof of claim (for defamation) would not necessarily resolve Vickie's counterclaim (for tortious interference with gift), even if there was some overlap in the claims.[12]
- The question was whether the action at issue stems from the bankruptcy itself or would necessarily be resolved in the claims allowance process.[13]

1.1.3 "Pierce did not truly consent to resolution of Vickie's [counter]claim in the bankruptcy court proceedings."[14] He had nowhere else to go if he wished to recover from Vickie's estate.

- And yet, *by course of conduct*, Pierce *did* consent to bankruptcy court adjudication of his defamation claim. Pierce advised the bankruptcy court that the parties agreed that the amount of his contingent proof of claim would be determined by the adversary proceedings.[15]
- The *Stern* majority therefore rejected Pierce's argument that § 157(b)(5) deprived a bankruptcy court of authority to try a personal injury tort claim. Finding the provision for a district court trial to be non-jurisdictional, the court concluded that Pierce forfeited any objection under that provision. The court compared § 157(b)(5) to § 157(c)(2), and did not indicate any reservations about the constitutionality about these provisions.[16]

1.2 *Ortiz v. Aurora Health Care, Inc.*, 665 F.3d 906 (7th Cir. 2011): Aurora Health Care, Inc. (Aurora) filed proofs of claim in an estimated 3,200 chapter 13 bankruptcy cases in the Eastern District of Wisconsin, which publicly disclosed the debtors' medical treatment information. Two groups of debtors filed separate class action lawsuits against Aurora – one in the U.S. Bankruptcy Court for the Eastern District of Wisconsin, and the other in a Wisconsin state court. In both cases, the debtors alleged that Aurora violated Wisconsin Statute § 146.82 by disclosing their medical records without permission. The state case was removed to the bankruptcy court. One group of debtors filed a motion for the bankruptcy court to abstain in favor of a Wisconsin court, while the other group filed a motion for the bankruptcy judge to remand the case back to the Wisconsin court. Aurora filed motions to have the district court withdraw the reference under 11 U.S.C. § 157(d). The motions were denied because the cases constituted "core" proceedings. The bankruptcy court granted summary judgment in favor of Aurora. The 7th Circuit Court of Appeals granted direct appeal under 11 U.S.C. § 157(d)(2).[17] *Stern* was decided after the court of appeals heard oral argument.

1.2.2 *Holding*: "Like the bankruptcy judge in *Stern v. Marshall*, the bankruptcy judge here lacked Article III authority to enter a final judgment on the debtors' state-law

[12] *Id.* at 2617.

[13] *Id.* at 2618.

[14] *Id.* at 2614.

[15] *Id.* at 2607.

[16] *Id.* at 2606-07.

[17] *Ortiz,* 665 F. 3d at 908.

claims. Without a final judgment we lack a statutory basis for appellate jurisdiction."[18]

- According to the Court of Appeals, the debtors' claims, like Vickie's counterclaim, involve private parties, disputing interests defined by state law. The claims do not flow from a federal statutory scheme, are not historically determined by the executive or legislative branches, nor do the claims address a "particularized area of the law" where Congress devised an 'expert and inexpensive method for dealing with a class of questions of fact which are particularly suited to examination and determination by an administrative agency specially assigned to that task.' The debtors' claims are simply "ordinary state-law claims."[19]
- Aurora's act of filing proofs of claim in the debtors' bankruptcies did not give the bankruptcy judge authority to adjudicate the debtors' state law claims.[20] There is no reason to believe that the process of adjudicating Aurora's proofs of claim would necessarily resolve the debtors' claims.[21] "That the circumstances giving rise to the claims involved procedures in the debtors' bankruptcies is insufficient to bypass Article III's requirements."[22]
- Consent was not present in the case. Noting the debtors' motions for abstention and remand to state court, the court of appeals concluded "we cannot find an implied consent to the bankruptcy judge's authority to resolve their claims. And even if we could find an implied consent on the debtors' part, we could not find that all parties consented because Aurora opposed the bankruptcy judge hearing the matter in its motions to withdraw. So this case does not present any question about a bankruptcy judge's authority to enter a final judgment when the parties have consented."[23]
- The debtors' claims were core proceedings, but the bankruptcy lacked authority to enter a final judgment on them. Therefore, the court of appeals lacked appellate authority to adjudicate this matter. The court dismissed the appeal and remanded to the bankruptcy court. "Unless and until an Article III judge enters a final judgment, we have no jurisdiction to review these matters."[24]

1.2.3 On remand, Judge Kelley entered Proposed Findings of Fact and Conclusions of Law on Defendant's Motion for Summary Judgment *and in the alternative* made a *sua sponte* motion to withdraw the reference to the District Court in

[18] *Id.* at 915.

[19] *Id.* at 914.

[20] *Id.*

[21] *Id.* Indeed, in at least some cases, they could not do so because the proofs of claim had already been allowed. It was merely coincidental that the thing that caused the harm was a proof of claim.

[22] *Id.*

[23] *Id.* at 915.

[24] *Id.*

the event she lacked the Constitutional authority to enter proposed findings and rulings.[25]

2. *Stern's* Core Contradictions. *Stern* is destabilizing because its logic embeds three sets of contradictions.

2.1 *Rhetorical Contradictions: "Narrow" v. "Broad."* The language of *Stern* claims the decision is "narrow" but reads (and implies) broad scope.

2.1.1 *Narrow Reading*:

- "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; *we agree with the United States that the question presented here is a "narrow" one*."[26]
- And yet, the language and logic of *Stern* appear to be much broader than mere counterclaims.

2.1.2 *Broad Language*: The "Judicial Power of the United States"

2.1.2.1 "It is clear that the Bankruptcy Court in [*Stern*] exercised the 'judicial power of the United States' in purporting to resolve and enter final judgments on a state common law claim."[27] This was a problem because many things a bankruptcy court does—and should do—appear to involve the "judicial power."

- "When a suit is made of 'the stuff of the traditional causes of action at common law tried by the courts at Westminster in 1789. . . and is brought within the bounds of federal jurisdiction, the responsibility for deciding that suit rests on Article III judges in Article III courts. The Constitution assigns that job—resolution of 'the mundane as well as the glamorous, matters of common law and statute as well as constitutional law, issues of fact as well as issues of law—to the Judiciary."[28]

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[25] *Ortiz v. Aurora Health Care, Inc. (In re Ortiz)*, 464 B.R. 807 (E.D. Wis. 2012).

[26] *Stern* at 2620 (emphasis supplied; citing brief of the United States as *Amicus Curiae* 23). The United States has gone on to take a more expansive approach, arguing in the *Bellingham Insurance* case, pending before the United States Court of Appeals for the Ninth Circuit, that "bankruptcy courts lack authority to enter final judgments in some, though not all, fraudulent conveyance actions." Brief for the United States as *Amicus Curiae, In re Bellingham Ins Agency,* No. 11-35162 (9th Cir. Jan. 19, 2012). As two practitioners recently noted, the fact that the United States, "which is charged with defending the constitutionality of acts of Congress [] has now conceded that § 157(b)(2)(H) [governing fraudulent transfer litigation], as applied to fraudulent-conveyance actions against noncreditors who have not consented to bankruptcy court adjudication is unconstitutional." *See* Danielle Spinelli and Craig Golblatt, *Bellingham: No Reasonable Argument for 'Narrow' Reading of Stern,* AM. BANKR. INST. L.J. 14 (Apr. 14, 2012).

[27] *Stern* at 2611.

[28] Ortiz, 665 F.3d, at 908-909 (quoting *Stern* at 2609).

- The "Judiciary" is created by Article III, not Article I. Thus, "traditional causes of action at common law" cannot be "decided" outside Article III.[29]

2.1.3 *Contradiction:* The Court claims the holding is "narrow" but the language is as broad as the definition of the Article III "judicial power."

- *Query*: Could the Court have come to the same result with narrower rhetoric?

2.2 *Structural Contradictions: Westminster v. The Revolution.* The logic of *Stern* rests on imagining how a particular court in England—"Westminster"[30]—would treat modern claims. Yet, the opinion also recognizes that the Constitution was framed in part to avoid structural problems with the English system.

- "Article III imposes some basic limitations that the other branches may not transgress. Those limitations serve two basic purposes. 'Separation of powers principles are intended, in part, to protect each branch of government from incursion by the others. Yet the dynamic between and among the branches is not the only object of the Constitution's concern. The structural principles secured by the separation of powers protect the individual as well."[31]
- "The colonists had been subjected to judicial abuses at the hands of the Crown, and the Framers knew the main reasons why: because the King of Great Britain 'made Judges dependent on his Will alone, for the tenure of their offices, and the amount and payment of their salaries."[32]
- "The Framers undertook in Article III to protect citizens subject to the judicial power of the new Federal Government from a repeat of those abuses. By appointing judges to serve without term limits, and

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[29] Query: If Congress can give preemptive power to arbitrators under the Federal Arbitration Act, why can it not permit bankruptcy courts to be "units" of District Courts under 28 U.S.C. § 151? *Compare* Rent-A-Center, West, Inc. v. Jackson, 561 U. S. ____, ____ (2010) (slip op., at 3) (holding that it is a "fundamental principle that arbitration is a matter of contract with 28 U.S.C. § 151 ("In each judicial district, the bankruptcy judges in regular active service shall constitute a unit of the district court to be known as the bankruptcy court for that district.").

[30] http://www.parliament.uk/about/living-heritage/building/palace/westminsterhall/government-and-administration/later-law-courts/ (visited April 29, 2012).

[31] *Stern* at 2609 (citations omitted).

[32] Id. (quoting Declaration of Independence ¶ 11). English superior court judges held office during "good behaviour," but their compensation was complex.

> The 1701 Act of Settlement provides for tenure during good behavior for the twelve judges of the three superior courts of common law, King's Bench, Common Pleas, and Exchequer, and requires that their salaries be "ascertained and established." Act of Settlement, 1701, 12 & 13 Will. 3, c. 2, § 3 (Eng.). The required "establish[ment]" of salaries did not foreclose the continued receipt of litigant fees. Indeed, fees for English superior court judges were not abolished until 1799.

James E. Pfander, *Judicial Compensation and the Definition of Judicial Power in the Early Republic*, 107 MICH. L. REV. 1, 8 n. 30 (2008).

> restricting the ability of the other branches to remove judges or diminish their salaries, the Framers sought to ensure that each judicial decision would be rendered, not with an eye toward currying favor with Congress or the Executive, but rather with the '[c]lear heads . . . and honest hearts' deemed 'essential to good judges.'"[33]

2.2.1 *The Irony of the Private Rights Exception*

The structural protections of Article III exist to insulate the judiciary from the other branches. Yet, since *Murray's Lessee v. Hoboken Land & Improvement Co.,*[34] the Supreme Court has recognized a "public rights" exception, whereby non-Article III tribunals can exercise the judicial power (or something like it). "Congress cannot 'withdraw from judicial cognizance any matter which, from its nature, is the subject of a suit at the common law, or in equity, or admiralty."[35] Thus, "the Court also recognized that 'there are matters, involving public rights, which may be presented in such form that the judicial power is capable of acting on them, and which are susceptible of judicial determination, but which congress may or may not bring within the cognizance of the United States, as it deems proper."[36]

2.2.2 *What is within the Public Rights Exception?*

- Government is a party to the action.
- "A matter that can be pursued only by grace of the other branches."[37]
- A matter that "'historically could have been determined exclusively by' those branches."[38]
- A matter that "flow[s] from a federal statutory scheme"[39] "in which Congress devised 'an expert and inexpensive method for dealing with a class of questions of fact which are particularly suited to examination and determination by an administrative agency specially assigned to that task."[40]

2.2.3 *Contradiction*: If protection from the other branches—Congress and the Executive—is central to the structure of the judicial power under Article III, why tolerate a public rights exception at all? Why, in questions of "private rights," is "the 'danger of encroaching on the judicial powers' . . . greater" than in public rights?[41]

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[33] Id. (quoting 1 Works of James Wilson 363 (J. Andrews ed. 1869)). The Chief Justice's source of authority is especially ironic. James Wilson spent two weeks in debtors in prison 1796. He was one of several framers to do so, and for whom, therefore, bankruptcy relief would appear to have been an especially important feature of the new Constitution. *See* Lipson, *supra* note **7**, at 122.

[34] 59 U.S. 272 (1856).

[35] *Stern,* at 2612 (quoting *Murray's Lessee,* at 284).

[36] Id. at 2612 (quoting *Murray's Lessee,* at 284).

[37] *Stern,* at 2614.

[38] Id. (quoting *Marathon*, at 68).

[39] *Stern*, at 2614 (citing *Thomas,* 473 U.S., at 584-585)

[40] Id. at 2615 (quoting *Crowell*, 285 U.S. at 46).

[41] *Stern* at 2625 (Breyer dissenting).

- Does allowing a bankruptcy court to adjudicate Vickie's counterclaim really "compromise the integrity of the system of separated powers and the role of the Judiciary in that system"?[42]

2.3 *Procedural Contradictions: Non-Justiciability.* In addition to these substantive contradictions, *Ortiz* recognizes that *Stern* creates a procedural contradiction: A class of "core" claims that cannot be adjudicated by a bankruptcy court as outside its Article I powers. Under § 157(c), however, it is not clear which court can adjudicate these "core non-Article I" (*Stern*) claims.

2.3.1 *Statutory Division of Labor*: "Related to" matters go elsewhere

2.3.1.1 *Proposed Findings of Fact:* "A bankruptcy judge may hear a proceeding that is not a core proceeding but that is *otherwise related to* a case under title 11. In such proceeding, the bankruptcy judge *shall submit proposed findings of fact* and conclusions of law to the district court, and *any final order or judgment shall be entered by the district judge* after considering the bankruptcy judge's proposed findings and conclusions and after reviewing de novo those matters to which any party has timely and specifically objected."[43]

2.3.1.2 *Consent.* "[T]he 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 . . . subject to [appellate] review under section 158 of this title."[44]

- In *Ortiz,* the problem was that the matter was deemed "core" not "related to," so it is not clear whether consent should have been effective.[45]

2.3.2 *Stern recognizes the contradiction*: "Pierce argues that we should treat core matters that arise neither under Title 11 nor in a Title 11 case as proceedings "related to" a Title 11 case . . . We think that a contradiction in terms. It does not make sense to describe a 'core' bankruptcy proceeding as merely 'related to; the bankruptcy case; oxymoron is not a typical feature of congressional drafting."[46]

2.3.3 *Ortiz Court of Appeals is Stuck.* "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 debtor's complaints were 'not a core proceeding' but are 'otherwise related to a case under title 11."[47] Yet, "the debtors' claims [*do*] qualify as core proceedings and therefore do not fit under § 157(c)(1). The direct appeal provision in 28 U.S.C. §

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[42] *Stern,* at 2620.

[43] 28 U.S.C. § 157(c)(1).

[44] Id. at § 157(c)(2).

[45] Historically, parties could consent to summary treatment of otherwise plenary claims *See* MacDonald v. Plymouth Cnty. Trust Co., 286 U.S. 263, 266–68 (1932).

[46] *Stern,* at 2605.

[47] *Ortiz,* at 915

158(d)(2)(A) also does not authorize us to review on direct appeal a bankruptcy judge's proposed findings of fact and conclusions of law."[48]

- "Like the bankruptcy judge in *Stern v. Marshall,* the bankruptcy judge here lacked Article III authority to enter a final judgment on the debtors' state-law claims. Without a final judgment we lack a statutory basis for appellate jurisdiction . . . . Unless and until an Article III judge enters a final judgment, we have no jurisdiction to review these matters."[49]
- Resolved "pragmatically"[50] by Judge Kelley in *Ortiz* (on remand), proposing findings of fact/rulings of law *and,* in the alternative, moving to withdraw the reference.

2.3.4 *Contradiction*(s): Some claims will be "core," as to which § 157(c) does not speak, yet under *Stern* are outside a bankruptcy judge's Article I authority. Section 157(c) does not give bankruptcy judges authority to "adjudicate" finally (on "consent") or "propose" findings of fact and conclusions of law (absent "consent") matters that are not "related to" a bankruptcy case.

2.3.5 *"Consent" a possible resolution?* An important inference from *Stern* is that merely filing a proof of claim will not be deemed to be "consent" to bankruptcy court adjudication of an estate's state-law claims against the creditor. Yet, the Court leaves open the possibility that "course of conduct" may constitute "consent" for certain purposes.[51]

2.3.3.1 *Consent by Conduct.* In *Stern,* Pierce argued that the bankruptcy court could not decide his defamation claim because it was a "personal injury tort" which the district court—not the bankruptcy court—was obligated to try. Under 28 U.S.C. § 157(b)(5), "[t]he district court shall order [that] the personal injury tort and wrongful death claims shall be tried in the district court in which the bankruptcy case is pending."[52] Although the *Stern* Court concluded that Pierce's proof of claim was not "consent" to Bankruptcy Court adjudication of Vickie's tortious interference with gift claim, it concluded that he had consented by his conduct in the litigation to having the bankruptcy adjudicate his proof of claim for defamation.

- "We agree with Vickie that Pierce not only could but did consent to the Bankruptcy Court's resolution of his defamation claim. . . . Pierce apparently did not object to any court that § 157(b) prohibited the Bankruptcy Court from resolving his

[48] Id.

[49] Id.

[50] *See Stern* at 2626 (discussing need to resolve bankruptcy disputes "pragmatically")(Breyer, J. dissenting).

[51] Cases such as *Thomas v. Union Carbide* suggest that parties may consent to bankruptcy court jurisdiction that would otherwise not be permissible. In *Thomas,* the Court characterized *Marathon* as "establish[ing] only that Congress may not vest in a non-Article III court the power to adjudicate, render final judgment, and issue binding orders in a traditional contract action arising under state law, *without consent of the litigants*, and subject only to ordinary appellate review." Thomas v. Union Carbide Agric. Prods. Co., 473 U.S. 568, 584 (1985) (emphasis supplied).

[52] 28. U.S.C. § 157(b)(5).

defamation claim until over two years—and several adverse discovery rulings—after he filed that claim in June 1996 . . . .[53]

- Under § 152(c)(2) the district court, "with the consent of all the parties to the proceeding," may refer a "related to" matter to the bankruptcy court for final judgment.

2.3.3.1 *Problems with Consent:*

- Section 157(b)(5) says nothing about consent. The Supreme Court treats Pierce's conduct as a waiver: "Given Pierce's course of conduct before the Bankruptcy Court, we conclude that he consented to that court's resolution of his defamation claim (and forfeited any argument to the contrary). We have recognized 'the value of waiver and forfeiture rules' in 'complex' cases . . . and this case is no exception."[54]
- *So,* why wasn't this consent sufficient to forfeit objection to Vickie's (counter)claim?
- Does it matter whether the title 28 specifically provides for consent? If not, what sort of conduct constitutes consent?
- "Inbound" v. "Outbound" Consent. Does the consent analysis turn on whether the proceeding involves a claim *against* the estate (as in Pierce's defamation claim) or an affirmative claim *of* the estate against a third party (even a creditor, as with Vickie's tortious interference claim)? Can consent only be "inbound" (to the court and claims resolution process), but not "outbound" (i.e., to "augment" the estate)?

2.3.4 *Consent and Proposed Revised Bankruptcy Rules.* Recognizing that party consent may be the most pragmatic way to resolve at least some of the uncertainty created by *Stern,* the National Bankruptcy Conference is considering proposing amendments to the Federal Rules of Bankruptcy Procedure that would facilitate the creation of this consent. *See* Appendix 1.

3. Bankruptcy Court Authority After *Stern*: Three Queasy Pieces

Stern's contradictions create instability: *Stern* has created significant doubts about what bankruptcy courts can finally adjudicate. Its contradictions derive from three different ways to conceptualize the role of bankruptcy courts. Neither *Stern* nor *Ortiz* is clear about which conception we should use. All three, however, are problematic.

3.1 *The English Model: Summary (Property-based) v. Plenary Jurisdiction*: The bankruptcy power in the United States was informed by the English system of bankruptcy. "This English version of bankruptcy jurisdiction, however, was limited to jurisdiction over a debtor's property that actually found its way into the hands of the [bankruptcy] commissioners and the estate's representative . . . . Thus, if a determination were required to

[53] *Stern* at 2606. "We need not determine what constitutes a "personal injury tort" in this case because we agree with Vickie that § 157(b)(5) is not jurisdictional, and that Pierce consented to the Bankruptcy Court's resolution of his defamation claim"

[54] *Stern,* at 2608 (quoting Exxon Shipping Co. v. Baker 554 U.S. 471, 487-88 (2008)).

determine whether property belonged in the bankrupt's estate or not, there was no 'bankruptcy' jurisdiction, as such, over the matter."[55]

3.1.1 *Washington, D.C., 1898*. The first "permanent" bankruptcy law in the United States recognized "summary" v. "plenary" jurisdiction akin to the English conception.[56] "The 1898 [Bankruptcy] Act reduced the sweep of federal bankruptcy jurisdiction essentially through a return to the English *in rem* model of bankruptcy jurisdiction in the now-infamous summary/plenary jurisdictional dichotomy."[57]

- Yet, the 1898 granted federal courts "plenary" in personam jurisdiction over avoidance actions.[58] "Moreover, in corporate reorganization proceedings, *any* plenary suit—even on a debtor's state-law cause of action to which the trustee merely succeeded as property of the estate—could be pursued in federal court as part of the 'bankruptcy proceedings.'"[59]
- Such actions could "enlarge" the estate, even though actions not commenced in state (or other) courts of general jurisdiction.

3.1.3 *Problem*: Scope determined by understanding of "property" and willingness of courts to adapt jurisdiction to that understanding.

- In any case, *Stern* does not suggest that Pierce's defamation claim or Vickie's counterclaim were outside the *subject matter* jurisdiction of bankruptcy—only that the wrong court (bankruptcy) did the wrong thing (grant Vickie summary judgment).

3.2 *The Administrative Model and the "Public Rights" Exception*. Bankruptcy is the only Article I power conducted largely through courts rather than administrative agencies. Historically, this is not surprising, since the collection of debts—and relief for debtors—was a problem that well-preceded the creation of the administrative welfare state.[60] Yet, Article I powers and conceptions of adjudication seem apt in this context. Article I tribunals can apparently do much that *Stern* says bankruptcy courts cannot.

3.2.1 *Public Rights Exception after Marathon*. "The Court has continued [] to limit the [public rights] exception 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

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[55] Ralph Brubaker, *A "Summary" Statutory and Constitutional Theory of Bankruptcy Judges' Core Jurisdiction after* Stern v. Marshall, 86 AM. BANKR. L.J. 121, 123 (2012). "If a [bankruptcy trustee] were required to sue someone to recover money or property *for* the estate . . . there was no "bankruptcy" jurisdiction at all; such an action required an ordinary formal suit in the appropriate superior court." Id.

[56] Pub L. No. 55-171, ch 541, 30 Stat. 544 (amended 1903-1976 & repealed 1978).

[57] Brubaker, *supra* note 55, at 127.

[58] Id. at 128.

[59] Id. (citations omitted).

[60] Thomas W. Merrill, *Article III, Agency Adjudication, and the Origins of the Appellate Review Model of Administrative Law,* 111 Colum. L. Rev. 939 (2011).

agency is deemed essential to a limited regulatory objective within the agency's authority."[61]

- Is the Bankruptcy Code a "complex regulatory scheme?" Are bankruptcy judges an "expert and inexpensive method for dealing with a class of questions of fact which are particularly suited to examination and determination by an administrative agency specially assigned to that task?"[62]
- Does it matter whether we call a bankruptcy court a "court" or an "agency?"

3.2.2 *CFTC v. Schor*.[63] *Schor* involved a dispute not between the government and an individual, but instead between two private parties—a disgruntled stock customer suing his broker under the Commodities Futures Trading Commission Act.[64] Initially, the plaintiff's case was heard by the Commodity Futures Trading Commission (CFTC), which by regulation permitted the broker-defendant to assert counterclaims arising out of the same transaction or occurrence against the customer.[65] When the CFTC decided the counterclaims in the defendant's favor, the plaintiff claimed the administrative body lacked jurisdiction over the counterclaim.[66] Justice O'Connor observed that "there is no reason inherent in separation of powers principles to accord the state law character of a [private rights] claim talismanic power in Article III inquiries."[67]

- In concluding that this non–Article III entity had authority to resolve this dispute between two private parties, Justice O'Connor distinguished *Northern Pipeline* on the grounds that the bankruptcy jurisdiction at issue in that case was much broader than that of the CFTC.[68] Moreover, although the CFTC could resolve the dispute, the victor would still have to go to a district court to enforce whatever decree the agency issued.[69]
- "[I]t is hard to distinguish the counterclaim in *Stern* from the counterclaim the Commodities Futures Trading Commission was allowed to resolve in *Schor*."[70]

3.2.3 *Problem*: Too broad. Although bankruptcy has administrative aspects, it routinely addresses "private" questions, e.g., adjudicating proofs of claim arising from contract claims or, more generally, "adjustment of the debtor creditor relationship."

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[61] *Stern,* at 2613.

[62] *Stern* at 2615 (quoting Crowell v. Benson, 285 U.S. 22, 46 (1932))

[63] Commodity Futures Trading Comm'n v. Schor, 478 U.S. 833, 853 (1986).

[64] *Id.* at 837.

[65] *Id.*

[66] *See id.* at 838.

[67] Id. at 853.

[68] *See id.* at 852–53 (characterizing bankruptcy jurisdiction as unconstitutional because it includes "'all civil proceedings arising under title 11 or arising in or related to cases under title 11'" (quoting 28 U.S.C. § 1471(b) (1982))).

[69] *Id.* at 853.

[70] Douglas G. Baird, *Blue Collar Constitutional Law,* 86 AM. BANKR. L.J. 3, 15 (2012).

3.3 *The Pragmatic Model: "Restructuring" the Debtor/Creditor Relationship.* "From the beginning, the 'core' of federal bankruptcy proceedings has been 'the restructuring of debtor-creditor relations.'"[71] "Restructuring" could refer to one or more of four tasks: (i) determining *liability* of the debtor or creditor; (ii) determining *certain characteristics* of liability, such as the amount and nature of liability of the debtor or creditor established elsewhere; (iii) *making distributions* on account of net liabilities, and (iv) *discharging* debt not otherwise paid out by the bankruptcy process.

- From the standpoint of *Stern*, the first and second are most problematic, especially as applied to claims of the estate against creditors or third parties. A pragmatic approach to bankruptcy court authority, however, would generally give bankruptcy courts all (or almost all) four tasks.

3.3.1 *The Jury Question.* Sometimes, the scope of bankruptcy court authority has been addressed in the context of cases considering whether a defendant in an avoidance action had a right to a jury trial. In *Granfinanciera, S.A. v. Nordberg,* the Supreme Court held that a non-creditor defendant to a fraudulent transfer action was entitled to a jury trial before an Article III judge. "We reasoned that fraudulent conveyance suits were 'quintessentially suits at common law that more nearly resemble state law contract claims brought by a bankrupt corporation to augment the bankruptcy estate than they do creditors' hierarchically ordered claims to a pro rata share of the bankruptcy res.'"[72]

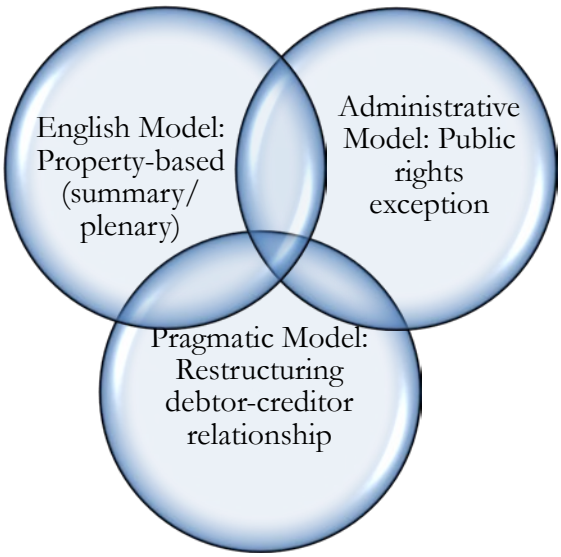
- Does *Granfinanciera* apply by analogy to larger Article III question? Although *Stern* seems to think so, jury trials are not about inter-branch relations, but instead about the division of labor within a court.

3.3.2 *Problem*: Too broad. Everything could involve restructuring the debtor/creditor relationship. Adjudicating Vickie's counterclaim would have "restructured" her relationship with Pierce.

[71] *Stern,* at 2629 (quoting *Marathon*, at 71) (Breyer, J., dissenting).

[72] *Stern,* at 2614 (quoting *Granfinanciera,* at 56). This seems to misstate the nature of fraudulent transfer claims. Deriving from the Statute of Elizabeth, they apparently had both a revenue-generation function (preserving the crown's capacity to collect transfer taxes) and an "estate augmentation" function, as they enabled creditors—whether contractual or otherwise—to recover their debtor's property. *See* Jonathan C. Lipson, *Secrets and Liens: The End of Notice in Commercial Finance Law*, 21 EMORY BANKR. DEV. J. 421 (2005) (discussing historical development of fraudulent transfer law).

Figure 2: *Three Different Conceptions of Bankruptcy Court Power*



4. Practical Implications

4.1 *Takeaway Points*

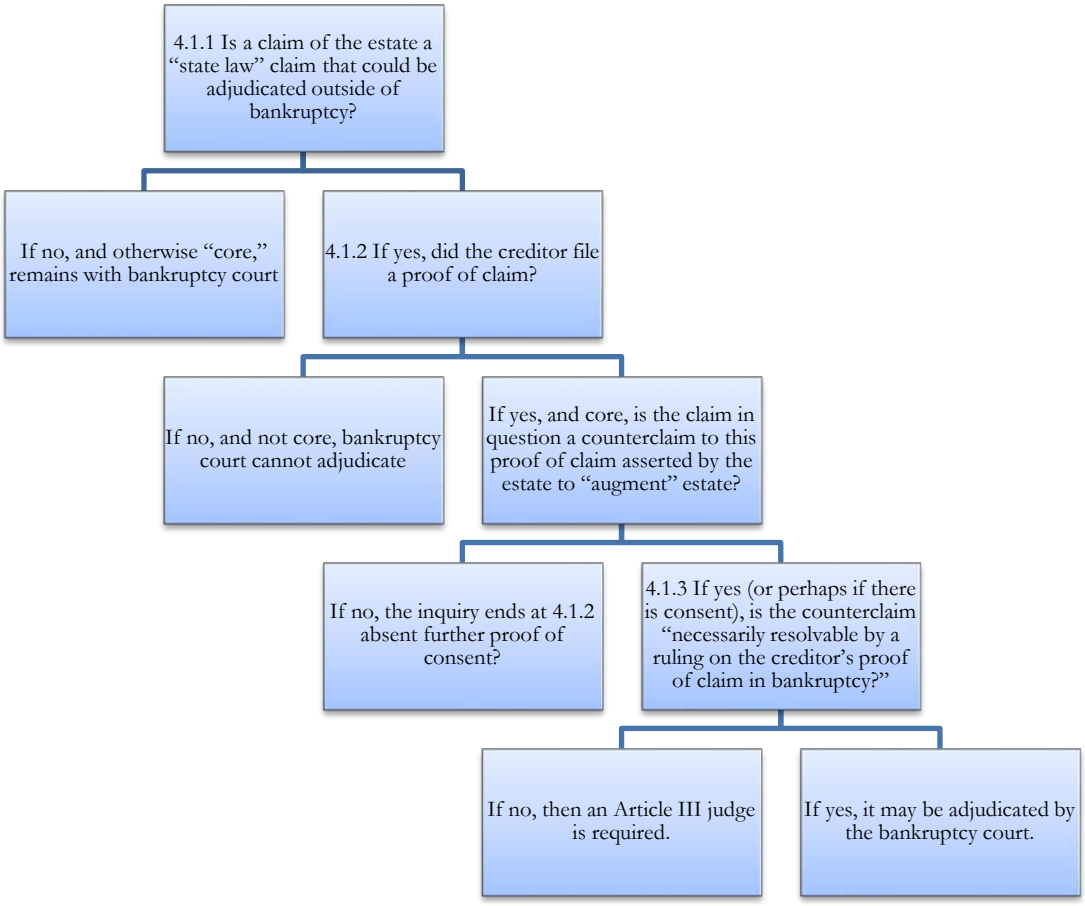
- *Stern* applies to more than state law counterclaims against creditors. Pay attention to all actions that could trigger the *Stern/Ortiz* analysis.
- A counterclaim to a proof of claim is not automatically "part of the claims allowance process." A bankruptcy court lacks constitutional authority to enter a final judgment on a state law counterclaim that is not "necessarily resolved in the process of ruling on a creditor's proof of claim."
- "Consent" may become an important tool for resolving uncertainty about the scope of bankruptcy court power. Courts are recognizing that parties can consent to bankruptcy court adjudication of both core-*Stern* matters and non-core matters. It would seem that inbound consent (as in Pierce's consent to adjudication of his defamation claim) is more plausible than outbound consent (i.e., to bankruptcy court authority to "augment" the bankruptcy estate). But we do not know the boundaries of consent.
- When it is in your client's interest, make consent clear. A party's course of conduct may establish "consent," but filing a proof of claim is (apparently) not enough.
- If you plan to object to bankruptcy court adjudication, object early, or you may risk forfeiting your objection.

4.2 Key Questions

Three-Step Decision "Shrub." In attempting to sort out the implications of *Stern* and *Ortiz,* we found it helpful, if challenging, to attempt to develop a three-part checklist of questions that practitioners should consider when in doubt about the "*Stern*-ness" of a claim. Ordinarily, we would call this a "decision tree." But, given the contradictions and uncertainties embedded in *Stern,* it is difficult to say this analysis rises to the level of a full "decision tree." It may thus more appropriately

be characterized as a "decision shrub." Nevertheless, it would seem to be helpful to ask the following sorts of questions:

Figure 3: When Do You Have a Stern Problem?



4.2 *Hypotheticals.* Following are brief hypotheticals that illustrate some easier and some more difficult problems raised by *Stern*. In each case, the question is simple: What is the "division of labor" between a bankruptcy court and another tribunal in solving the problem at hand? In each case, assume that the parties have not formally consented to bankruptcy court adjudication.

4.2.1 Sustainable Energy, LLC filed for bankruptcy relief under Chapter 11. A trustee was appointed, who sued Midwest Enterprise LLC under § 547 to recover roughly $900,000.00 in payments Sustainable Energy made during the ninety days before it filed bankruptcy.

4.2.2 Business tycoon William Peterson enticed investors to invest in a Ponzi scheme, promising substantial returns. Charles and Barbara Townsend invested $500,000.00 in the scheme and received approximately $700,000.00 from their investments. One year after the initial investment, William filed for Chapter 7 relief, and Charles and Barbara filed a proof of claim. The Chapter 7 trustee commenced an action under § 548, seeking avoidance of the $700,000.00 Charles and Barbara received.

4.2.2.1 Would it matter if the bankruptcy case were commenced three years after the transfer (outside the § 548 window), and the fraudulent transfer action was commenced under the applicable state fraudulent transfer law, as incorporated by Bankruptcy Code section 544?

4.2.3 George Bailey's Building and Loan Association (a non-bank debtor) has gone out of business. The day the business closed, Bailey and his creditor Mr. Potter got into a heated argument outside the building. Mr. Potter punched Bailey in the nose, and Bailey had to undergo expensive reconstructive surgery as a result of his injury. Bailey later filed for Chapter 13 relief, and Mr. Potter filed a proof of claim. Bailey filed a counterclaim, seeking personal-injury and medical expense damages from the prepetition nose incident.

4.2.4 Anna Nicole bought a 2005 Toyota Corolla XRS three years ago, and obtained financing from Prime Financial Services. Prime Financial failed to perfect its lien on the car. Anna Nicole recently filed a Chapter 7 petition in the Western District of Wisconsin, and Prime Financial filed a proof of claim. The Chapter 7 trustee filed an adversary proceeding, seeking to avoid Prime's lien under § 544(a).

4.2.5 Harold Johnson III hired Carly Contractor to build his home in 2007. Carly failed to tell Harold she was not a licensed contractor, and three months after the home was complete, the roof caved in. Carly filed a Chapter 7 petition. Harold brought an adversary proceeding against her, claiming the debt Carly owed him was non-dischargeable under § 523(a)(2)(A). The bankruptcy court found that Carly's debt was non-dischargeable, and entered a judgment in favor of Johnson specifying the amount of damages he was owed. There was no underlying state court judgment establishing damages.

4.2.6 BigBank has a first priority perfected security interest in the assets of Debtor. BigBank is oversecured. Under the loan and security agreement, and applicable state law, it is entitled to collect its legal fees. Debtor challenges BigBank's legal fees as being "unreasonable" under 506(b).

4.2.7 AmFin is the publicly-traded parent corporation of AmIns, a Wisconsin insurance company that has been taken into receivership under applicable state law. AmFin simultaneously commenced a chapter 11 case in the Southern District of New York (assume venue is proper). AmFin believes AmIns has assets that belong to AmFin, and files a motion for turnover under section 542.

4.2.7.1 AmFin, from the prior problem, has solvent non-debtor subsidiaries that are not insurance companies and therefore not in any bankruptcy or related procedure. AmFin seeks to cause the subsidiaries to declare dividend distributions to AmFin. AmFin is a controlling, but not the sole, shareholder of these subsidiaries. The other shareholders object to the distribution.

4.2.7.1 AmFin's reorganization plan includes releases of claims for breach of fiduciary duty that could have been asserted by the estate.

Appendix 1

Proposed Bankruptcy Rule Amendments[73]

At its March meeting, the Advisory Committee on Bankruptcy Rules approved a preliminary draft of rule amendments in response to *Stern*. These amendments will be presented to the Committee on Rules of Practice and Procedure ("the Standing Committee") at its June meeting. If approved by the Standing Committee for publication, 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 would 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*-type 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

[73] Courtesy of Professor S. Elizabeth Gibson. http://www.law.unc.edu/faculty/directory/gibsonselizabeth/.

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*-type proceeding.