Stern v. Marshall: The Powers of Bankruptcy Judges Questioned -- Again

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Lou Jones Breakfast Club

Thomas L. Shriner, Jr.
Foley & Lardner LLP
Milwaukee

Rebeca López
Third-Year Student
Marquette University School of Law

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I. INTRODUCTION

This outline provides a brief overview of the history of the bankruptcy courts and analyzes the impact of the Supreme Court's June 23, 2011 decision in *Stern v. Marshall*, 131 S. Ct. 2594, 180 L. Ed. 2d 475, on the adjudicative authority of bankruptcy judges. Although Chief Justice Roberts, the author of the Court's opinion, emphasized that *Stern* is a narrow decision that should have minimal impact on the day-to-day business of the bankruptcy courts, the dissent questioned that assertion, and a handful of decisions and comments since the decision have begun to call it into question.

II. THE UNITED STATES CONSTITUTION

A. Article III, § 1 of the United States Constitution: "The judicial Power of the United States, shall be vested in one supreme Court, and in such inferior Courts as the Congress may from time to time ordain and establish. The Judges, both of the supreme and inferior Courts, shall hold their Offices during good Behaviour, and shall, at stated Times, receive for their Services, a Compensation, which shall not be diminished during their Continuance in Office."

III. EARLY DEVELOPMENT OF BANKRUPTCY COURTS

A. Bankruptcy Act of 1898: Creation of the "Courts of Bankruptcy"

1. After a couple of short-lived exercises of its Art. I, § 8 power to establish "uniform Laws on the subject of Bankruptcies throughout the United States," intended to get through the aftermath of economic panics earlier in the Nineteenth Century, Congress passed the Bankruptcy Act of 1898, giving federal district courts jurisdiction over bankruptcy cases.

2. The district courts appointed referees to conduct bankruptcy proceedings and decide bankruptcy cases. The district court had the ability to withdraw a bankruptcy case from a referee. A referee's final order was appealable to the district court.[1]

3. The courts had summary jurisdiction over controversies involving property in the actual or constructive possession of the estate and, with consent, over "some 'plenary matters'—such as disputes involving property in the possession of a third person."[2] A good deal of litigation turned on which types of matters were subject to the courts' summary jurisdiction and which were not. An unconsented-to exercise of plenary jurisdiction under the mistaken view that the matter was within the court's

[1] *Northern Pipeline Const. Co. v. Marathon Pipe Line Co.*, 458 U.S. 50, 53 (1982) (citing 28 U.S.C. § 1471 (b)).

[2] *Id.*

summary jurisdiction required reversal for lack of jurisdiction. In cases where the issue was close, therefore, trustees often chose to file in a state court or in a federal district court under some other jurisdictional grant. This often led to delay in winding up the bankruptcy estate.

B. Bankruptcy Act of 1978: Creation of the Bankruptcy Code

1. The Bankruptcy Act of 1978. Pub. L. 95-598, created the Bankruptcy Code and provided for the eventual establishment of "United States Bankruptcy Courts," one in each judicial district of the country. The bankruptcy judges were to be appointed by the President, with the advice and consent of the Senate.

2. The 1978 Bankruptcy Act granted the new bankruptcy courts jurisdiction over "all civil proceedings arising under the bankruptcy code or arising in or *related to* bankruptcy cases, with review in Article III courts under a clearly erroneous standard."[3] The bankruptcy courts were to have all the powers of a court of law or equity. (The Act eliminated the prior distinction between summary and plenary jurisdiction, with a view toward removing that ground for delay in the administration of estates.)[4]

3. Considerable debate regarding the status of bankruptcy judges preceded the passage of the Act. Some advocates, because of the expanded powers granted to bankruptcy judges, supported granting them Article III status, with life tenure and irreducible salaries. Contrary views ranged from concern that life tenure would make the selection process inappropriately political, to the thought that all Article III judges should be generalists, and even that Congress should retain the flexibility to eliminate judgeships if the workload proved too light.

4. Congress ultimately chose not to confer Article III status upon the new bankruptcy judges. Instead, they were to be appointed by the President and confirmed by the Senate and to serve 14-year terms (subject to removal by the Judicial Council of the circuit), with their salaries to be set (and subject to adjustment) by Congress.

5. Aware of the argument that the broad powers being given to the new courts might require that the judges be given Article III status, Congress split the baby by granting to the district courts "original and exclusive jurisdiction of all cases under title 11," with that jurisdiction then "reassigned" to the new bankruptcy courts, which were to act as

[3] *Northern Pipeline*, 458 U.S. at 54 (emphasis in original).

[4] *Id.* at 53.

"adjuncts" to the district courts.[5] In a further attempt to avoid the Article III problem, the bankruptcy courts were prohibited from enjoining other courts or punishing criminal contempt that did not take place before the judge.

6. Although the Bankruptcy Act was passed in 1978, and most provisions took effect October 1, 1979, the bankruptcy courts created by the Act "were not to come into existence until April 1, 1984."[6] Even though the Act eliminated the existing referee system, Congress provided for a transition period to phase out the referee system and to implement the new courts. Until 1984, the existing referees (whose title had been changed to "bankruptcy judge" in 1973) were to continue hearing cases, but exercising the broader jurisdiction conferred on bankruptcy courts under the 1978 Bankruptcy Act.

7. Before the new bankruptcy courts could come into existence, the Supreme Court in 1982 determined that the jurisdiction conferred on the bankruptcy courts under the 1978 Bankruptcy Act was unconstitutional. As a result, the new courts contemplated by that Act never began to operate.

IV. *NORTHERN PIPELINE* AND SUBSEQUENT CONGRESSIONAL ACTION

A. *Northern Pipeline Construction Co. v. Marathon Pipe Line Co.*[7]

1. History of the Case

The facts of *Northern Pipeline* are scarcely referred to in the case. Northern Pipeline filed a Chapter 11 petition in the bankruptcy court in Minnesota. As permitted by the 1978 Bankruptcy Act, Northern Pipeline filed suit in the bankruptcy court against a non-debtor, Marathon, for breach of contract, misrepresentation, coercion, and duress. Marathon moved to dismiss the suit on the ground that the 1978 Bankruptcy Act "unconstitutionally conferred Article III power on judges who did not have life tenure and whose salary was not protected.[8] The bankruptcy court denied the motion, but the district court reversed. Under then-existing statutes, appeal from the district court's judgment went directly to the Supreme Court.

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[5] 1-2 Collier on Bankruptcy § 2.01 (16th ed. 2010).

[6] *Id.*

[7] 458 U.S. 50 (1982).

[8] *Id*. at 52–54.

2. The issue presented in *Northern Pipeline*[9] was whether the 1978 Bankruptcy Act violated Article III of the United States Constitution by allowing a portion of the "judicial power of the United States" to be exercised by judges who did not have the protections that Article III dictates for "Judges . . . of the supreme and inferior Courts."

   A four-justice plurality of the Supreme Court, with two other justices joining in the judgment,[10] held that Congress, by conferring Article III powers on an adjunct system of courts staffed by non-Article III judges, "impermissibly removed most, if not all, of the essential attributes of the judicial power" from the district courts upon which the bankruptcy jurisdiction had been conferred. Therefore, Congress's delegation of authority to the bankruptcy courts was unconstitutional.

   Notably, six justices agreed that the parts of the 1978 Bankruptcy Act that enabled the bankruptcy court to enter a final judgment on Northern Pipeline's common law suit against Marathon violated Article III. Justice Rehnquist wrote separately because he thought that the plurality decision was overly broad, that it was sufficient to hold that the grant of authority to resolve the type of claim involved in *Northern Pipeline* was unconstitutional. He thought it unnecessary to discuss, therefore, as the plurality opinion did, the three case-law exceptions to the Article III requirement that federal judicial power be exercised only by life-tenured judges protected from salary diminution. Justice Rehnquist said that *Northern Pipeline* did not implicate any of the exceptions.[11] Because his and Justice O'Connor's votes were necessary to make up a majority, this narrow view constitutes the holding of *Northern Pipeline*.[12]

3. Justice Brennan's plurality opinion discussed the importance of an independent judiciary. The plurality said that bankruptcy judges lacked independence because they were dependent on the President and the

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[9] According to Justice Brennan; as discussed next, Justice Rehnquist thought this was not the issue.

[10] Justice Brennan wrote the plurality opinion, joined by Justices Marshall, Blackmun, and Stevens. Justice Rehnquist, joined by Justice O'Connor, wrote an opinion concurring in the judgment, but disagreeing with the plurality on a number of salient points. Justice White, joined by Chief Justice Burger and Justice Powell, dissented. Chief Justice Burger also wrote a separate dissent. *Id*.

[11] *See id*. 89–92.

[12] The Chief Justice, in his separate dissent, pointed this out. *Id.* at 92.

Senate for reappointment, on Congress for their salaries, and could be removed from office by a process other than impeachment.[13]

4. The plurality discussed the three exceptions to the requirement of Article III recognized in prior cases: territorial courts, military courts, and "legislative courts and administrative agencies created by Congress." The latter category was a permissible exception to the requirement that all federal judicial power be exercised by life-tenured judges, Justice Brennan said, because legislative courts and agencies adjudicated cases involving "public rights," that is, "matters between the government and persons subject to its authority in connection with the performance of the constitutional functions of the executive or legislative departments.[14]

5. The plurality said that the claim at issue in *Northern Pipeline* was clearly a private common law matter between private parties and that none of the three exceptions applied. Therefore, the 1978 Bankruptcy Act, by conferring authority to hear such cases on bankruptcy judges, was unconstitutional.

6. The plurality said that calling the bankruptcy courts adjuncts of the district courts did not avoid the constitutional problem and that Congress could not delegate the authority to decide rights not created by federal statute to non-Article III judges.

7. All six justices in the majority agreed that the structure of the new bankruptcy courts contemplated in the 1978 Bankruptcy Act was sufficiently integrated that the entire structure should be struck down. Or, as Justice Rehnquist put it, the authorization in the Act for bankruptcy courts to hear the type of claim in *Northern Pipeline* could not be severed from the rest of the (potentially constitutional) grant of authority.

B. Emergency Rule

The Court made the judgment in *Northern Pipeline* prospective, rather than retroactive, and granted a stay until October 4, 1982 to allow Congress time to amend the law. Congress failed to act in time and during a further extension of the stay. As a result, the Judicial Conference of the United States proposed an emergency interim rule, adopted by all the district courts in the country, that prevented bankruptcy judges from entering final orders without the consent of the parties. Under the emergency rule, the bankruptcy courts had to submit proposed findings of fact and conclusions of law to the district

[13] *Id*. at 57–60.

[14] *Id*. at 68.

courts for *de novo* review. Despite some doubt by bankruptcy judges themselves, the emergency rule's constitutionality was upheld.[15]

Congress finally acted "to correct the constitutional defect" in 1984.[16]

C. The Bankruptcy Amendments and Federal Judgeship Act of 1984

The 1984 Act "adopted the structure devised in the emergency rule."[17] District courts retained original jurisdiction over bankruptcy proceedings and were permitted to delegate it to the bankruptcy courts, now described as "units" of the district courts.[18] Congress also made two notable changes from the scheme contemplated in 1978:

1. **Appointment:** Judges are appointed by the court of appeals of the circuit in which the bankruptcy court is located. The bankruptcy judges enjoy a 14-year term, and their salaries are set at 92% the salaries of Article III judges.[19]

2. **"Core v. Non-Core Proceedings"**: Congress distinguished between "core" and "non-core" proceedings. Bankruptcy courts have the power to enter final judgments in core proceedings.

   a. Core proceedings are defined by statute to include 16 categories of disputes,[20] including "counterclaims by [a debtor's] estate against persons filing claims against the estate."[21] A bankruptcy judge may enter a final judgment in a core proceeding. Parties may appeal final judgments of a bankruptcy court in core proceedings

[15] *See, e.g., Moody v. Martin*, 27 B.R. 991 (W.D. Wis. 1983).

[16] Lloyd George, *From Orphan to Maturity: The Development of the Bankruptcy System During L. Ralph Mecham's Tenure as Director of the Administrative Office of the United States Courts*, 44 Am. U. L. Rev. 1494–95 (1995).

[17] *Id*. at 1495.

[18] 28 U.S.C. § 151.

[19] 28 U.S.C. §§ 152, 153.

[20] 28 U.S.C. § 157(b)(1)–(2).

[21] 28 U.S.C. § 157(b)(2)(C).

to the district court, which reviews them under traditionally deferential appellate standards.[22]

b. In non-core proceedings, a bankruptcy court submits proposed findings of fact and conclusions of law to the district court for *de novo* review and entry of final judgment. With the consent of the parties, the bankruptcy judge can enter a final judgment in a non-core proceeding.[23]

V. *STERN V. MARSHALL*

And then along came Anna Nicole . . .

A. History of the Case

> This "suit has, in course of time, become so complicated, that . . . no two . . . lawyers can talk about it for five minutes, without coming to a total disagreement as to all the premises. Innumerable children have been born into the cause: innumerable young people have married into it;" and, sadly, the original parties "have died out of it." A "long procession of [judges] has come in and gone out" during that time, and still the suit "drags its weary length before the Court."[24]

Vickie Lynn Marshall (a/k/a "Anna Nicole Smith") married a Texas billionaire, J. Howard Stern II. Vickie was J. Howard's third wife and married him a year before he died. During the marriage, J. Howard's son Pierce persuaded his father to create a living trust. J. Howard gave Vickie many gifts during their marriage, but he did not include her in his will. Vickie claimed that J. Howard had intended to leave her half his property. Even before J. Howard died, Vickie filed a claim in a Texas probate court, alleging that Pierce had fraudulently induced J. Howard to leave her out of his will.

After J. Howard died, Vickie filed a bankruptcy petition in California. Pierce filed an adversary complaint in the bankruptcy court, seeking a determination that a defamation claim that he had against Vickie (because her attorneys had defamed him by what they told the press about his efforts to gain control of his father's wealth) was not dischargeable. Pierce also filed a proof of claim in Vickie's bankruptcy, seeking damages for the defamation.

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[22] 28 U.S.C. § 158(a); Fed. Rule Bkrtcy. Proc. 8013. *See Stern*, 131 S. Ct. 2594, 180 L. Ed. 2d 475, 489.

[23] 28 U.S.C. § 157(c).

[24] *Stern*, 131 S. Ct. at 2600, 180 L. Ed. 2d at 484–85 (2011) (quoting C. DICKENS, *Bleak House*, 1 WORKS OF CHARLES DICKENS 4–5 (1981)).

Vickie asserted truth as a defense and counterclaimed against Pierce for tortious interference with the gift that she alleged J. Howard had intended to leave her. In 1999, the bankruptcy court granted summary judgment against Pierce on the defamation claim. In 2000, the bankruptcy court ruled in favor of Vickie on her counterclaim, awarding her $400 million in compensatory damages and $25 million in punitive damages.

In post-trial proceedings, Pierce argued that the bankruptcy court lacked authority to hear Vickie's counterclaim because it was not a core proceeding. The court held that it was a core proceeding.

The district court, relying on its reading of *Northern Pipeline* to help it interpret the statute, concluded that a "counterclaim should not be characterized as core" when it "is only somewhat related to the claim against which it is asserted, and when the unique characteristics and context of the counterclaim place it outside of the normal type of set-off or other counterclaims that customarily arise." 264 B. R., at 632. Accordingly, the district court treated the bankruptcy court's judgment "as proposed rather than final."

While these proceedings were transpiring in California, the Texas probate court had conducted a jury trial, which resulted in a verdict and a judgment in Pierce's favor. The district court did not accord that ruling preclusive effect. Instead, it found that Pierce had tortiously interfered with Vickie's gift and awarded her damages in excess of $88 million.

The Court of Appeals for the Ninth Circuit initially reversed the district court on the ground that the case fell within the "probate exception" to federal jurisdiction.[25] The Supreme Court reversed on this ground and remanded the case to the court of appeals to consider grounds that that court had not reached.[26]

On remand, the court of appeals, also reading the statute in light of its understanding of *Northern Pipeline*, held that the counterclaim was not a core proceeding. The court said that "a counterclaim under §157(b)(2)(C) is properly a 'core' proceeding 'arising in a case under' the [Bankruptcy] Code only if the counterclaim is so closely related to [a creditor's] proof of claim that the resolution of the counterclaim is necessary to resolve the allowance or disallowance of the claim itself." 600 F.3d at 1058. Because the bankruptcy court had no power to enter a final judgment, and the Texas probate court judgment intervened between the bankruptcy court's entry of judgment and the district court's vacation of that judgment and entry of its own, the district court should have "'afforded preclusive effect' to the Texas 'court's determination of relevant legal and factual issues.'" *Id.* at 1064-65.

The Supreme Court again granted certiorari. Chief Justice Roberts (joined by Justices Kennedy, Thomas, and Alito) wrote the opinion for the Court, fully joined in by Justice Scalia, who concurred to express his longstanding opposition to multi-factor tests for the

[25] *Marshall v. Marshall*, 392 F.3d 1118 (9th Cir. 2004).

[26] *Marshall v. Marshall*, 547 U.S. 293 (2006).

"public rights" exception to the requirement that only Article III judges can exercise federal judicial power. Justice Breyer wrote a dissent, joined by Justices Ginsburg, Sotomayor, and Kagan.[27]

B. Issues Presented to the Supreme Court

1. Whether the bankruptcy court had statutory authority to enter judgment on Vickie's counterclaim?

   Yes. All nine justices agreed that the clear text of 28 U.S.C. § 157(b)(1) authorized the bankruptcy court to enter final judgment on Vickie's counterclaim. Specifically, the Court agreed with Vickie that, under § 157(b)(2)(C), her counterclaim was a core proceeding.

   Next, in response to Pierce's argument that the bankruptcy court lacked jurisdiction because his defamation claim was a "personal injury tort" that had to be tried in a district court, under § 157(b)(5), the Court (without deciding whether a defamation claim fits that description) held that § 157(b)(5) is not jurisdictional and that Pierce had consented to the bankruptcy court's deciding the case and had forfeited any argument to the contrary. Pierce had stated repeatedly that he was "happy to have the case litigated there." With (one suspects) tongue firmly planted in cheek, the Chief Justice said: "We will not consider his claim to the contrary, now that he is sad."

2. Whether the bankruptcy court had the constitutional authority to enter judgment on Vickie's counterclaim?

   No. Being unable to avoid the constitutional question by statutory interpretation, the majority of the Court held that the bankruptcy judge was exercising the judicial power of the United States by entering final judgment on Vickie's claim and that doing so violated Article III. Vickie's claim was adjudicated a year after Pierce's claim had been dismissed. As a result, the counterclaim did not arise from the bankruptcy, nor would it have been resolved in the claims approval process.

   The Court addressed several issues that it said supported its holding:

   a. **Article III**: Article III requires that the judicial power of the United States be vested in judges appointed by the President with

[27] Making the Chief Justice's *Bleak House* quotation seem particularly apt, by the time the case got to the Supreme Court for the second time in 2011, both Vickie and Pierce had died, and they were represented by the executors of their estates. And, of course, the dispute goes on even after this latest decision.

the advice and consent of the Senate, who hold office during their good behavior, and whose salary is not subject to change by Congress. The Court reviewed the importance of an independent judiciary.

Because bankruptcy judges do not enjoy life tenure or compensation independence from Congress, it was unconstitutional to delegate to them the authority to hear and determine common law claims. The Court held, in this regard, that the changes to bankruptcy court jurisdiction made by the 1984 Act were insufficient to avoid the constitutional violation identified in *Northern*.

b. **Exceptions to Article III:** Vickie's case did not fall within the "public rights" exception to Article III. Vickie's case was a matter between two private individuals and, therefore, not a matter of public rights.

> 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.[28]

(i) In *Northern Pipeline*, the Court held that the public rights exception did not apply to the state law claim in issue there, a common law contract dispute.

(ii) The Court discussed and cited *Murray's Leasee v. Hoboken Land & Improvement Company*[29] for the proposition that

[28] 131 S. Ct. at 2615, 180 L. Ed. 2d at 501.

[29] 59 U.S. (18 How.) 272 (1856). This early case upheld the authority of Congress to preclude judicial review of a determination by Treasury Department auditors that certain former Treasury officials were indebted to the Government.

"Congress cannot 'withdraw from judicial cognizance any matter which, from its nature, is the subject of a suit at the common law, equity or admiralty.'" The Court also cited *Crowell v. Benson*[30] in stating that private rights involved the determination of liability between two private individuals.[31]

(iii) In *Granfinanciera, S.A. v. Nordberg*,[32] the most recent Supreme Court case discussing public rights in the context of bankruptcy, the Court had "rejected a trustee's argument that a fraudulent conveyance action filed on behalf of a bankruptcy estate against a non-creditor in a bankruptcy proceeding fell within the exception." The Court says that the claim in *Granfinanciera* was not a matter pursued through the other branches, was not derived from a federal statutory scheme, nor was it a claim created by federal law. Therefore, the public rights exception did not apply. Likewise, Vickie's counterclaim involves a final determination of a common law cause of action that does not "derive[] nor depend[] upon a regulatory scheme." Therefore, the exception did not apply to Vickie's counterclaim.

c. **Consent:** Pierce's filing of a proof of claim did not constitute consent to the bankruptcy court's adjudication of Vickie's counterclaim. Pierce was forced to file in bankruptcy court because there was no other forum in which he could collect from Vickie's bankruptcy estate.[33] Therefore, "the notion of 'consent'

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[30] 285 U.S. 22 (1931). Justice Scalia noted that the Court is "governed (for better or worse) by our landmark decision in" *Crowell*. The case related to the constitutional propriety of delegating to an administrator certain fact-finding related to worker's compensation awards under federal maritime law, subject to district court review and the entry of any judgment by that court.

[31] The Court also discussed and distinguished *Thomas v. Union Carbide Agricultural Products Co.*, 473 U.S. 568 (1985) (upholding a mandatory arbitration scheme for obtaining compensation from the Government under a regulatory statute), and *Commodity Futures Trading Comm. v. Schor*, 478 U.S. 833 (1986) (upholding CFTC jurisdiction to adjudicate counterclaims connected to reparations proceedings within its jurisdiction to regulate commodity brokers).

[32] 492 U.S. 33 (1989).

[33] The Court explained that 11 U.S.C. § 523 compels someone in Pierce's position to file his claim in the bankruptcy case.

does not apply in bankruptcy proceedings as it might in other contexts."

d. **Adjunct Courts**: The bankruptcy courts are not "adjuncts" of the district courts. The Court distinguished bankruptcy courts from "true adjunct courts" because bankruptcy courts do not make narrow, specialized fact determinations regarding a "particularized area of the law." Unlike the administrative decision-making scheme discussed in *Crowell*, in which a district court entered the final order, the bankruptcy courts' judgments are only reviewed on appeal, applying the deferential standard normally applied by appellate courts to the judgments of trial courts with full adjudicative authority. The Court said that the bankruptcy courts could no more be considered adjuncts of the district courts than a "district court can be deemed such an 'adjunct' of the court of appeals."[34]

e. **Impact:** The Court first asserts that the desire for efficiency in the bankruptcy courts will not justify delegation of authority to them if the delegation is contrary to the Constitution. The Court further states that the impact of its ruling will be minimal. The majority asserts that the consequences are not "significant" and that the framework of the 1984 Act already provides a process through which the claims can be resolved.

3. The Court concludes that Congress "in one isolated respect" exceeded Article III's limitation on the authority to exercise the federal judicial power that can be given to non-Article-III judges. As a result, the bankruptcy court lacked authority to decide Vickie's counterclaim.

C. Dissent

Justice Breyer's dissent agrees with the Court's opinion that the bankruptcy court had statutory authority to decide the case but concludes that the Constitution permits bankruptcy courts to decide counterclaims like the one asserted by Vickie. In the dissent's view, the Court overemphasizes *Northern Pipeline* and should rather place emphasis on *Crowell*.

The dissent next states that it would also look to *Thomas* and *Schor* for a more pragmatic approach to the constitutional question. The dissent states that, under a pragmatic approach, the delegation of authority to bankruptcy judges does not violate the "separation of powers principles inherent in Article III." Although the nature of the claim resembles a common law action, Justice Breyer argues that (1) the nature of the

[34] 131 S. Ct. at 2619, 180 L. Ed. 2d at 505.

bankruptcy court tribunal, (2) the control exercised by Article III district court judges over bankruptcy proceedings, (3) the consent of the parties and (4) the "nature and importance of the legislative purpose" weigh heavily in favor of deciding that the bankruptcy court's authority to resolve Vickie's counterclaim was constitutional.

Finally, the dissent disputes the Court's statement that the holding will not change much. Justice Breyer asserts that counterclaims like Vickie's are common in bankruptcy proceedings and that the ruling will result in a "game of jurisdictional ping-pong" that will "lead to inefficiency, increased cost, delay, and needless additional suffering among those faced with bankruptcy."

VI. AFTERMATH OF THE DECISION – TO DATE

By the time of a LEXIS search on July 21, 2011, twelve judicial decisions had already cited *Stern*. The most interesting of these is *In re Bearingpoint*[35] Bankruptcy Judge Robert Gerber of the Southern District of New York gave his reasons for allowing the trustee of a Chapter 11 litigation trust to modify a previously confirmed reorganization plan in order to avoid prolonged litigation over jurisdictional questions resulting from *Stern*.

Naturally, some parties are also now questioning bankruptcy courts' prior rulings in light of *Stern*.[36]

***In re Bearingpoint, Inc*.**

1. In *Bearingpoint*, the bankruptcy judge modified a confirmed reorganization plan to allow the trustee of a litigation trust to assert claims against former officers and directors of a debtor (he refers to them as "the Targets") in a federal district court, instead of (as the plan required) channeling all such litigation into the confirming bankruptcy court. Judge Gerber states that he has found the state law claims against the Targets to be colorable, and in light of *Stern*, the trustee should be allowed to pursue them in a court with undoubted jurisdiction, because the bankruptcy court will not be able to enter a final judgment.

2. Although Judge Gerber states that he is hesitant to modify any confirmation order, several concerns lead him to do so here.

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[35] Case No. 09-10691, 2011 Bankr. LEXIS 2585 (Bankr. S.D.N.Y. July 11, 2011).

[36] *See, e.g. Corwin v. Gorilla Cos. LLC*, No. CV-10-1029-PHX-DGC, 2011 U.S. Dist. LEXIS 71427, 2-3 (D. Ariz. July 1, 2011) (on a motion for rehearing, "arguing that an intervening change in the law requires the Court to reconsider its October 14, 2010 order affirming the bankruptcy court's resolution of the core/noncore issue.")

a. **Bankruptcy Judge's Inability to Enter Final Orders**: The bankruptcy judge determines that the claim in issue would be non-core. As a result, he will not have the authority to enter a final judgment. The judge would have to enter proposed findings of fact and conclusions of law for a round of *de novo* review by the district court. Assuming that the Article III judge, or a jury, would have to make the requisite findings, the bankruptcy judge's findings would be of "little or no value," as he would not be the trier of fact.

> While there is no issue, even after Stern v. Marshall, as to the subject matter jurisdiction of the bankruptcy court to hear this controversy, the claims here are not "core." If I require this action to be litigated here in the bankruptcy court—or, more precisely, initially in the bankruptcy court-there is a material risk, in my mind, that especially with the inspiration of Stern v. Marshall, and the Targets' pointed reminder that I wouldn't be authorized to enter final judgment, this action will be tied in procedural knots by motion practice, here and in the District Court, exploiting asserted or actual inabilities on my part, as an Article I bankruptcy judge, to issue findings and orders.[37]

b. **Consent**: After *Stern*, Judge Gerber questions the validity of consent in non-core cases. The judge is uncertain as to whether consent is still effective to grant the bankruptcy court the authority to enter a final judgment. The judge states that, "it may now be, and it's fair to assume that it will now be argued, that consent, no matter how uncoerced and unequivocal, will never again be sufficient for bankruptcy judges ever to issue final judgments on non-core matters."

c. **Efficiency**: The judge raises the concern that parties can tie up cases in litigation when the claim in issue is non-core.

[37] *Id*. at *3–4.

***Matrix v. Am. Nat. Bank and Trust Co.*[38]**

This recent decision of the Court of Appeals for the Seventh Circuit (written by Judge Diane Sykes) raises the issue of the impact of *Stern* on a circuit split regarding the claim preclusive effect of a bankruptcy court's ruling in a core proceeding on subsequent litigation that would have led to a non-core proceeding in the bankruptcy court. The "core" of the issue relates to the breadth of claim preclusion doctrine, and, in particular, its bar to further litigation, not only of claims that have been reduced to judgment, but of claims that *could have been* resolved in the first litigation, but were not.

1. In *Matrix*, the dispute arose from a sale of plastic products by Matrix, the creditor, to Stylemaster, the debtor. At a time when Stylemaster was delinquent in paying invoices, Matrix got Stylemaster to grant it a lien on the particular plastic products that Matrix was holding for Stylemaster under the contract. During this same time, Stylemaster pledged all of its assets to its lender, ANB, to obtain a higher line of credit.

2. Stylemaster filed for bankruptcy in 2002. Matrix filed a proof of claim and objected to the sale of the assets subject to its lien. This led to a lien-priority dispute between Matrix and ANB. Matrix alleged that Stylemaster had fraudulently induced it to produce containers in order to build its inventory and then sell it at a reduced price in a bankruptcy sale to a related company, Gateway.[39] Matrix claimed that ANB's lien should be subordinated because ANB had participated in Stylemaster's fraud. Matrix's claims failed in the bankruptcy court, in the district court and in the court of appeals.

3. Then, Matrix filed a new suit in a federal district court against ANB and Gateway, asserting RICO violations and common-law fraud. The district court dismissed the claims based on both claim preclusion and issue preclusion. The court held that Matrix had litigated and lost the same claims in the bankruptcy proceeding.

4. *Matrix* highlights "some tension in our caselaw and a lopsided circuit split on how claim preclusion applies in this context." Because the parties had not briefed the effect of *Stern*, and because it may avoid the claim preclusion issue by doing so, the Seventh Circuit affirms on the ground of issue preclusion, but notes that *Stern* "suggests that resolving the conflict may be a bit more complicated than the caselaw presently admits."[40]

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[38] No. 08-397, 2011 U.S. App. LEXIS 15537 (7th Cir. July 28, 2011).

[39] Gateway was formed by Stylemaster's principals. Matrix contended that Gateway assisted Stylemaster in increasing its inventory for the bankruptcy "fire sale."

[40] No. 08-397, 2011 U.S. App. LEXIS 15537, at *4.

a. **Claim Preclusion:** Claim preclusion bars a claim based on issues decided in a prior case and all issues which could have been brought by the party. The doctrine has three elements: (1) an identity of the parties, or their privies; (2) an identity of the cause of action; and (3) *a final judgment* on the merits.[41] The Seventh Circuit holds that all three elements are met in *Matrix*, and that, generally, the inquiry would end there; however, Judge Sykes notes, "a profound conflict in our caselaw on this issue gives us reason to pause."[42]

b. ***Barnett v. Stern*:** In the 1990 case of *Barnett*,[43] the Seventh Circuit had held that a bankruptcy court's "resolution of a core claim will not have res judicata [claim preclusion] effect on a noncore claim that could have been brought, but wasn't, under the court's 'related' jurisdiction." *Barnett* relied upon the "interplay between claim-preclusion principles and the bankruptcy court's authority to enter final judgments."[44] The Seventh Circuit relied on the reasoning of a Fifth Circuit decision in its holding. *Barnett* held that a RICO claim was a non-core proceeding. Therefore, the bankruptcy court's adjudication of the core claim—an adversary proceeding to recover the assets of a sham trust—did not have res judicata effect on the non-core claim.[45]

c. **Circuit Split:** The Seventh Circuit notes in *Matrix* that every circuit to consider the issue since *Barnett* has rejected the core/non-core distinction in deciding the claim preclusion issue. Moreover, even the Fifth Circuit has since "cast doubt" on the distinction. Judge Sykes asserts that the split gives the Seventh Circuit reason to revisit *Barnett*'s recognition of that distinction.[46]

d. ***Stern*:** Moreover, "the allocation of jurisdiction between the bankruptcy and district courts does not speak to a party's ability to receive a final judgment in a bankruptcy proceeding; rather, it

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[41] *Id*. (emphasis added).

[42] *Id*. at *26.

[43] 909 F.2d 973 (7th Cir. 1990).

[44] 2011 U.S. App. LEXIS 15537 at *27.

[45] *Id*.

[46] *Id.* at *28–30.

stipulates which court has the authority to render the judgment."[47] Judge Sykes notes that *Stern* highlights the "jurisdiction-allocation question." In *Stern*, the Supreme Court held that a bankruptcy court does not have the 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."[48] Although Congress specifically designated such claims as core, the Supreme Court held that Article III prevents a bankruptcy court from making a final ruling on such claims.[49]

Accordingly, despite the fact that the split among the circuits on the core/non-core distinction and its impact on the claim preclusion effect of a bankruptcy judgment would otherwise seem ripe for resolution (arguably, by the Seventh Circuit's receding from its outlier position), *Stern's* recent retrenchment on the authority of bankruptcy courts to enter final judgments on common law claims means that that conflict remains unresolved and the effect of a bankruptcy court judgment will, for the present, remain unclear.

VII. OPEN QUESTIONS AND PRACTICE CONSIDERATIONS

A. Open Questions

According to early commentaries on the decision, there are several questions left unresolved by the Court's decision in *Stern*. These questions include:

1. Whether bankruptcy courts have the constitutional authority to resolve objections to claims? If so, whether they may adjudicate state law counterclaims for offset or as a defense and whether the bankruptcy judge's decision will have preclusive effect in subsequent proceedings?[50]

2. Whether express consent is sufficient to overcome constitutional objections?

3. Whether the bankruptcy courts can hear common law claims and enter final judgments?

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[47] *Id.* at *30–31.

[48] *Id.* at *31. (quoting *Stern*, 131 S. Ct. at 2620).

[49] *Id*.

[50] Kenneth Klee, *Klee on Stern v. Marshall***,** 2011 Emerging Issues 5743 (June 30, 2011).

In *Douglas v. Demarco*,[51] the bankruptcy court in Philadelphia raised concerns about its ability to hear common-law claims against nondebtor entities.

4. How compulsory counterclaims and claims objections will be treated procedurally? Whether claimants will seek to require district courts to withdraw the claims as a matter of course or will attempt to remain in bankruptcy court, leading to subsequent litigation in the district courts?

B. Practice Considerations

1. Analyze whether counterclaims must be resolved in the bankruptcy claims process.

"*Stern v. Marshall* is an important statement of the Article III limitations on bankruptcy courts' power. The decision will breed much litigation over the scope and limits of bankruptcy courts' jurisdiction. Practitioners will do well to analyze whether counterclaims must necessarily be resolved in the claims process. It could well take years to develop a clear body of case law regarding the application of *Stern v. Marshall's* ruling in the many contexts in which it may arise."[52]

Bankruptcy courts may also abstain from adjudicating compulsory counterclaims. Given the time that it takes the bankruptcy courts to develop proposed findings of fact and conclusions of law, and that the findings are subject to *de novo* review, bankruptcy courts may abstain completely from deciding the claims. Although some courts may hear them because they recognize that district courts are overburdened and will wish to defer to the bankruptcy court, it is unclear how the bankruptcy courts will treat compulsory counterclaims.

2. Anticipate a rise in counterclaim settlements.

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[51] NO. 10-13033-MDC, 2011 Bankr. LEXIS 2563, at *15–16 (Bankr. E.D. Pa. June 28, 2011) (internal citations omitted).

> Although the precise implications of the Supreme Court's decision in Stern on the related-to jurisdiction of bankruptcy courts remain to be determined, the Supreme Court's holding that bankruptcy courts may not decide "a common law cause of action, when the action neither derives from nor depends on any agency regulatory regime," suggests that, consistent with this Court's decision herein, this Court would lack jurisdiction to hear the Plaintiffs' claims against the nondebtor entities.

[52] Klee, *supra.*

As previously discussed, *Stern* will likely result in prolonged litigation over which court has the authority to decide counterclaims. Until a body of law is developed, it is likely that there will be an increase in the settlement of counterclaims in bankruptcy courts and that claimants will steer counterclaims toward district courts. Most commentators also agree that the "dual court dynamic" will result in a longer, more expensive process and an increased administrative burden on the district courts. As a result, parties will be further encouraged to settle claims.

3. Anticipate an increase in forum shopping and develop a strategy for litigating in multiple forums.

   As is made apparent by the history of *Stern*, the outcomes in two different courts (like a Texas probate court and a California bankruptcy or district court) can be drastically different. Debtors may be discouraged from filing counterclaims in bankruptcy court because of the risk that the outcome will not be final and also that a decision in one court will not be granted preclusive effect in another court. Therefore, attorneys should plan for the potential of litigating cases in multiple forums.