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SUBCOMMITTEE ON COURTS, COMMERCIAL AND ADMINISTRATIVE LAW

HEARING ON THE IMPACT OF THE SUPREME COURT'S DECISION IN *STERN v. MARSHALL*

JULY 20, 2012

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[1] The NCBJ and I are grateful for the invaluable assistance of Chief Judge Frank J. Bailey, his law clerk David Mawhinney, and Margaret M. Crouch in preparing this statement.

Table of Contents

Appendix

I. EXECUTIVE SUMMARY

In June, 2011, the Supreme Court issued its decision in *Stern v. Marshall*. The Court invalidated a portion of the statute under which United States bankruptcy judges derive their authority to enter final orders and judgments in bankruptcy cases and proceedings. The proceeding at issue in *Stern*, a state-law counterclaim of the debtor brought against a creditor who had filed a claim against the debtor's bankruptcy estate, is defined as a "core" proceeding under 28 U.S.C. § 157(b)(2)(C). Congress intended for bankruptcy judges to adjudicate all "core" proceedings. However, the Supreme Court ruled that any decision on a state-law counterclaim must be entered by a judge capable of exercising the "judicial power of the United States." Under Article III of the United States Constitution, only judges possessing life tenure can exercise this power. Because bankruptcy judges do not have life tenure, they cannot decide proceedings like the one at issue in *Stern*.

Stern has driven the bankruptcy system into a state of confusion. Although the Court directed that its decision be interpreted narrowly, the reasoning and language of the *Stern* majority has called the general authority of bankruptcy judges into question. Wasteful litigation over whether the bankruptcy court or the district court is the proper forum for adjudicating bankruptcy matters has exploded. District courts are seeing an increase in the filing of motions asking them to take bankruptcy cases and proceedings away from bankruptcy judges because *Stern* has called those judges' authority into question. Once removed from bankruptcy courts, it falls on district courts to resolve these cases and proceedings.

Litigating these disputes drains bankruptcy estate resources, delays the administration of bankruptcy cases, and reduces payment to creditors. The cost of *Stern*-based litigation is ultimately borne by the creditors who must wait longer to receive distributions from bankruptcy estates that are rapidly being consumed by the added administrative expense of litigating proceedings first, in the

bankruptcy and then, the district court. Most troubling, however, is the inconsistency in case law applying *Stern*'s holding, which disrupts the uniformity essential to the bankruptcy system. In short, the process by which bankruptcy cases are resolved has become less uniform and more expensive.

Congress can eliminate the confusion in the courts created by *Stern*, increase the financial return to creditors and the predictability crucial to the credit industry, and restore uniformity to the bankruptcy system by taking a variety of legislative actions. Each has its strengths and weaknesses.

Congress could defer to case law and procedural rule-making. However, the problem with relying on case law is that it often splits on the most important issues, leading to a lack of uniformity in how the law is applied. Indeed, case law is already splitting on the authority of bankruptcy judges to decide vital bankruptcy proceedings like fraudulent transfers and preferential transfers. Furthermore, if case law decides that bankruptcy judges have less authority to resolve bankruptcy cases after *Stern*, only an act of Congress can restore that authority. There are similar problems with relying on federal and local rule-making to fix the problems created by *Stern*. Changes to the Federal Rules of Bankruptcy Procedure are at least two years away. In the interim, local rule-making will occur sporadically and, because it is local, it cannot restore national uniformity to the bankruptcy system. District courts can order that bankruptcy judges hear proceedings in the first instance, but they cannot confer authority on bankruptcy judges to decide proceedings if it is concluded that, following *Stern*, they cannot enter a final order or judgment in a particular proceeding. In sum, rule-making cannot bring substantive changes to the bankruptcy system. It cannot restore the authority of bankruptcy judges to resolve bankruptcy proceedings.

Congress could amend 28 U.S.C. § 157, the statute under which bankruptcy judges currently exercise their authority, in several ways. First, it could eliminate or rewrite the portion of the statute—§ 157(b)(2)(C)—that the Supreme Court held unconstitutional in *Stern*. But simply amending § 157(b) will not restore uniformity to the bankruptcy system. *Stern* is creating uncertainty

because of its potential to affect bankruptcy matters *beyond* § 157(b)(2)(C) counterclaims. Second, Congress could allow bankruptcy judges to hear proceedings like the one at issue in *Stern* and submit proposed findings of fact and conclusions of law to the district court for final adjudication. Yet this would only add permanence and legitimacy to the current problem inherent in the bankruptcy system, namely that litigants need to visit both the bankruptcy court and district court to resolve their disputes. Third, Congress could amend § 157 to allow parties to consent to final adjudication by a bankruptcy judge. However, consent requires agreement of all parties to a dispute and therefore, by its nature, is ad hoc. Consent cannot be compelled, and one litigant, desiring to delay a proceeding for strategic purposes, could simply withhold its consent. Moreover, allowing private parties to consent to an Article I bankruptcy judge resolving a proceeding that requires the exercise of judicial power might violate the Separation of Powers Doctrine.

Finally, Congress could confer Article III status on bankruptcy judges. This measure would ensure the authority of bankruptcy judges to resolve all bankruptcy proceedings, including those requiring exercise of the judicial power of the United States. Article III status is the only solution that will decisively curtail litigation on the scope of bankruptcy court's authority. Without it, bankruptcy judge orders and judgments will be the subject of further challenge and potential invalidation for the foreseeable future. The House of Representatives understood the need for Article III bankruptcy judges when it passed its version of bankruptcy reform, HR-8200, in 1978. Given the shortcomings of the alternative options described above, granting bankruptcy judges Article III status is the only way Congress can restore uniformity to the bankruptcy system.

II. INTRODUCTION

Mr. Chairman and Members of the Subcommittee on Courts, Commercial and Administrative Law:

Thank you for the opportunity to testify about the impact of the Supreme Court's decision in *Stern v. Marshall*[2] on the bankruptcy system. My name is Joan N. Feeney and I am one of five bankruptcy judges serving the District of Massachusetts. I have had the privilege to be a bankruptcy judge for twenty years. I am also the co-author of the *Bankruptcy Law Manual* (West Group) and *The Road out of Debt: Bankruptcy and Other Solutions to Your Financial Problems* (John Wiley & Sons). I appear today as President of the National Conference of Bankruptcy Judges (the "NCBJ").

Emblematic of the current financial crisis in the United States is the chaos and financial pain inflicted on institutions and individuals by investment fund operator Bernie Madoff. At this sensitive moment in our financial history, the Supreme Court's decision in the case of *Stern v. Marshall* has cast orderly resolution of the fallout from the Madoff case into grave doubt. Public perception of the effectiveness of the judiciary, indeed of government, will be deeply impacted by confusion in the disposition of cases such as this.

The Constitution provides that Congress may establish "uniform Laws on the subject of Bankruptcies."[3] Today, my focus is not the laws set forth in the Bankruptcy Code; for example, those which establish how a debtor's estate is distributed or what types of debts are nondischargeable.[4] My focus is on the laws which establish the structural and organizational scheme of authority—namely who decides bankruptcy disputes, and who presides over bankruptcy cases and brings them to resolution.

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[2] 131 S. Ct. 2594 (2011).

[3] U.S. Const. art. I, § 8, cl. 4.

[4] 11 U.S.C. § 101 *et seq.*

District courts have original and exclusive jurisdiction over all bankruptcy cases. They have original but not exclusive jurisdiction over all civil proceedings arising under title 11 of the United States Code (the "Bankruptcy Code") or arising in or related to cases under title 11.[5] However, they may and do refer bankruptcy cases and proceedings arising in or related to bankruptcy cases to the bankruptcy judges in their district.[6] Since 1984, every district court in the United States has adopted a local court rule or permanent standing order that automatically refers bankruptcy cases to the bankruptcy courts. District courts reserve the power to withdraw referred bankruptcy proceedings from the bankruptcy courts for adjudication in the district court. Thus, for the past twenty-eight years, every single bankruptcy case filed in the United States has come under the jurisdiction of the bankruptcy courts.

Since 1984, bankruptcy judges have operated as Article I judges appointed by the Courts of Appeal to fourteen-year terms. Unlike their Article III brethren, bankruptcy judges do not have life tenure. They are currently compensated at 92 percent of the salary afforded U.S. district court judges. Bankruptcy judges preside over millions of cases and adjudicate numerous proceedings that arise daily in bankruptcy cases.

Last summer, in its decision in *Stern v. Marshall*, the Supreme Court ruled that the Article I status of bankruptcy judges prevents them from deciding certain proceedings referred to them by the district courts.[7] In allowing the district courts to refer these proceedings, namely certain state law counterclaims by the estate brought against persons filing claims against the estate, to the bankruptcy courts for final order, the Court held that Congress had "in one isolated respect" exceeded constitutional limitations. Nevertheless, *Stern* has driven the bankruptcy system into a state of confusion. Wasteful litigation over which court is the proper forum for adjudicating bankruptcy

[5] *See* 28 U.S.C. § 1334(a)-(b).

[6] *See* 28 U.S.C. § 157(a).

[7] *See Stern*, 131 S. Ct. at 2616; 28 U.S.C. § 157(b)(2)(C).

matters has exploded. The cost is ultimately borne by the creditors who must wait longer to receive distributions from bankruptcy estates that are rapidly being consumed by the added administrative expense of litigating bankruptcy proceedings in multiple courts.

Most troubling, however, is the inconsistency in case law applying *Stern*'s holding. In the year since *Stern*, strategic-minded litigants across the country are attempting to use the Supreme Court's reasoning to circumvent the bankruptcy process entirely and take their disputes straight to the district court. District and bankruptcy courts have responded to *Stern*-based challenges to bankruptcy judge authority in a growing volume of opinions whose rulings are as diverse as the legal analysis employed. In short, the process by which bankruptcy cases are resolved has become less uniform and more expensive. A selection of case studies reflecting the variety of *Stern*-influenced litigation across the country is appended to this statement as *Exhibit A*.

We submit that it is the appropriate time for Congress to address this lack of uniformity. This statement analyzes several options Congress may pursue to restore uniformity to the "subject of Bankruptcies throughout the United States." Each has strengths and weaknesses. Regardless of which course Congress ultimately takes, an efficient, fair, and cost-effective bankruptcy system is unachievable without an Act of Congress.

III. THE WORK OF THE BANKRUPTCY COURT

The recent Chapter 11 bankruptcy cases of Lehman Brothers, General Motors, Chrysler, and American Airlines demonstrate the vital role bankruptcy has played in the federal response to the economic downturn in recent years. From the largest corporations employing thousands, to families struggling to stay in their homes, bankruptcy is one of the most important social safety nets the

United States government has made available to its citizenry.[8] In the past year, the seldom-used Chapter 9 of the Bankruptcy Code has increasingly become an option for municipalities looking to restructure debt and pension liabilities. On June 29, 2012, the city of Stockton, California, became the largest city to file for bankruptcy in United States history following a housing market crash that left it unable to pay its workers, pensioners, and bondholders.

In the year since the Supreme Court issued its decision in *Stern v. Marshall*, there have been 1,209,517 new bankruptcy cases filed.[9] To put this number in perspective, the total number of civil cases for 2011 commenced in all the United States district courts was 289,969. For every civil case filed in 2011, there were five new bankruptcy cases. In 2007, the Administrative Office of the United States Courts began providing annual statistics on individual debtors with primarily consumer debts seeking relief under Chapter 7, 11, and 13 of the Bankruptcy Code. Individual debtors filing bankruptcy in 2010 alone reported $407 million in assets against $473.8 million in liabilities.[10]

Most bankruptcy cases are individual Chapter 7 cases with no assets to distribute. Consequently, these cases travel through the system uncontested without need of a hearing before a judge. However, the remaining bankruptcy cases involve significant distributions. The Office of the United States Trustee reports that during fiscal year 2011, Chapter 7 trustees administered 69,588

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[8] *See* President George W. Bush, *Statement By President George W. Bush Upon Signing S. 256 (Bankruptcy Abuse Prevention, Consumer Protection Act)*, 2005 U.S.C.C.A.N. S7, ("Our bankruptcy laws are an important part of the safety net of America."); Congressman Steve Cohen, *Subcommittee on Commercial and Administrative Law*, UNITED STATES HOUSE OF REPRESENTATIVES, http://cohen.house.gov/issue/judiciary/subcommittee-commercial-and-administrative-law, (last visited July 6, 2012) ("The bankruptcy system should act as a safety net that allows people to pursue an education with the assurance that, should their finances come under strain by layoffs, accidents, or other unforeseen life events, they will be protected.").

[9] This figure is published by the Administrative Office of the United States Courts and is available online at http://jnet.ao.dcn/Statistics/Data_File_Exchange.html.

[10] These figures appear in the *2010 Report of Statistics Required by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005* available online at: http://www.uscourts.gov/uscourts/Statistics/BankruptcyStatistics.aspx.

asset cases that generated more than $2.6 billion in creditor payments, while Chapter 12 and Chapter 13 trustees administered over 1.2 million cases and disbursed $6.5 billion to creditors.[11]

When a bankruptcy case is filed, not all of the assets that will eventually be distributed to creditors are property of the bankruptcy estate. Sometimes, a debtor has transferred assets to creditors or other third-parties prior to the bankruptcy. These assets are recovered for the benefit of the bankruptcy estate through adversary proceedings. Adversary proceedings are in the nature of civil actions brought by estate representatives and creditors, and must be decided by a judge. In the year since *Stern*, 52,953 adversary proceedings were commenced in the bankruptcy courts. It is within these adversary proceedings that the *Stern*-type authority issues arise requiring the involvement of the district courts.

IV. BACKGROUND

A. The Office of Bankruptcy Judge

The framers of the Constitution understood that putting bankruptcy laws in the exclusive control of the federal government was necessary to prevent state governments from enacting insolvency laws suited purely to local interests.[12] From the beginning, federal bankruptcy laws were seen as essential to the regulation of interstate commerce. Placing bankruptcy in federal courts assured a creditor from one state a neutral forum in a bankruptcy case filed by a debtor in another state regardless of where the bankruptcy case was heard. Uniform procedures of bankruptcy meant that lenders and borrowers in different states could conduct business with greater certainty of the

[11] This information is tracked by the Department of Justice, Office of the United States Trustee and can be found in its *Annual Report, Fiscal Year Report 2011* available online at http://www.justice.gov/ust/eo/public_affairs/annualreport/index.htm.

[12] S. Todd Brown, *Constitutional Gaps in Bankruptcy*, Am. Bankr. Inst. L. Rev. Vol. 20, at 184-85 (2012).

bankruptcy outcome in the event borrowers became unable to repay their debts, regardless of where the borrowers, their several creditors, or their property were located.

Before there were bankruptcy judges, there were referees. The Bankruptcy Act of 1898 conferred jurisdiction over bankruptcy matters in the federal district courts. The district court could appoint bankruptcy referees (they would be called judges beginning in 1973) to exercise "summary" but not "plenary" jurisdiction in bankruptcy. The summary/plenary jurisdictional divide had its roots in the 18th century English bankruptcy system.[13] "Summary" jurisdiction was a form of *in rem* jurisdiction, allowing bankruptcy referees to decide "matters relating to property over which they had direct control."[14] However, if a trustee sought to augment the bankruptcy estate, by recovering a pre-bankruptcy preferential or fraudulent transfer, the trustee would have to bring suit in the district court.

The role of the bankruptcy referee expanded in the post-war twentieth century due to an explosion of consumer bankruptcy cases.[15] The growing number of bankruptcy cases placed an increased strain on the summary/plenary jurisdictional divide. Bankruptcy law became a more complex and specialized discipline and the caseload of district court judges increased dramatically without a corresponding increase in the number of judges.[16] The summary/plenary distinction also provided litigants with an opportunity for mischief. As the Honorable Leif M. Clark observed in a 2001 article:

> The old summary/plenary distinction led to costly and time-consuming litigation over whether a given matter was one or the other. It also drove up the cost of bankruptcy reorganization, requiring counsel to conduct litigation in multiple forums

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[13] Ralph Brubaker, *A "Summary" Statutory and Constitutional Theory of Bankruptcy Judges' Core Jurisdiction After Stern v. Marshall*, 86 Am. Bankr. L. J., 121, 125 (2012).

[14] Brown, *supra* note 12, at 190.

[15] *Report of the Commission on the Bankruptcy Laws of the United States*, (the "Commission Report") H.R. Doc. No. 93-137, Pt. 1 (1973). In 1945 consumer credit outstanding amounted to $5.6 billion. It had swelled to $209.1 billion by 1978. *See* Conrad K. Cyr, *Structuring a New Bankruptcy Court: A Comparative Analysis*, 52 Am. Bankr. L. J. 99, 143 n.2 (1978).

[16] *See* H.R. Rep. No. 95-595, at 13-14 (1977).

> at the same time. Most nefariously, it offered numerous opportunities for abuse to those intent on frustrating the bankruptcy process.[17]

In 1970, Congress created the National Bankruptcy Review Commission to consider the state of bankruptcy in the United States and propose amendments to the 1898 Act. It released its Commission Report in 1973. The Commission Report recommended the establishment of a bankruptcy court with jurisdiction to determine most controversies in bankruptcy cases.[18] It recommended staffing this court with judges appointed by the President with the advice and consent of the Senate to serve fifteen-year terms. Addressing the necessity for these new courts, the Commission Report noted the need for the timely resolution of thousands of bankruptcy cases by tribunals possessing the requisite expertise to handle them. The costs and delays imposed by litigating the summary/plenary division were depleting bankruptcy estates of vital assets. The Commission recognized that superfluous litigation is unfortunate in any case, but had uniquely detrimental effects in bankruptcy. Scholar Susan Block-Lieb has observed:

> [T]he distinction between *in rem* summary jurisdiction and *in personam* plenary jurisdiction over disputes that arose in the context of bankruptcy was unclear, thus inviting strategic litigation over the court's jurisdiction. Delay and expense often create leverage, but leverage takes on a new dimension when litigation expends the scarce resources of an insolvent bankruptcy estate. The Commission justified its recommendation of a broad grant of bankruptcy jurisdiction on policy grounds: a broad grant of jurisdiction will discourage costly and time-consuming jurisdictional litigation and will result in greater uniformity in federal bankruptcy law.[19]

Congress appreciated the need for comprehensive bankruptcy reform.[20] The legislative process that resulted in the Bankruptcy Reform Act of 1978 included sixty-two days of hearings over

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[17] Hon. Leif M. Clark, *Jury Trials and Bankruptcy: Getting the Procedures Right*, 20 Am. Bankr. Inst. J. 26, n.1 (2001).

[18] *See* Commission Report*, supra* note 15, at App. Pt. 4-331.

[19] Susan Block-Leib, *What Congress Had To Say: Legislative History as a Rehearsal of Congressional Response to Stern v. Marshall*, 86 Am. Bankr. L. J., 55, 62 (2012).

[20] A comprehensive and thoughtful history of the Bankruptcy Act of 1978 can be found in the Honorable Geraldine Mund's superb five part series *Appointed or Anointed: Judges, Congress, and the Passage of the Bankruptcy Act of 1978 Part Three: On the Hill*, 81 Am. Bankr. L.J. 1, 165, 341, 515 (2007) & 82 Am. Bankr. L.J. 175 (2008).

a period of three years.[21] The 1978 Act replaced the 1898 Act with the Bankruptcy Code and amended portions of title 28 of the United States Code ("Judiciary and Judicial Procedure") to expand federal bankruptcy jurisdiction to all disputes arising in, arising under, or related to the bankruptcy case. Additionally, the definition of "claim" included virtually any right to payment or equitable remedy.[22] The Act also created statutory analogues for common law fraudulent transfer and preferential transfer actions: essential tools for recovering estate assets since the earliest English bankruptcies.[23] Once codified, actions to recover fraudulent transfers and preferences were unequivocally within the subject matter jurisdiction of the bankruptcy court.

B. The Authority of Bankruptcy Judges

The expanded scope of bankruptcy law under the new Bankruptcy Code meant that many disputes involving state and common law would come within the jurisdiction of the federal bankruptcy court once a debtor filed a petition of bankruptcy. Resolving all the debtor's legal issues in a single forum was ideal for effectuating a swift restructuring of debtor-creditor relations. But adjudicating the diverse range of issues would require a federal judge with a broad range of subject matter jurisdiction *and* authority to adjudicate the variety of disputes captured by federal bankruptcy jurisdiction. It would sometimes require a judge authorized to exercise "judicial power" on behalf of the United States. Scholar Douglas G. Baird explains:

> Obtaining a judgment is the way that one private citizen can call upon the state to use force against another citizen to vindicate her rights. Authorizing the forcible seizure of property is a serious business. It is the essence of the judicial power. Because the bankruptcy judge is not an Article III judge, she lacks the power to authorize one citizen to take property away from another. It is just as if a janitor at the courthouse entered the judgment. He does not possess the judicial power either.

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[21] *See* Hon. Geraldine Mund*, supra* note 20, *Appointed or Anointed, Part Five: The White House*, 82 Am. Bankr. L.J. 175, 197 (2008).

[22] *See* Brown*, supra* note 12, at 192.

[23] *See* 11 U.S.C. §§ 544, 547, 548.

> If you want authorization to take someone else's property in the federal judicial system on account of an ordinary debt, you need to get it from an Article III judge.
> …
> Due process and Article III in this sense are fused at the hip. Once a judgment is entered, a private citizen can bring the coercive force of the state to bear against another citizen. Absent extraordinary circumstances . . . deploying the forces of the state to seize and sell someone's property constitutes an exercise of the judicial power.[24]

Article III of the Constitution describes the "judicial power" of the United States as extending to "all Cases, in Law and Equity, arising under this Constitution."[25] It vests the judicial power exclusively in judges who shall "hold their Offices during good Behavior, and shall, at stated Times, receive for their Services, a Compensation, which shall not be diminished during their Continuance in Office."[26] The Supreme Court has interpreted these provisions as prohibiting Congress from withdrawing from the "judicial cognizance" of Article III judges, "any matter which, from its nature, is the subject of a suit at the common law, or in equity, or admiralty."[27] When a suit is made of "the stuff of the traditional actions 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 with Article III judges in Article III courts.[28]

The 1973 Commission Report recommended that bankruptcy judges appointed to 15-year terms could resolve all proceedings arising in, arising under, or related to a bankruptcy case. The Report did not address the judicial power or the requirements of Article III judges. It was not until a 1976 hearing on an early version of the Bankruptcy Reform Act in the House of Representatives that someone first opined that the proposed bankruptcy court structure might be unconstitutional.[29]

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[24] Douglas G. Baird, *Blue Collar Constitutional Law*, 86 Am. Bankr. L. J., 3, 5 (2012).

[25] U.S. Const. art. III, § 2, cl. 1.

[26] *Id.* art. III, § 1.

[27] *See Murray's Lessee v. Hoboken Land & Improvement Co.,* 59 U.S. 272, 284 (1856).

[28] *See Stern*, 131 S. Ct. at 2609 *quoting Northern Pipeline Const. Co., v. Marathon Pipe Line Co. ("Marathon")*, 458 U.S. 50, 90 (1982).

[29] Block-Leib*, supra* note 19, at 69-70.

The Honorable Geraldine Mund recounts the circumstances leading to the addition of Article III bankruptcy judges in an early version of the House bill:

> [T]he Article III concept was incorporated because the testimony of William T. Plumb, Jr. had convinced Ken Klee and Richard Levin, the House staffers, that it would be unconstitutional to vest the proposed expanded jurisdiction in term appointees, and that the Tax Court model, which had been used by the Commission and echoed by [the National Conference of Bankruptcy Judges], was legally insufficient to accomplish this goal. As a result of this concern, Congressman Peter W. Rodino, Jr. (D-NJ), chair of the House Judiciary Committee, had sent a letter to several constitutional scholars asking for their opinions on the constitutionality of the various proposals. Their responses led Klee and Levin to conclude that only judges appointed under Article III could fully exercise the pervasive jurisdiction that Congress wanted to grant them.[30]

For the next 18 months, the status of the new bankruptcy judges was fiercely debated. The office of bankruptcy judge in place today is the product of compromise.

The version of the Bankruptcy Reform Act that was eventually passed by the House of Representatives was HR-8200. The Report of the Committee on the Judiciary (the "House Report") accompanying HR-8200 noted that "district judges have long made clear their lack of interest in bankruptcy matters," and observed, "[a]s the system has evolved, district judges have removed themselves further and further from the consideration of bankruptcy matters. The area has become too specialized and requires too much expertise to be able to be handled on an ad hoc basis by a generalist."[31] Everyone agreed bankruptcy judges were needed to realize the goal of an efficient bankruptcy system. To address the constitutional issues surrounding bankruptcy judges' authority and to attract qualified judges, HR-8200 gave bankruptcy judges Article III status.[32] The House

[30] Hon. Geraldine Mund, *supra* note 20, *Appointed or Anointed, Part One: Outside Looking In*, 81 Am. Bankr. L. J. 1, 29-30 (2007).

[31] H.R. Rep. 95-595 at 9, 14 (1977).

[32] *See id.* at 7 ("The judges of the proposed bankruptcy courts are granted full constitutional tenure.").

Report noted that the concept of a separate and independent Article III bankruptcy court "has been nearly universally supported."[33]

Despite heavy support for Article III bankruptcy judges, the Judicial Conference of the United States opposed HR-8200 in favor of a bill in which bankruptcy judges would retain the Article I status given to the bankruptcy referees under the 1898 Act.[34] Some members of the Conference expressed the view that the prestige of their office would be diminished by elevating bankruptcy judges to Article III status.[35] Several Senators objected to the idea of increasing the number of Article III judges with life-tenure.

In the fall of 1978, the House and Senate passed a comprehensive bankruptcy bill with hundreds of substantive provisions and a new structure for the bankruptcy courts. It provided for bankruptcy judges to be appointed by the President to serve 14-year terms (after the conclusion of a five year transition period) who would be subject to removal by the judicial council of the circuit in which they served for "incompetency, misconduct, neglect of duty, or physical or mental

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[33] *See id.* at 18 (The Report continues, "The Commission on the Bankruptcy Laws proposed it. The National Bankruptcy Conference testified in support of the proposition. The Commercial Law League of America and the American Bankers Association urged the Subcommittee to create an independent court system. Finally, the American Bar Association, at its 1976 meeting, and the Association of the Bar of the City of New York have called for the creation of an independent bankruptcy court. During 35 days of hearings in the House and 20 days in the Senate, not one witness reached the conclusion that the present bankruptcy court system should be retained. The only opposition to the separation of the bankruptcy courts from the district courts has come from the Judicial Conference. Its opposition has been belated at best.").

[34] *See* Cyr, *supra* note 15, at 141 ("Notwithstanding its serious shortcomings [a bill that would have kept bankruptcy judges at Article I status] was supported by the Chief Justice of the United States, the Attorney General of the United States and the Judicial Conference of the United States. It was vigorously opposed by virtually every other group and organization actively engaged in the long debate over the future needs of the bankruptcy system.").

[35] *See* Hon. Geraldine Mund, *supra* note 20, *Appointed or Anointed, Part One: Outside Looking In*, 81 Am. Bankr. L. J. 1, 2 (2007) *quoting Memorandum from Robert Lipshutz, Counsel to the President, to President Carter, 10/31/78* ("Insofar as I can ascertain, the only remaining opposition [to the Bankruptcy Act of 1978] is that of the Judicial Conference, 25 judges headed by the Chief Justice. It is my judgment that the principal reason for this emotional opposition is the desire of this small group, and particularly the district court judges, to retain the right of appointment of bankruptcy judges (referees), which they now have, and to have these judges continue (in the language of the Chief Justice) 'to serve as adjunct aides to district judges.' Every other group of persons concerned with this important subject matter has concluded that this legislation is extremely necessary because of the importance today of both consumer credit and commercial credit."); *see also* Eric G. Behrens, *Stern v. Marshall: The Supreme Court's Continuing Erosion of Bankruptcy Court Jurisdiction and Article I Courts*, 85 Am. Bankr. L. J. 323, 390 (2011) ("Troublingly, the Article III judges' opposition did not address whether the proposed reforms would remedy the problems that the congressional Commission cited in its report, but instead focused on whether their *own* status would be diluted by the elevation of bankruptcy judges.").

disability."[36] The bill gave bankruptcy judges the power under 28 U.S.C. § 1471 to decide all civil proceedings arising under the new Bankruptcy Code or arising in or related to cases under the Code.[37] Judge Geraldine Mund described the vocal support of a number of constituencies who urged President Carter to sign the bill:

> Creditor support was particularly active. The National Association of Credit Management, representing 42,000 member companies, and the Credit Managers Association of Southern California, an affiliate of the National Association of Credit Management with 3,000 member companies, "flooded" the White House with seventeen letters of support focusing on the need to have a bankruptcy system that recognized the practicalities of modern business practice. There were also letters or telegrams on behalf of organized labor, the bar, consumer lawyers, and many national bankruptcy groups.[38]

On November 6, 1978, President Carter signed the Bankruptcy Reform Act into law. Ten years after the first congressional hearings on establishing the 1973 Commission and following five years of legislative consideration, and hundreds of hours of hearings, the bankruptcy system moved into the modern age.[39]

C. The *Marathon* Decision

Four years later, in *Northern Pipeline Construction Co. v. Marathon Pipe Line Co ("Marathon")*, the Supreme Court struck down the statutory scheme of 28 U.S.C. § 1471 that granted bankruptcy judges authority to decide cases under the Bankruptcy Reform Act.[40] In *Marathon*, the debtor, Northern Pipeline, sued Marathon Pipe Line Company in the bankruptcy court for breach of a contract the two had entered into prior to the bankruptcy. The bankruptcy judge denied Marathon's

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[36] *See Marathon*, 458 U.S. at 60; Behrens, *supra*, note 32, at 393.

[37] *See* 28 U.S.C. § 1471(b) (1976 ed., Supp. IV).

[38] Hon. Geraldine Mund, *supra* note 21, at 179.

[39] Hon. Geraldine Mund, *supra* note 21, at 193.

[40] *See Marathon*, 458 U.S. at 87.

motion to dismiss.[41] The Supreme Court held that the bankruptcy judge lacked authority to decide the dispute. The Court's reasoning was simple. Since a contract claim was a "suit at common law," the bankruptcy judge would need to exercise "judicial power" to adjudicate it. And since the bankruptcy judges created under the 1978 Reform Act were not Article III judges, they could not exercise judicial power.

In the summer of 1982, Congress held hearings on an appropriate legislative action to remedy bankruptcy jurisdiction in the wake of *Marathon*. Professor Martin Redish provided five options for Congressional action:

> First. Declare all of the judges in the bankruptcy courts to be article III judges, with all of the constitutional protections required by that article. Second. Retain the current structure of bankruptcy courts as non-article III bodies, but remove from those courts [the] jurisdiction to adjudicate all State common law claims involving the bankrupt, and instead vest jurisdiction to adjudicate those claims in the Federal district courts. Third. Provide article III status to a segment of the bankruptcy judges, and have those judges adjudicate the common law suits against the bankrupt, while the non-article III bankruptcy judges continue to distribute the bankrupt's assets. Fourth. Retain the combination of summary and plenary jurisdiction, but abandon the present structure of bankruptcy courts in favor of a system comparable to the pre-1978 "judge-referee" system. Fifth. Abandon entirely the 1978 act's adjudication structure in favor of a completely administrative system, with final enforcement of the administrative agency's order in an article III court.[42]

Congress responded to *Marathon* with the Bankruptcy Amendments and Federal Judgeship Act of 1984 ("BAFJA"). BAFJA replaced the unconstitutional 28 U.S.C. § 1471 with the tandem of 28 U.S.C. §§ 157 and 1334, which exist today.[43] Section 1334 gives the district court for the district in which the bankruptcy petition is filed jurisdiction over all cases commenced under the Bankruptcy Code and all civil proceedings arising under the Code or arising in or related to cases commenced

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[41] *See id.* at 56.

[42] Susan Block-Lieb, *supra*, note 19 at 94 n. 201 (*citing Hearings on the Northern Pipeline Bankr. Decision Before the S. Judiciary Comm., 98th Cong.* at 292 (July 22 and 23, 1982)).

[43] In 2005, Congress passed the Bankruptcy Abuse Prevention and Consumer Protection Act ("BAPCPA"), which enacted comprehensive reforms to the Bankruptcy Code. However, BAPCPA did not alter BAFJA's jurisdictional scheme.

under the Code.[44] Section 157 allows district courts to refer these cases and proceedings to the bankruptcy courts in their district by standing order.[45] Section 157 divides every matter a bankruptcy judge might encounter into "core" proceedings and proceedings "related to" the bankruptcy (colloquially referred to as "non-core" proceedings).[46] The legislative mandate was to define "core" proceedings as those in which final adjudication could be achieved without exercising the judicial power of the United States.[47] Congress assumed a bankruptcy judge could adjudicate all core proceedings. Bankruptcy judges could decide non-core proceedings with the parties' consent.[48] Absent consent, bankruptcy judges could hear non-core proceedings and submit proposed findings of fact and conclusions of law to the district court for entry of final order or judgment.

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[44] 28 U.S.C. § 1334(a) and (b).

[45] 28 U.S.C. § 157(a).

[46] 28 U.S.C. § 157(b).

[47] Section 157(b)(2) contains a non-exhaustive list of sixteen core proceedings. They are as follows:

(A) matters concerning the administration of the estate;
(B) allowance or disallowance of claims against the estate or exemptions from property of the estate, and estimation of claims or interests for the purposes of confirming a plan under chapter 11, 12, or 13 of title 11 but not the liquidation or estimation of contingent or unliquidated personal injury tort or wrongful death claims against the estate for purposes of distribution in a case under title 11;
(C) counterclaims by the estate against persons filing claims against the estate;
(D) orders in respect to obtaining credit;
(E) orders to turn over property of the estate;
(F) proceedings to determine, avoid, or recover preferences;
(G) motions to terminate, annul, or modify the automatic stay;
(H) proceedings to determine, avoid, or recover fraudulent conveyances;
(I) determinations as to the dischargeability of particular debts;
(J) objections to discharge;
(K) determinations of the validity, extent, or priority of liens;
(L) confirmation of plans;
(M) orders approving the use or lease of property, including the use of cash collateral;
(N) orders approving the sale of property other than property resulting from claims brought by the estate against persons who have not filed claims against the estate;
(O) other proceedings affecting the liquidation of the assets of the estate or the adjustment of the debtor-creditor or equity security holder relationship, except personal injury tort or wrongful death claims; and
(P) recognition of foreign proceedings and other matters under chapter 15 of title 11.

Case law provides further guidance on whether a proceeding is core. *See, e.g., In re Arnold Print Works, Inc.*, 815 F.2d 165 (1st Cir. 1987) (Defining a core proceeding by "its relation to the basic function of the bankruptcy court-not the state or federal basis for the claim."). BAFJA left non-core proceedings undefined, but presumably they included actions like the contract claim in *Marathon*: a claim based entirely on state law, which arose prior to and existed completely apart from the bankruptcy.

[48] *See* 28 U.S.C. § 157(c).

BAFJA also allows district courts to "withdraw, in whole or in part, any case or proceeding" referred to the bankruptcy court, "on its own motion or on timely motion of any party, for cause shown."[49] In determining whether "cause" exists, the district court considers "the goals of promoting uniformity in bankruptcy administration, reducing forum shopping and confusion, fostering the economical use of the debtors' and creditors' resources, and expediting the bankruptcy process."[50]

Under BAFJA, bankruptcy judges are appointed by the court of appeals of the United States for their respective circuit.[51] A merit screening panel recommends candidates for appointment. Each judge is appointed for a term of fourteen years and receives a salary at an annual rate that is equal to 92 percent of the salary of a district court judge.[52] The bankruptcy bench has thrived under BAFJA's appointment process. Today, some 340 high-caliber jurists sit in the United States bankruptcy courts. Under their guidance, the bankruptcy court has become a leader in federal court administration—for example, being the first to adopt an electronic filing system. Moreover, bankruptcy judges have been quite prolific over the last twenty-eight years in issuing reported decisions; West's Bankruptcy Reporter is at 465 volumes and counting. The judicial opinions of bankruptcy judges have become the leading source for resolving issues of commercial and consumer law.

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[49] 28 U.S.C. § 157(d). Additionally, the district court *shall* withdraw any proceeding if the court determines that resolution of the proceeding requires consideration of both title 11 and other laws of the United States regulating organizations or activities affecting interstate commerce. *See id.*

[50] *Zahn v. Yucaipa Capital Fund (In re Almac's)*, 202 B.R. 648, 657 (D.R.I. 1996).

[51] *See* 28 U.S.C. § 152(a).

[52] *See* 28 U.S.C. §§ 152(b), 153(a).

V. *Stern v. Marshall*

A. The *Stern v. Marshall* Decision

When the Supreme Court issued its decision in *Stern v. Marshall* on June 23, 2011, the bankruptcy system had been operating without constitutional challenge under BAFJA for over twenty-five years. BAFJA's success was due in large part to its definition of core proceedings, which was broad enough to cover matters arising most frequently in bankruptcy cases. Prior to *Stern*, the bankruptcy judges could enter final orders in any type of core proceedings, subject only to appellate review.[53]

Stern holds that a bankruptcy judge lacking life tenure and a fixed salary may not decide a debtor's counterclaim against a creditor who has filed a proof of claim against the estate, despite the counterclaim's designation as a "core" proceeding under 28 U.S.C. § 157(b)(2)(C).[54] Unlike the *Marathon* decision, in which four justices would have struck down the entirety of 28 U.S.C. § 1471,[55] *Stern* states that it is a "narrow" decision, where Congress exceeded the limitations of Article III "in one isolated respect."[56] Some courts take the language of the majority opinion in *Stern* literally that the holding "does not change all that much."[57] Still others find that *Stern*'s reasoning inevitably removes the authority of bankruptcy judges to decide other core proceedings listed under 28 U.S.C. § 157(b)(2).[58]

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[53] *See In re Teleservices Group, Inc.*, 456 B.R. 318, 320-21 (Bankr. W.D. Mich. 2011) ("For over twenty-five years, my colleagues and I have operated with the understanding that we were properly constituted judges capable of rendering final judgments in many, but not all, matters arising in connection with a bankruptcy proceeding. . . . Moreover, in exercising my delegated authority, I have entered countless orders as final without a second thought about the legitimacy of what I was doing. . . . However, *Stern v. Marshall* reveals how misplaced my confidence has been.").

[54] *Id.*

[55] *See* 458 U.S. at 84.

[56] *See Stern*, 131 S. Ct. at 2620.

[57] *Id.; see, e.g., In re USDigital, Inc.*, 461 B.R. 276, 292 (Bankr. D. Del. 2011).

[58] *See, e.g., Kirschner v. Agoglia*, No. 11 Civ. 8250 (JSR), 2012 WL 1622496 (S.D.N.Y. May 9, 2012) ("[C]autionary dicta and past practice do not overcome the logic of the Supreme Court's holding in *Stern.* This Court concludes that simple logic dictates unequivocally that fraudulent conveyance claims like those brought here are "private rights" claims that, under *Stern* and the Constitution, must be finally decided by an Article III judge.").

Stern divides bankruptcy proceedings into two categories: actions that seek "to augment the bankruptcy estate" and those that seek "a pro rata share of the bankruptcy res."[59] A bankruptcy judge may decide the latter, but not the former. *Stern* goes on to state that a bankruptcy judge's authority is limited to deciding proceedings that "stem[] from the bankruptcy itself or would necessarily be resolved in the claims allowance process."[60] Some courts refer to this as the *Stern* "two-prong test" for authority.[61]

Stern has disturbed the allocation of authority between the district and bankruptcy courts prescribed in 28 U.S.C. § 157. Significantly, the Supreme Court agreed with the bankruptcy court that the counterclaim at issue in *Stern* was, indeed, a core proceeding within the meaning of § 157(b)(2)(C). Nevertheless, because the counterclaim sought to "augment" the bankruptcy estate, did not "stem from the bankruptcy" and would not be resolved through ruling on the creditor's proof of claim, only an Article III judge exercising the judicial power could decide it. Congress did not anticipate such a proceeding when it enacted BAFJA. The proceeding at issue in *Stern*—statutorily "core" but requiring the judicial power of the United States for adjudication—opens a chasm between core and non-core proceedings that § 157 cannot readily transverse. Section 157(c)(1) allows a bankruptcy judge to submit proposed findings of fact and conclusions of law to the district court in *non-core* proceedings. Section 157(c)(2) allows a bankruptcy judge to decide *non-core* proceedings with the parties' consent. Yet § 157 does not speak to a *Stern*-type proceeding; one that is "core," yet beyond the inherent authority of a bankruptcy judge to decide.

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[59] *See Stern*, 131 S. Ct. at 2618.

[60] *Id.*

[61] *See, e.g., In re Southeastern Materials, Inc.*, 467 B.R. 337, 348 (Bankr. M.D.N.C. 2012).

B. Court Decisions Interpreting *Stern v. Marshall*[62]

Which courts should hear which bankruptcy proceedings, in what order, and in what capacity has been the source of much confusion since *Stern*. District courts across the country are seeing an explosion of motions pursuant to 28 U.S.C. § 157(d) to withdraw proceedings from bankruptcy courts for "cause" based on *Stern*. Those advocating withdrawal argue it will always be more efficient for a district court to hear a proceeding that could otherwise be "tied in procedural knots by motion practice" concerning the bankruptcy court's constitutional authority to enter a final judgment, regardless of whether the proceeding is characterized as core or non-core.[63]

Without any clear guidance on the scope of *Stern*, district courts are granting or denying withdrawal requests for a variety of reasons. A coherent standard for *Stern*-based withdrawal requests has yet to emerge. As the occasions for withdrawal increase, the efficiency of the bankruptcy system is diminished. Some districts have amended their standing order of reference (the order that automatically transfers bankruptcy cases to the bankruptcy courts) to ensure that any *Stern*-type proceedings are first heard by a bankruptcy judge. The judge then submits his or her decision in the form of proposed findings of fact and conclusions of law to the district court for final adjudication. This solution, while creating a uniform process for dealing with *Stern*-type proceedings, does not solve the problem of increased administrative costs and delays that are so toxic to effective bankruptcy reorganization.

In 2012, the question of whether *Stern* invalidates the authority of bankruptcy judges to decide other types of core proceedings pursuant to 28 U.S.C. § 157 will be answered in the context of several high-profile bankruptcy cases. On October 13, 2011, the Ninth Circuit Court of Appeals

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[62] Several of the cases discussed in this section appear in the case studies appended to this Statement as *Exhibit A*.

[63] *See In re Extended Stay, Inc.*, 466 B.R. 188, 206 (S.D.N.Y. 2011*) quoting In re BearingPoint, Inc.*, 453 B.R. 486, 488 (Bankr. S.D.N.Y. 2011).

heard oral argument in *Executive Benefits Insurance Agency v. Arkison (In re Bellingham Insurance Agency)*.[64] At issue is whether a bankruptcy court has authority to decide a Chapter 7 trustee's avoidance of alleged fraudulent transfers to an entity that had not filed a proof of claim against the bankruptcy estate. The Ninth Circuit invited supplemental briefs by *amicus curiae* addressing the following question: Does *Stern v. Marshall* prohibit bankruptcy courts from entering a final, binding judgment on an action to avoid a fraudulent transfer? The Attorney General of the United States took the position that in light of *Stern* "bankruptcy courts may not enter final judgment in a case where the defendant in the fraudulent [transfer] action is not a creditor, and where the parties have not either explicitly or through their actions consented to bankruptcy court entry of summary judgment."[65] The decision of the Attorney General of the United States not to support the constitutionality of BAFJA's allocation of authority evidences the pervasiveness of *Stern*'s reasoning and the real threat it poses to the current bankruptcy system.

This summer, *Stern* will be at the forefront of the Madoff bankruptcy case when the Southern District of New York decides which court shall ultimately preside over some 300 lawsuits brought by Madoff-trustee Irving Picard to recover profits investors received from the biggest Ponzi scheme in United States history.[66] Picard's most powerful tools for recovering Ponzi scheme profits are the fraudulent transfer provisions of the Bankruptcy Code. Judge Jed Rakoff, the district court judge presiding over the case, has ruled in a previous case that after *Stern*, bankruptcy judges no longer have the authority to decide fraudulent transfer actions.[67]

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[64] 661 F.3d 476 (9th Cir. 2011).

[65] *Brief for the United States as Amici Curiae* at 2*, Exec. Benefits Ins. Agency v. Arkison (In re Bellingham Insurance Agency)*, 661 F.3d 476 (9th Cir. 2011).

[66] *See* http://mobile.bloomberg.com/news/2012-06-12/bankruptcy-judges-can-t-hear-madoff-suits-defendants-say?category=%2Fsports%2F

[67] *See In re Refco Securities Litigation*, No. 11 Civ. 8250 (JSR), 2012 WL 1622496 (S.D.N.Y. May 9, 2012).

The authority of bankruptcy judges to decide fraudulent transfer actions is essential to the efficient functioning of the bankruptcy system. Courts are split on whether bankruptcy judges may still do this after *Stern*.[68] A strange—but increasingly common outcome—was seen in the North Carolina bankruptcy case of Southeastern Materials, Inc., a manufacturer of roof tresses.[69] Southeastern's bankruptcy trustee believed the family that operated Southeastern had caused it to transfer thousands of dollars to family members prior to its bankruptcy for no consideration. The trustee commenced fraudulent transfer actions against the family members to recover those funds. Relying on *Stern*'s "two-prong test," the bankruptcy judge concluded that even though the Bankruptcy Code contains express provisions for the recovery of fraudulent transfers, these actions do not "stem from the bankruptcy" because they "had long been decided in English courts of law through the application of the common law."[70] Therefore, only an Article III judge can decide them. However, the bankruptcy judge noted that *Stern* provides an exception. If the creditor against whom the fraudulent transfer action is brought has filed a proof of claim in the bankruptcy, then the judge *can* decide it. The reason for this is that *Stern* suggests bankruptcy judges may decide actions that could be resolved while determining whether to allow or disallow a creditor's proof of claim. The problem in the Southeastern bankruptcy case was that not all the family members had filed proofs of claim. Accordingly, the bankruptcy judge divided the creditors into two camps: those who

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[68] *Compare Wadsworth v. Baker (In re DeLaFuente)*, 2012 WL 1535848 *3 (Bankr. D. Colo. Apr. 30, 2012) (focusing on *Stern*'s language asserting its "narrow" holding and concluding the decision does not affect a bankruptcy judge's authority to hear and decide fraudulent conveyance actions), with *Southeastern Materials,* 467 B.R. at 349-51 (focusing on *Stern*'s reasoning and concluding a bankruptcy judge may not enter a final judgment with respect to a fraudulent transfer action).

[69] *Southeastern Materials*, 467 B.R. at 337.

[70] *Id.* at 362. The Supreme Court reached a similar conclusion in *Granfinanciera, S.A. v. Nordberg*, 492 U.S. 50 (1989). At issue was whether the defendants had a right to trial by jury under the Seventh Amendment when a bankruptcy trustee sued them to recover a fraudulent transfer under 11 U.S.C. § 548. Although the basis for the trustee's fraudulent transfer claim was § 548 of the Bankruptcy Code, the Court noted that, historically, such actions were "quintessentially suits at common law" to which a jury right attached. *See id.* at 56. The Court concluded that in codifying fraudulent transfer claims, Congress had not created a new cause of action but "simply reclassified a pre-existing, common-law cause of action . . . This purely taxonomic change cannot alter our Seventh Amendment analysis. Congress cannot eliminate a party's Seventh Amendment right to a jury trial merely by relabeling the cause of action to which it attaches and placing exclusive jurisdiction in an administrative agency or a specialized court of equity." *See id.* at 61.

had filed a proof of claim would be bound by a final decision of the bankruptcy court;[71] those who had *not* filed a proof of claim would still have to defend the fraudulent transfer action in the bankruptcy court, but would have a further opportunity to challenge the bankruptcy judge's "proposed findings and conclusions" in the district court.[72]

The lesson from the Southeastern bankruptcy case is two-fold. First, if a bankruptcy judge's authority to decide certain proceedings turns on whether or not the defendant has filed a proof of claim in the bankruptcy, the defendant has the power to alter the course of the entire bankruptcy case and not for the better. A defendant might be persuaded not to file a proof of claim if it will gain leverage in negotiating a more favorable settlement on any fraudulent or preferential transfer for which it may be liable. The longer it takes for the proceeding to come before a judge with the authority to make a decision, the stronger the defendant's negotiation position will be. By choosing not to file a proof of claim the defendant can increase the time and cost required to resolve the proceeding if it is determined that the bankruptcy judge lacks authority to decide the action. For example, before *Stern*, a defendant in possession of $100,000 that is arguably subject to turnover pending a finding that it received a fraudulent transfer, might offer the bankruptcy trustee $75,000 in settlement. The trustee would happily accept this money if he or she were to conclude that it would cost more (in estate resources) to litigate the claim to a favorable conclusion. After *Stern*, if the bankruptcy court can no longer decide the fraudulent transfer claim, and instead must submit proposed findings of fact and conclusions of law to the district court to review and perhaps to elicit further evidence, the hypothetical litigation costs contemplated by settlement skyrocket. Now the creditor might offer $50,000 on the same facts. The trustee just might take it when he or she considers the added costs of enforcing the bankruptcy judge's proposed ruling in the district court.

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[71] *Southeastern Materials*, 467 B.R. at 351.

[72] *Id.* at 366-67.

Second, assigning final resolution of fraudulent transfer claims to either the district or bankruptcy court, depending on whether the defendant has filed a proof of claim, subjects litigants to different processes. Resolution of the estate's claims against defendants who have not filed proofs of claim will be a longer and more costly affair. The bankruptcy judge's recommendation must be approved by the district court after opportunity for further argument. Defendants who have filed proofs of claim must await the delayed resolution of the non-filing defendants' litigation before they receive a distribution. In larger bankruptcies where proofs of claim are traded, the value of these claims will plummet as litigation over which court can decide which proceedings delays the resolution of the bankruptcy and the distribution of estate assets. In a Chapter 13 bankruptcy, one can imagine a scenario where a plan contemplates money coming into the estate to fund a plan from a successful fraudulent transfer action. Since Chapter 13 plans cannot last longer than five years, it is possible a Chapter 13 bankruptcy could "expire" before the fraudulent transfer claim is finally adjudicated. The result would be a dismissal of the bankruptcy case without the debtor receiving a discharge and without any payment to creditors, who have been stayed from pursuing their rights for the previous five years. In short, if we assume *Stern* will require district courts to review more proposed findings of fact and conclusions of law, resolving bankruptcy cases will take more time and lead to diminishing returns for the creditors.

Applying different processes to bankruptcy proceedings depending on whether the defendant has filed a proof of claim might also create issue preclusion problems. As the district court for the District of Delaware points out, this problem is caused by entering final orders in some proceedings and submitting proposed findings and conclusions in others:

> [D]ifferent standards of review would apply to different claims, depending on whether the claim was core or non-core. This could result in the application of different facts to different claims in the same case. For example, if the Bankruptcy Court found a certain fact relevant in both a core and a non-core claim, but this Court found that fact to be erroneous, though not clearly erroneous, then this Court would be required to accept that fact for the core claim and reject that fact for the

> non-core claim. Uniformity in bankruptcy administration would not be promoted by such an irrational result.[73]

The cumulative effect of the multiple issues *Stern* raises was articulated by bankruptcy judge Robert Gerber in *In re BearingPoint, Inc.*[74] BearingPoint had recently emerged from Chapter 11 reorganization when *Stern* was decided. One provision of BearingPoint's reorganization plan approved by Judge Gerber was that he would hear and decide any future claims brought against BearingPoint's former officers and directors arising out of actions on their part that allegedly substantially reduced the company's value. As the judge who had presided over BearingPoint's bankruptcy for years, his knowledge of the company and expertise in handling the several moving parts of its reorganization made Judge Gerber the ideal jurist to resolve this litigation. However, following *Stern*, he ruled that he would no longer require the claims to be brought in the bankruptcy court, and that they could be better resolved in state court. Judge Gerber lamented that the confusion borne by *Stern* would simply make future litigation in the bankruptcy court prohibitively costly:

> [T]here is a material risk, in my mind, that especially with the inspiration of *Stern v. Marshall*, and the [former officers and directors'] 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. . . . I think I erred in assuming that I could try these claims with the efficiency with which I've normally decided cases. I failed to consider how litigants could tie a case up in knots by exploiting their rights to an Article III judge determination when litigation against them is non-core.
> . . .
> After having urged me to retain jurisdiction, and having argued the advantages of my keeping the case, the [defendants] here could move for withdrawal of the reference, or contend that I could only make proposed Findings of Fact and Conclusions of Law to the district court, with a de novo review process thereafter to follow. Any such measures would result in material additional expense and delay.[75]

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[73] *Michaelson v. Golden Gate Private Equity (In re Appleseed's Intermediate Holdings, LLC)* Civ. No. 11-807, 2011 U.S. Dist. LEXIS 144315 (D. Del. Dec. 15, 2011).

[74] 453 B.R. 486 (S.D.N.Y. 2011).

[75] *Id.* at 488.

More than 300 written decisions have interpreted *Stern* to date. The case law is developing in a binary fashion: some courts insist *Stern* has a "narrow" application; others find *Stern*'s reasoning compels the withdrawal of cases from the bankruptcy courts or the vacating of bankruptcy court orders in a variety of proceedings. Twenty-nine years separate the Supreme Court decisions of *Marathon* and *Stern*. It is uncertain when we can expect the Court to clarify the meaning of *Stern*. In the interim, the process by which bankruptcy cases are litigated and decided has become less uniform. The practical consequences are increased costs and delays and unfair negotiating leverage. Worse still, time and money is being spent, not on the actual issues arising in these bankruptcy cases, but on who has the requisite authority to *decide* those issues. When it enacted the Bankruptcy Reform Act of 1978, Congress never contemplated the bankruptcy system it created would have to absorb these burdens. The time is ripe for Congress to act, pursuant to its constitutional mandate, and restore uniformity to the bankruptcy laws of the United States.

VI. POSSIBLE CONGRESSIONAL RESPONSES TO *STERN v. MARSHALL*

In responding to *Stern v. Marshall* Congress has a number of options available:

- Abstain from taking any action in response to *Stern*
- Amend provisions of 28 U.S.C. § 157
- Authorize the appointment of bankruptcy judges with Article III status

A. Abstain From Action in Deference to Case Law, Local Orders of Reference, and Federal and Local Rule Making

The first option Congress may consider is not to take any action at all. Support for this option can be found in *Stern* itself, as the majority professed its holding would not "meaningfully change[] the division of labor in the current statute."[76] Congress could abstain from taking action in favor of the bankruptcy specialists—judges and private practitioners with an acute understanding of *Stern*'s impact—resolving any disruptions *Stern* has caused to the bankruptcy system. Case law is already developing in the courts and defining *Stern*'s scope. The Federal Rules of Civil Procedure empower district courts to "adopt and amend rules governing its practice" and, where there is no controlling law, a judge or district court may regulate practice in any manner consistent with federal law and the district court's local rules.[77] Finally, rule-making committees on the local and national level can propose amendments to bankruptcy procedure to deal with *Stern's* impact. Between the flexibility of district courts to amend procedure, and rule-making on the national and local level, the uncertainty surrounding *Stern* might be alleviated. Indeed, as discussed in Part VI, A.2, *infra*, a number of district courts have already amended their rules in response to *Stern*.[78]

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[76] 131 S. Ct. at 2620.

[77] Fed. R. Civ. P. 83; *see First Nat'l Bank v. Small Bus. Admin.*, 429 F.2d 280, 284 (5th Cir. 1970).

[78] The District of Massachusetts recently enacted Local Rule 206, which provides that bankruptcy courts shall continue to hear *Stern*-type proceedings in the first instance and submit proposed findings of fact and conclusions of law to the district court for entry of final order or judgment. The text of Local Rule 206 is appended to this Statement as *Exhibit B.*

1. Relying on Case Law to Define *Stern*'s Scope

The case law that is developing in the wake of *Stern* provides the best understanding of how *Stern* is actually affecting bankruptcy cases. Congress may choose to let the case law develop through the circuits before taking any legislative action in response to *Stern*. Case law has the advantage of applying *Stern* flexibly on a case-by-case basis. Case law can explore the subtleties of *Stern*'s reasoning in ways that legislative amendment cannot. Once *Stern*-based questions have been presented and thoughtfully answered in more cases, Congress will have a better idea of where ameliorative legislation is needed. Indeed, a knee-jerk legislative response could actually make things worse.

However, the problem with relying on case law to solve *Stern*'s problems is that case law often splits on the most important issues, leading to a lack of uniformity in how the law is applied. The most obvious example of a split emerging in post-*Stern* case law is whether bankruptcy judges can decide fraudulent transfer actions.[79] With a Supreme Court decision potentially years away, a split in case law can only be cured by legislative action.

Another problem with case law is that it can produce curious outliers. In *Samson v. Blixseth (In re Blixseth)* the bankruptcy court for the District of Montana considered its subject matter jurisdiction, *sua sponte*, soon after *Stern* was released.[80] The bankruptcy court concluded that it not only could not decide a fraudulent transfer action after *Stern*, but it could not *hear* the action either since 28 U.S.C. § 157(c)(1) only allows bankruptcy courts to hear and submit proposed findings of fact and conclusions of law in statutorily non-core proceedings, and a fraudulent transfer action is explicitly defined as core under § 157(b)(2)(H). Since *Blixseth* was decided, nearly every other court

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[79] *Compare In re DeLaFuente*, 2012 WL 1535848 *3 (Bankr. D. Colo. Apr. 30, 2012) (bankruptcy judges can decide fraudulent conveyance actions), *with In re Sitka Enters.*, 2011 U.S. Dist. LEXIS 90243 (D.P.R. Aug. 12, 2011) (they cannot), *and In re Southeastern Materials,* at 349-51 (Bankr. M.D.N.C. 2012) (sometimes they can and sometimes they cannot).

[80] 2011 WL 3274042 (Bankr. D. Mont. Aug. 1, 2011).

has concluded that a bankruptcy judge may, at the very least, hear and submit proposed findings of fact and conclusions of law in fraudulent transfer actions.[81] On January 3, 2012, the *Blixseth* court modified its order, acknowledging that its earlier decision was "flawed" insofar as it has read *Stern* to deprive a bankruptcy court of subject matter jurisdiction to hear a fraudulent transfer action.[82]

Finally, the ability of case law to define the substantive reach of *Stern* does nothing to address the procedural confusion and increased costs and delays *Stern* has already wrought on the bankruptcy system. Asking the district court to withdraw a bankruptcy proceeding is inherently time consuming and costly. Requiring the district court to review a bankruptcy judge's proposed findings of fact and conclusions of law for entry of final order is also time consuming and costly. *Stern* cracked the statutory foundation of bankruptcy judge authority and changed the way proceedings travel through the system. Case law can trace the extent of this crack, but only Congress can repair it.

2. District Court Amendments to Standing Orders of Reference

A district court may refer all bankruptcy cases and any or all proceedings arising under the Bankruptcy Code or arising in or related to a bankruptcy case to the bankruptcy judges in its district.[83] Since 1984, every district court in the country has provided for automatic referral of all bankruptcy cases and proceedings via a standing order or local district court rule. The automatic referral can be overcome in any particular case or proceeding. Parties can file a motion to withdraw the reference from the bankruptcy judge and, if they are successful, the district court will hear and

[81] *See, e.g., In re Refco Inc.*, 461 B.R. at 193.

[82] *See In re Blixseth*, 463 B.R. 896, 907 (Bankr. D. Mont. 2012).

[83] *See* 28 U.S.C. § 157(a).

decide the proceeding.[84] Regardless of whether these motions are ultimately successful, they can put the bankruptcy proceedings in a state of uncertainty for months.[85]

It is common practice for bankruptcy courts to hold motions to withdraw the reference for objection and then transmit the motion to the district court for disposition.[86] The filing of a motion to withdraw the reference does not automatically stay the administration of the bankruptcy case before the bankruptcy judge.[87] In practice, however, both the bankruptcy judge and the parties become less enthusiastic about moving forward with the case if a motion to withdraw the reference is pending. A district court's decision to withdraw a proceeding from the bankruptcy judge could affect other aspects of the bankruptcy. Withdrawal of a proceeding could motivate a party to settle a dispute. Either the bankruptcy judge or district judge may enter an order staying all proceedings "on such terms and conditions as are proper" pending disposition of the motion to withdraw. But even if the judge does not officially stay proceedings, parties will often move to continue hearings until the withdrawal of the reference is decided. Therefore, either on an official order or through continuance of hearings, bankruptcy cases in which a motion to withdraw the reference is pending can effectively grind to a halt.

District courts across the country have seen an increase in requests that they withdraw proceedings from the bankruptcy court for resolution by district court judges based on the argument that the bankruptcy judges no longer have the authority to decide the proceedings on account of *Stern*. At least one district court judge has withdrawn the reference, *sua sponte*.[88] Because *Stern* has created doubts about which proceedings bankruptcy judges may constitutionally decide, some

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[84] *See* 28 U.S.C. § 157(d).

[85] *See Wells Fargo Bank N.A. v. Madan (In re AJ Town Centre)*, 2012 WL 1106747 (D. Ariz. Apr. 2, 2012) (denying the motion to withdraw the reference six months after the motion was filed).

[86] *See, e.g.,* MLBR 5011-1.

[87] *See* Fed. R. Bankr. P. 5011(c).

[88] *See, e.g., Schwartz v. Deutsche Bank Nat'l. Trust (In re Schwartz)*, Docket No. 07-04098 (D. Mass. Feb. 1, 2012).

litigants try to forgo the bankruptcy courts entirely, in favor of district court judges empowered to enter final orders resolving their disputes.

Several district court judges have concluded that a bankruptcy judge may still propose findings of fact and conclusions of law to the district court where entry of a final order or judgment on a core proceeding would be inconsistent with Article III.[89] One case, *In re Coudert Brothers, LLP*, required the bankruptcy judge to adjudicate a claim for tortious interference with a partnership agreement.[90] The proceeding arose prior to *Stern*, and the bankruptcy judge dismissed the claim. The district court reviewed the decision after *Stern* and concluded the bankruptcy judge lacked constitutional authority to dismiss the claim. However, rather than simply vacating the order, the district judge treated the bankruptcy judge's "final" determination dismissing the claim as "a report and recommendation" of dismissal. The judge explained:

> [T]reating the findings below as mere recommendations subject to *de novo* review here also preserves as far as possible the division of labor intended by the 1984 [Code]. As discussed, the intent behind that [Code] is clear: **Congress wanted Bankruptcy Judges to finally adjudicate bankruptcy-related matters whenever Article III permitted them to do so, and to issue recommended findings subject to *de novo* review in the District Court whenever it did not**.[91]

(Emphasis added.)

Federal Rule of Civil Procedure 83 allows each district court to "adopt and amend rules governing its practice." Where there is no controlling law, Rule 83(b) provides that a judge or district court may regulate practice in any manner consistent with federal law and the district court's local rules. On January 31, 2012, the Southern District of New York amended its Standing Order of Reference to affirm what several district judges were already

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[89] *See In re Extended Stay, Inc.*, 466 B.R. 188; *see also In re Refco Inc.*, 461 B.R. at 193 (finding the bankruptcy court could still submit proposed findings of fact and conclusions of law to the district court, even though 28 U.S.C. § 157 does not specifically contemplate such a procedure for "core" proceedings and commenting, "[s]uch a result clearly comports with the directive that when addressing the consequences of holding a statute unconstitutional courts must impose a remedy that best corresponds to what Congress would have intended if it had known about such holding").

[90] *See* 2011 WL 5593147 *15 (S.D.N.Y. Sept. 23, 2011).

[91] *Id.* at *13.

doing. In essence, it provides that any *Stern*-type proceedings are to be treated like non-core proceedings under the current version of 28 U.S.C. § 157(c)(1) with the bankruptcy judge hearing the proceeding and submitting proposed findings of fact and conclusions of law to the district court for entry of final order or judgment.[92] Other districts have adopted similar standing orders or have amended their local rules to ensure that *Stern*-type proceedings are heard first in the bankruptcy court.[93]

By amending their standing orders of reference the district courts are preserving the division of labor contemplated by BAFJA. Congress wanted bankruptcy judges to finally adjudicate bankruptcy related matters whenever Article III permitted them to do so, and to issue recommended findings subject to *de novo* review in the district court whenever it did not.[94] These amended standing orders essentially "fill the gap" *Stern* created in 28 U.S.C. § 157 between core and non-core proceedings by allowing bankruptcy courts to treat *Stern*-type proceedings as if they were non-core proceedings. An advantage of the district court approach is that it preserves the status quo and provides a process for how *Stern*-type proceedings ought to be handled. At least in theory, novel arguments for withdrawing the reference based on *Stern* are refuted by a local standing order that keeps proceedings in the bankruptcy court.

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[92] *See* S.D.N.Y. Amended Standing Order of Reference M10-468.

> Pursuant to 28 U.S.C. Section 157(a) any or all cases under title 11 and any or all proceedings arising under title 11 or arising in or related to a case under title 11 are referred to the bankruptcy judges for this district.
>
> If a bankruptcy judge or district judge determines that entry of a final order or judgment by a bankruptcy judge would not be consistent with Article III of the United States Constitution in a particular proceeding referred under this order and determined to be a core matter, the bankruptcy judge shall, unless otherwise ordered by the district court, hear the proceeding and submit proposed findings of fact and conclusions of law to the district court. The district court may treat any order of the bankruptcy court as proposed findings of fact and conclusions of law in the event the district court concludes that the bankruptcy judge could not have entered a final order or judgment consistent with Article III of the United States Constitution.

[93] The Middle District of Florida and the District of Delaware have amended their standing orders of reference to resemble the Southern District of New York. In June, the District Court for the District of Massachusetts adopted a new rule, L.R. 206, which accomplishes the same result as the amended standing orders. The District of Massachusetts Local Rule 206 is appended to this Statement as *Exhibit B*.

[94] *See In re Coudert Bros.* 2011 WL 5593147, at *13.

One drawback to the standing orders is that they do not restore the bankruptcy judges' authority to decide *Stern*-type proceedings. In fact, in some cases they encourage district courts to *treat* a bankruptcy judge's final order as "proposed" if the judge's constitutional authority is found lacking upon further review.[95] Paradoxically, courts that know they have a safe-harbor in submitting proposed findings and conclusions are more accepting of the argument that *Stern* abrogates a larger portion of bankruptcy judge authority than its "narrow" holding would suggest.[96]

A second drawback to proposed findings and conclusions is the inevitable delay between the time the bankruptcy court submits its proposal and the entry of final order in the district court. Frequently, the necessary delay occasioned by the need for review of a bankruptcy judge's proposed findings and conclusions will delay the administration of the main bankruptcy case. In bankruptcy, time is money. In the year since the Supreme Court decided *Stern*, an accurate picture of the delay has yet to emerge, but a look at magistrate recommendations in civil cases provides a fairly accurate indicator of the typical delay between submission of the magistrate's report and the entry of final order by the district court.[97] For commercial law cases like the ones arising in a bankruptcy, a delay of several months to one year is not uncommon.[98]

A third drawback to the amended standing orders is that they might not always accomplish the goal of preventing withdrawal of the reference. Parties might move to withdraw the reference in

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[95] *See Sundale, Ltd. v. Florida Assocs. Capital Enters., LLC,* 2012 WL 488110 (S.D. Fla. Feb 14, 2012) (Concluding the bankruptcy judge had authority to enter final orders, but out of an abundance of caution conducting *de novo* review and noting that its affirming opinion would constitute a "final judgment" that would "cure" any constitutional infirmities with the bankruptcy court's decision).

[96] *See, e.g., Southeastern Materials*, discussed in part V, B *supra*.

[97] Like bankruptcy judges, magistrate judges lack Article III status, and are authorized to submit reports and recommendations to the district court for entry of final order. *See* 28 U.S.C. § 636(b)(1)(B).

[98] *See, e.g., Kiskidee, LLC v. Certain Interested Underwriters at Lloyd's of London*, 2012 WL 1067918 (D.V.I. Mar. 26, 2012) (rejecting magistrate judge's recommendation in breach of contract case one year and nine months after report submitted); *H.R.R. Zimmerman Co. v. Tecumseh Prods., Co.* 2002 WL 31018302 (N.D. Ill. 2002) (approving in part magistrate judge's recommendation in a breach of contract case nine months after the report was submitted); *Allied Semi-Conductors Int'l Ltd. v. Pulsar Components Int'l, Inc.*, 907 F. Supp. 618 (E.D.N.Y. 1995) (approving magistrate judge's recommendation in case involving the Uniform Commercial Code one year and eleven months after report submitted).

spite of the standing order—especially if the stakes are high. Before *Stern*, when district courts were presented with a motion to withdraw the reference they considered several factors including "whether the claim or proceeding is core or non-core . . . considerations of efficiency, prevention of forum shopping, and uniformity in the administration of bankruptcy law."[99] After *Stern*, some courts have additionally considered whether the bankruptcy judge can constitutionally decide the proceeding at issue as a relevant factor to whether the proceeding should be withdrawn.[100]

Although some courts have concluded that the bankruptcy court's familiarity with the case and its expertise outweigh any considerations in favor of withdrawal,[101] others have stated that "there will be no advantage to allowing the matter to be heard in Bankruptcy Court" if all the bankruptcy judge can do is submit proposed findings of fact and conclusions of law.[102] One district court, fearing future challenges to the finality of a bankruptcy court judgment, withdrew the reference concluding that "[t]o avoid confusion and future collateral attacks on a judgment by the Bankruptcy Court, the prudent action is to withdraw the reference at this juncture."[103]

It may be that *Stern* has so eroded the confidence in bankruptcy court authority that the district courts will become the forum of choice for deciding high-stakes bankruptcy proceedings. In the Illinois bankruptcy of Emerald Casino, Inc., the trustee filed a series of counterclaims against the officers and directors of the bankrupt company (who had filed proofs of claim) seeking to recover $500 million in damages arising out of state law claims for breach of contract and breach of fiduciary

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[99] *See In re Orion Pictures Corp.*, 4 F.3d 1095, 1101 (2d Cir. 2003).

[100] *See Dev. Specialist Inc. v. Akin Gump Strauss Hauer & Feld, LLP*, 462 B.R. 457 (S.D.N.Y. 2011).

[101] *See, e.g., Slettin v. Regent Capital Partners, LLC* (*In re Rothstein, Rosenfeldt, Adler, P.A.*), 2012 WL 882497 (S.D. Fla. Mar. 14, 2012) ("At this time, the Court, in its discretion, finds that neither judicial economy nor substantial prejudice to Defendants require the immediate withdrawal of the reference. Withdrawal of the reference at this stage would result in this Court losing the benefit of the bankruptcy court's experience in both the law and facts, and leading to an inefficient allocation of judicial resources.").

[102] *See Dev. Specialist Inc.*, 462 B.R. at 467.

[103] *In re Appleseed's Intermediate Holdings, LLC* 2011 U.S. Dist. LEXIS 144315 (D. Del. Dec. 15, 2011).

duty.[104] When the district court considered whether to withdraw the reference, it acknowledged that efficiency and familiarity favored leaving the case with the bankruptcy judge who had heard the evidence and appeared to be close to a ruling. The court also noted "[t]he factor of uniformity and efficiency of bankruptcy administration also militates against recusal." However, notwithstanding the completion of a trial in bankruptcy court, the district court withdrew the reference because such withdrawal could, "even at this late stage," eliminate delay and further cost for the parties. On this point, the court cited a mandamus petition pending in the Seventh Circuit to remove the bankruptcy judge from the case and said it "was not insensitive to the burden of the additional litigation on the recusal issue."[105]

In conclusion, although the district courts have wide latitude under the Federal Rules of Civil Procedure to control when and how matters come before them, they lack the power to restore the foundation upon which bankruptcy courts entered final orders prior to *Stern*. District courts alone cannot restore confidence in the final orders of bankruptcy courts and in the absence of legislative action, district courts will find themselves taking on the most complex and time-consuming bankruptcy cases. If this proves true, then the bankruptcy system will find itself right back where it started in 1970.

3. National and Local Bankruptcy Rule-Making

The bankruptcy system in the United States has promulgated national and local rules of procedure which implement the provisions of 28 U.S.C. § 157 and the Bankruptcy Code. It is possible that national and local rule-making could restore some uniformity to the bankruptcy system.

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[104] *See Emerald Casino v. Flynn* (*In re Emerald Casino, Inc.*), 467 B.R. 128, 130 (N.D. Ill. 2012).

[105] *Id.* at 135.

i. Local Rule-Making

On the local level, Fed. R. Bankr. P. 9029(a) allows the district courts to authorize the judges of the bankruptcy court to make and amend rules of bankruptcy practice and procedure. Pursuant to this rule, individual bankruptcy districts commonly have standing committees that promulgate local rules to better implement the provisions of the Bankruptcy Code and Federal Rules of Bankruptcy Procedure.

One of the first districts to amend its local rules in response to *Stern* was the Southern District of New York. Bankruptcy courts in the Southern District now require parties to include a statement in any complaint commencing an adversary proceeding in a bankruptcy case, and any reply thereto, as to whether the party does or does not consent to the bankruptcy judge entering a final order or judgment in the proceeding.[106]

In *In re Olde Prairie Block Owner*, the bankruptcy court noted that the Supreme Court's opinion in *Stern* "in no way altered the system of final adjudication by consent embodied in § 157(c)(2)."[107] The bankruptcy judge concluded that the parties had consented to his entry of final orders on their *Stern*-type counterclaims, which he considered non-core proceedings, and commented:

> Consent given for final ruling on non-core matters has widespread use and importance in bankruptcy cases in this District, to such an extent that relatively few non-core proceedings go to District Judges for entry of final judgments. The statutory right of parties to agree to final adjudication of non-core proceedings by Bankruptcy Judges is therefore a significant part of the efficiency of the bankruptcy process under which the role of the District Judge is usually that of adjudging appeals from the consented final judgments.[108]

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[106] *See* S.D.N.Y. Local Rules 7008-1, 7012-1, 9027-1, and 9027-2. The Western District of Michigan and the District of Maryland have adopted similar consent provisions.

[107] 457 B.R. 692, 700 (Bankr. N.D. Ill. 2011).

[108] *Id.*

Several bankruptcy and district courts have reached the same conclusion.[109]

The notion that a litigant's behavior can create implied consent has been advanced in at least one bankruptcy court decision following *Stern*.[110] The Western District of Michigan's Local Bankruptcy Rules now require a statement in all original pleadings that the party either does or does not consent to the bankruptcy judge entering a final order or judgment and includes the caveat, "If the required statement is not included in a party's pleading, that party shall be deemed to have consented to entry of a final judgment by the Court as to every matter pled that is within the scope of 28 U.S.C. § 157(b)(2)."[111] However, anything less than an explicit statement of consent to the bankruptcy judge deciding each particular proceeding would probably not withstand appeal.[112]

The idea that consent can restore a bankruptcy judge's authority to decide a *Stern*-type proceeding is based on 28 U.S.C. § 157(c)(2), which allows bankruptcy judges to decide non-core proceedings with the parties' consent. Just as the amended standing orders provide for proposed

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[109] *See Dev. Specialists, Inc.* 462 B.R. at 471; *Mercury Companies, Inc. v. FNF Sec. Acquisition, Inc.* 460 B.R. 778, 783 (D. Colo. 2011); *Boyd v. King Par, LLC* 2011 WL 5509873, *2 (W.D. Mich. Nov. 10, 2011); *In re Coudert Bros., LLP*, 2011 WL 5593147, *10 (S.D.N.Y. Sept. 23, 2011); *In re Civic Partners Sioux City, LLC*, 2012 WL 761361, *8 (Bankr. N.D. Iowa Mar. 8, 2012); *In re Kingston*, 2012 WL 632398, *3 (Bankr. D. Idaho Feb. 27, 2012); *In re Tolliver*, 464 B.R. 720, 734 (Bankr. E.D. Ky. 2012); *In re Black, Davis and Shue Agency, Inc.*, 2012 WL 360062, *12 (Bankr. M.D. Pa. 2012); *In re GB Herndon and Associates, Inc.* 459 B.R. 148, 159 (Bankr. D. Dist. Colo. 2011); *In re Custom Contractors, LLC*, 462 B.R. 901, 909 (Bankr. S.D. Fla. 2011); *In re Safety Harbor Resort and Spa*, 456 B.R. 703, 718 (Bankr. M.D. Fl. 2011).

[110] *See In re Sunra Coffee, LLC*, 2011 WL 4963155 (Bankr. D. Haw. Oct. 18, 2011) (finding that a corporate-debtor's guarantor implicitly consented to entry of a $2 million default judgment against him by the bankruptcy judge when he failed to object to the trustee's allegations when they were first made, failed to object to the trustee's motion to remove the state court proceeding to the bankruptcy court, and finally, failed to appeal or seek relief from the bankruptcy court's judgment).

[111] *See* W.D. Mich. LBR 7008.

[112] *Stern* is somewhat ambiguous on the consequences of a party's failure to expressly state whether or not it consents to entry of final order or judgment by a bankruptcy judge. In *Stern*, the creditor, Pierce, filed a proof of claim against Vickie's estate, the basis of which was a tort claim for defamation. Even though 28 U.S.C. § 157(b)(5) requires that any personal injury tort claims be tried in the district court, the Supreme Court concluded that Pierce could and did consent to the bankruptcy court's resolution of his defamation claim. *See* 131 S. Ct. at 2607. Pierce never explicitly consented, but his failure to object in a timely fashion was enough to allow the bankruptcy court's decision to stand. *See id.* ("Pierce identifies no point in the record where he argued to the Bankruptcy Court that it lacked authority to adjudicate his proof of claim because the claim sought recompense for a personal injury tort. . . . Indeed, Pierce apparently did not object to any court that § 157(b)(5) prohibited the Bankruptcy Court from resolving his defamation claim until over two years—and several adverse discovery rulings—after he filed that claim."). However, later in the opinion, the Court concluded that Pierce "did not truly consent" to resolution of Vickie's *counterclaim* simply because he had filed a proof of claim. *See id.* at 2614, 2615 n. 8 (noting that Pierce had "nowhere else to go" if he wished to recover from Vickie's estate and concluding that because creditors have no choice but to file their claims in bankruptcy proceedings if they want to pursue the claims at all, "'consent' does not apply in bankruptcy proceedings as it might in other contexts.").

findings of fact and conclusions of law in *Stern*-type proceedings, amending the rules of bankruptcy procedure to require explicit statements of consent in *Stern*-type proceedings would extend the option of consent, already available in non-core proceedings, to *Stern*-type proceedings.

ii. National Rule-Making

The Judicial Conference of the United States contains a Committee on Rules of Practice and Procedure. Operating under this Committee is the Advisory Committee on Bankruptcy Rules. The Advisory Committee drafts bankruptcy rules and submits them to the Committee on Rules of Practice and Procedure. Upon approval, proposed bankruptcy rules are submitted to the Supreme Court for publication. Once the Supreme Court publishes a new rule it typically takes effect in December of the following year. The Advisory Committee is staffed by bankruptcy experts.

The Advisory Committee has recently proposed amendments to the Federal Rules of Bankruptcy Procedure, rules 7008, 7012, 7016, 9027, and 9033.[113] Like the S.D.N.Y. local rules, the essence of these amendments is to reinforce the concept of requiring litigants to state whether or not they consent to the bankruptcy judge entering final orders.

iii. Interposing Consent Though Bankruptcy Rules

The general advantages and disadvantages of consent as a solution to the problems caused by *Stern* are discussed in Part VI, B.3, *infra*. Specifically, there are advantages of interposing consent to bankruptcy court adjudication via rules of procedure. Rule-making relies on small groups of bankruptcy experts. These experts understand bankruptcy procedure and can fashion consent

[113] Proposed rules 7008 and 7012 set forth the required statements contained in complaints and answers. Proposed rule 7016 governs pretrial procedures and provides: "The bankruptcy court shall decide, on the court's own motion or on the timely motion of a party, whether to hear and determine the proceeding, issue proposed findings of fact and conclusions of law, or take some other action." Proposed rule 9027 covers motions to remove proceedings to the bankruptcy court. Finally, proposed rule 9033 sets forth the procedure once a bankruptcy court has issued proposed findings of fact and conclusions of law. The proposed rules with commentary are appended to this Statement as *Exhibit C*.

provisions designed to work efficiently within the bankruptcy system. Additionally, rule-making on a local level can be accomplished relatively swiftly by a standing order of the bankruptcy judges in a district. Given the process of review involved at the national level, however, similar amendments to the Federal Rules of Bankruptcy Procedure would probably not take effect until December of 2014. If such rules were eventually adopted they would have the advantage of national application.

The degree to which rule-making can restore uniformity to the bankruptcy system is limited. First, until national rules become effective in late 2014, the response will be limited to local rule-making. Local rule-making will occur sporadically, possibly *increasing* the lack of uniformity among the districts. Second, national and local rule-making does not change the substance and does not address the substantive flaws of 28 U.S.C. § 157 following *Stern*. All a rule can do is to require parties to plead whether they do or do not consent. In this respect, consent is nothing more than words on a page. New rules might reduce ambiguity by requiring explicit statements of consent in pleadings, but the substantive effect of the statement is for the courts to determine.[114] Thus, rules requiring statements of consent might be of little consequence without concurrent action by Congress establishing the consequences of consent.

[114] One issue to be determined is whether a consenting-party may later withdraw its consent. Resolution of this issue might turn on how Congress fashions a consent provision for bankruptcy and how a court characterizes consent in the bankruptcy context. The court could view consent in bankruptcy as analogous to the consent litigants give to resolution of a civil matter by a magistrate judge under the Magistrates Act. *See* 28 U.S.C. § 636(c). There, a party who has consented must show "extraordinary circumstances" before a district court will vacate the reference to the magistrate. *See* 28 U.S.C. § 636(c)(4); *Southern Agriculture v. Dittmer*, 568 F. Supp. 645, 646 (W.D. Ark. 1983) (finding no "extraordinary circumstances" which would justify withdrawal of defendants' consent when the magistrate had presided over the matter for more than a year and was very familiar with the factual and legal issues presented). Courts could also view consent as a waiver of a party's constitutional right to Article III adjudication. Parties who consent to binding arbitration have essentially waived this right. The Federal Arbitration Act provides that a written arbitration agreement shall be "valid, enforceable and irrevocable, save upon such grounds as exist at law or in equity for the revocation of any contract." *See* 9 U.S.C. § 2. Accordingly, a party wishing to avoid the consequences of an arbitration agreement must resort to generally applicable contract defenses, such as fraud, duress, or unconscionability. *Cf. Doctor's Associates, Inc v. Casarotto*, 517 U.S. 681 687 (1996). Finally, a consenting-party might also argue that consent is unconstitutional. *See* Part VI, B.3, *infra*.

B. Congressional Amendments to the Provisions of 28 U.S.C. § 157

Put in place by BAFJA in 1984, 28 U.S.C. § 157 allocates the authority for resolving bankruptcy proceedings between the district courts and bankruptcy judges. Because *Stern* held a portion of § 157 unconstitutional, Congress might consider establishing the bounds of bankruptcy judge authority through amendments to § 157.

1. Amend § 157(b)(2)(C) to Eliminate or Redefine "Counterclaims"

The bankruptcy judge found authority to decide the trustee's counterclaim at issue in *Stern* based on 28 U.S.C. § 157(b)(2)(C). Section 157(b)(2)(C) defines a "core" proceeding, in which the bankruptcy judge can enter a final order or judgment as any "counterclaims by the estate against persons filing claims against the estate." The Supreme Court concluded the bankruptcy judge lacked constitutional authority to decide the counterclaim because it constituted a state law action, independent of federal bankruptcy law, and would not necessarily be resolved in ruling on the defendant-creditor's proof of claim.[115] Thus, *Stern* renders § 157(b)(2)(C) ineffective insofar as it vests bankruptcy judges with authority to decide state law counterclaims that require the bankruptcy judge to make factual and legal determinations that are unnecessary in determining the allowance of a proof of claim.[116]

Because *Stern* only dealt with the constitutionality of § 157(b)(2)(C), Congress could simply remove § 157(b)(2)(C) counterclaims from the statutory definition of core proceedings. There is

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[115] *Stern*, 131 S. Ct. at 2611.

[116] This part of *Stern*'s holding acknowledges an earlier line of case law recognizing bankruptcy judges' authority to decide preferential transfer actions against a defendant-creditor as part of the process of determining whether and to what extent to allow the creditor's proof of claim. *See Katchen v. Landy*, 382 U.S. 323 (1966); *see also Langenkamp v. Culp*, 498 U.S. 42 (1990) (following *Katchen*'s reasoning and allowing bankruptcy judges to decide fraudulent transfer actions). Under the 1898 Act, bankruptcy referees unquestionably had summary jurisdiction to determine proofs of claim. Because it would not be possible to rule on a creditor's proof of claim without first resolving a potentially off-setting action for preferential transfer or fraudulent transfer, the Supreme Court has historically approved of bankruptcy judges resolving these actions, which would otherwise require a final order from an Article III judge. *See Katchen*, 382 U.S. at 334 (Reasoning that once the referee has ruled on the voidable preference in determining whether the creditor has an allowable claim against the estate "nothing remains for adjudication in plenary suit" and commenting such a suit "would be a meaningless gesture.").

historical precedent for this response. In the *Marathon* decision, the Supreme Court held that a bankruptcy judge could not decide a state law claim for breach of contract that arose prior to the debtor filing bankruptcy.[117] Congress responded in 1984 by enacting BAFJA and the current 28 U.S.C. § 157(b)(2). State law contract claims are conspicuously absent from the sixteen examples of core proceedings. Now that *Stern* has removed another type of proceeding from the scope of bankruptcy judges' adjudicative authority, the simple solution is to remove the offending language, thereby retaining as much of 28 U.S.C. § 157 as possible without running afoul of the four corners of the *Stern* decision.

Alternatively, Congress could rewrite § 157(b)(2)(C) to preserve certain counterclaims that *Stern* does not invalidate. The problem with the offending counterclaim in *Stern* was that the bankruptcy judge determined facts and made rulings of law that were unnecessary for determining the extent of the creditor's proof of claim. Such adjudication went beyond the scope of prior Supreme Court cases upholding bankruptcy judge rulings on counterclaims that could be fully resolved in the claims allowance process.[118] *Stern* does not explicitly overrule these cases. Therefore, *Stern* can be read to support a bankruptcy judge's adjudication of a counterclaim if all the facts necessary to render the decision are germane to establishing the creditor's proof of claim.[119] An amended § 157(b)(2)(C) might read as follows:

> (C) counterclaims by the estate against persons filing claims against the estate, to the extent that such counterclaims would be necessarily resolved in the claims allowance process

This amendment would preserve more bankruptcy judge authority under 28 U.S.C. § 157 than omitting § 157(b)(2)(C) entirely.

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[117] *See* 458 U.S. at 91-92 (Rehnquist, J., concurring).

[118] *See supra*, note 116.

[119] *See Stern*, 131 S. Ct. at 2618 ("[T]he question [of whether Congress may assign proceedings to non-Article III courts for final resolution] is whether the action at issue stem from the bankruptcy itself *or would necessarily be resolved in the claims allowance process*.") (Emphasis added.)

But simply amending § 157(b) will not restore uniformity to the bankruptcy system. *Stern* is creating uncertainty because of its potential to affect bankruptcy matters *beyond* § 157(b)(2)(C) counterclaims. Amending the statute to remove a sliver of bankruptcy judge authority the Supreme Court has already abrogated does nothing to restore confidence in the parts of the bankruptcy system *Stern* left standing.

2. Amend § 157(c)(1) to Allow for Proposed Findings and Conclusions in *Stern*-type Proceedings

Currently, 28 U.S.C. § 157(c)(1) permits a bankruptcy judge to hear non-core proceedings and submit proposed findings of fact and conclusions of law to the district court for entry of final order or judgment. Congress could follow what case law and several districts have done via standing orders and local rules and explicitly extend § 157(c)(1) to *Stern*-type proceedings. An amended § 157(c)(1) might read:

> (c)(1) A bankruptcy judge may hear a proceeding that is not a core proceeding **or a core proceeding for which entry of a final order or judgment by a bankruptcy judge would not be consistent with Article III of the United States Constitution**. In such a 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.

The key language expanding § 157(c)(1) beyond non-core proceedings appears in bold. The utility of this amendment is that it cures the problem of the "statutory gap" created by *Stern* when a proceeding is "core" under the definitions of § 157(b)(2) but nevertheless requires adjudication by an Article III judge. Another advantage of this amendment is it treats proceedings like the one at issue in *Stern* as if they were non-core proceedings. This provides guidance to the bankruptcy system by placing *Stern*-type proceedings in a familiar category that the system is already equipped to handle. If Congress wishes to preserve the basic structure of 28 U.S.C. § 157 put in place by BAFJA, this amendment is essential.

Despite its advantages, amending § 157(c)(1) only serves to add permanence and legitimacy to the current problems inherent in the bankruptcy system and may inadvertently make the district court the forum of choice in resolving bankruptcy matters. As discussed in Part V, B *supra*, courts are already reading 28 U.S.C. § 157(c)(1) as permitting bankruptcy judges to hear a *Stern*-type proceeding and submit their proposed ruling to the district court. Nevertheless, many parties find this procedure an empty exercise given that proposed findings of fact and conclusions of law can be reargued at the district court.[120] Many complex proceedings may be candidates for withdrawal of the reference after *Stern* if the bankruptcy judge cannot resolve them. The fundamental impediment to the expeditious resolution of bankruptcy cases posed by *Stern* is the delay occasioned by the dual involvement of bankruptcy and district courts. Whether the district court becomes flooded with proposed rulings requiring a final order, or withdraws proceedings after concluding that an initial trial in a court with no authority to enter a final order would be a waste of time and resources, the bankruptcy system will become less efficient and more expensive.

3. Amend § 157(c)(2) to Allow Parties to Consent to the Bankruptcy Judge Deciding *Stern*-type Proceedings

Currently, 28 U.S.C. § 157(c)(2) allows parties to consent to the bankruptcy judge entering a final order or judgment in a non-core proceeding. Courts and rule-making bodies across the country are giving serious thought to whether consent is the antidote for all *Stern* problems: a simple solution for restoring uniformity to the bankruptcy system. An amended § 157(c)(2) might read:

> (c)(2) Notwithstanding the provisions of paragraph (1) of this subsection, the district court, with the consent of all the parties to the proceeding, may refer **any**

[120] 28 U.S.C. § 157(c)(1) allows parties to object to portions of the bankruptcy judge's proposed ruling. The Federal Rules of Bankruptcy Procedure provide for written objections and responses to said objections. *See* Fed. R. Bankr. P. 9033. Then the whole record, the bankruptcy judge's proposed findings of fact and conclusions of law, and the parties' objections and responses, is sent up to the district judge who may "accept, reject, or modify the proposed findings of fact or conclusions of law, receive further evidence, or recommit the matter to the bankruptcy judge. *Id.* The whole process is similar to appellate review only broader because facts can be relitigated.

> **proceeding arising under title 11 or arising in or related to a case under title 11** to a bankruptcy judge to hear and determine and to enter appropriate orders and judgments, subject to review under section 158 of this title.

The bolded language would replace the current portion of § 157(c)(2) that allows the district court, with consent of the parties, to refer proceedings "related to a case under title 11" to the bankruptcy judge for final adjudication. The bolded language expands consent to all proceedings over which the district court has subject matter jurisdiction.[121]

As mentioned in Part VI, A.3, *supra*, the weight of case law supports consent as a viable solution to the problem of authority raised by *Stern*. By consenting to the bankruptcy judge entering a final order in the proceeding, the parties would confer authority on the bankruptcy court, not subject matter jurisdiction. In *Stern*, the Supreme Court recognized that § 157 does not implicate questions of subject matter jurisdiction.[122] Moreover, the constitutionality of the consent provision as it currently appears in 28 U.S.C. § 157(c)(2) has never been questioned.[123] The Supreme Court has upheld similar congressional schemes allowing a party to consent to adjudication by an Article I tribunal.[124] The Federal Magistrates Act of 1976 and Federal Arbitration Act of 1925 (both of which operate on theories of consent similar to § 157(c)(2)) have received favorable treatment by the

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[121] At least in theory, consent is irrelevant in core proceedings for which a bankruptcy judge possesses inherent constitutional authority to enter final orders or judgments. However, since *Stern* declined to elaborate on the scope of the bankruptcy judge's inherent authority, any amendment expanding the scope of consent must inevitably be overbroad and prophylactic.

[122] *See Stern*, 131 S. Ct. at 2607.

[123] At the time of writing, we could not find any cases dealing expressly with the constitutionality of § 157(c)(2). The Supreme Court has said that § 157 does not implicate subject matter jurisdiction, citing § 157(c)(2) for the proposition that parties may consent to entry of final judgment by bankruptcy judges in a non-core proceeding. *See Stern*, 131 S. Ct. at 2607. Section 157(c)(2) is "inspired by" 28 U.S.C. § 636(c)(1), the provision of the United States Code allowing magistrate judges to conduct civil proceedings with consent from the parties. *See* 1 Collier on Bankruptcy ¶ 3.03[4] (16th ed. 2011). Every circuit that has considered it has upheld the constitutionality of § 636(c)'s delegation of authority. *See* Part V, B.3, *infra*, note 126.

[124] *See Commodity Futures Trading Comm'n v. Schor*, 478 U.S. 833, 849-850 (1986) (finding that a plaintiff waived his right to have a counterclaim against him adjudicated in federal court when he had the option of bringing a claim against his broker for violations of the Commodity Exchange Act in federal court but chose instead to seek relief in a Commodity Futures Trading Commission reparations proceeding that was empowered to adjudicate all counterclaims arising out of the same series of transactions).

Supreme Court and the circuit courts.[125] Thus, adjudication of a *Stern*-type proceeding by a bankruptcy judge predicated on the express consent of the parties is at least arguably consistent with Article III of the United States Constitution.

An expanded consent provision under 28 U.S.C. § 157(c)(2) would be similar to the consent provision of the Magistrates Act. The Supreme Court has never decided whether 28 U.S.C. § 636(c)—the provision of the Magistrates Act that allows parties to consent to have a civil proceeding adjudicated to final resolution by a magistrate judge—is constitutional. However, every circuit that has considered the question has concluded that it is.[126] In reviewing the constitutionality of consent to adjudication by a magistrate, many circuits follow the approach articulated by the Ninth Circuit in *Pacemaker Diagnostics Clinic of America, Inc. v. Instromedix, Inc.*[127] First, the Ninth Circuit held that Article III adjudication was "in part, a personal right of the litigant" which could be freely and voluntarily waived.[128] Second, the Circuit considered whether permitting the judiciary to delegate its own authority to magistrate judges substantially impaired the Judicial Branch from performing its essential role in the constitutional system.[129] The Circuit found the "extensive

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[125] The Supreme Court has never directly addressed whether the ability of private parties to consent to the resolution of civil disputes by an arbiter encroaches on Article III of the Constitution but it has viewed arbitration agreements pragmatically. In *Scherk v. Alberto-Culver Co.*, the Court stated: "The invalidation of such an agreement in the case before us would not only allow the respondent to repudiate its solemn promise but would, as well, reflect a *parochial concept* that all disputes must be resolved under our laws and in our courts. . . . We cannot have trade and commerce in world markets and international waters exclusively on our terms, governed by our laws, and resolved in our courts." *See* 417 U.S. 506, 519 (1974).

[126] *See Goldstein v. Kelleher*, 728 F.2d 32 (1st Cir. 1983), *cert. denied*, 469 U.S. 852 (1984); *Collins v. Foreman*, 729 F.2d 108 (2d Cir. 1983), *cert. denied*, 469 U.S. 870 (1984); *Wharton-Thomas v. United States*, 721 F.2d 922 (3d Cir. 1983); *Gairola v. Com. of Va. Dep't. of Gen. Servs.*, 753 F.2d 1281 (4th Cir. 1985); *Puryear v. Ede's Ltd.*, 731 F.2d 1153 (5th Cir. 1984); *Bell & Beckwith v. Internal Revenue Serv.*, 766 F.2d 910 (6th Cir. 1985); *Geras v. Lafayette Display Fixtures, Inc.*, 742 F.2d 1037 (7th Cir. 1984); *Orsini v. Wallace*, 913 F.2d 474 (8th Cir. 1990), *cert. denied*, 498 U.S. 1128 (1991); *Pacemaker Diagnostics Clinic of America, Inc. v. Instromedix, Inc.*, 725 F.2d 537 (9th Cir. 1983) (*en banc*), *cert. denied*, 469 U.S. 824 (1984); *Fields v. Washington Metropolitan Area Transit Auth.*, 743 F.2d 890 (D.C. Cir. 1984).

[127] 725 F.2d at 541-47.

[128] *Id.* at 541, 543.

[129] *See id.* at 544.

administrative control over the management, composition, and operation of the magistrate system" was a sufficient protection to erosion of the judicial power.

The Article III judiciary's control over the bankruptcy system is virtually identical to the magistrate system. Under *Pacemaker*, § 157(c)(2)'s authority-by-consent provision would undoubtedly pass constitutional muster. The bankruptcy judge system is similar to the magistrate judge system. Magistrate judges and bankruptcy judges are appointed by Article III judges for a term of years. The congressional designation of Article III judges to appoint bankruptcy judges is explicitly provided for in the Constitution. Article II, Section 2 provides that "Congress may by law vest the appointment of such inferior officers, as they think proper . . . in the Courts of Law."[130] Bankruptcy judges are removable by the judicial council of the circuit (which consists of the circuit judges and chief district court judges for the districts within the circuit) for "incompetency, misconduct, neglect of duty, or physical or mental disability."[131] Magistrate judges are removable for the same criteria by the district court judges for the district in which the magistrate serves. The district court can remove proceedings before a bankruptcy and magistrate judge on its own motion to decide them itself.[132] This reservation of direct Article III control further insures the independence and impartiality of decisions on a case-by-case basis.[133] Finally, both the Magistrates Act and BAFJA provide for appellate review of all judgments by Article III courts.[134] Questions of law in bankruptcy and magistrate proceedings are reviewed *de novo*.[135]

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[130] U.S. Const. art. II, § 2. The 9th Circuit commented that this section of the Constitution, "implies an important dimension to the judicial power: the judiciary is permitted a degree of control and discretion for the design and shape of its own system." *Pacemaker*, 725 F.2d at 545.

[131] *Compare* 28 U.S.C. § 631(i), *with* § 152(e).

[132] *Compare* 28 U.S.C. § 636(c)(4) (district court may vacate a reference to a magistrate judge for "good cause"), *with* § 157(d) (district court may withdraw a proceeding referred to a bankruptcy judge for "cause").

[133] *See Pacemaker*, 725 F.2d at 545.

[134] *Compare* 28 U.S.C. § 636(c)(3), *with* § 158.

[135] *See In re Gerhardt*, 348 F.3d 89, 91 (5th Cir. 2003); *Pacemaker*, 725 F.2d at 546.

In a recent article on *Stern*, scholar Troy McKenzie concludes that in light of the practice employed under the Magistrates Act, consent to final adjudication by bankruptcy judges is constitutional:

> Taking the magistrate cases as the guide suggests that no structural concerns would remain to block final adjudication in bankruptcy court once the litigants consent. Like the magistrate judge in *Peretz*, a bankruptcy judge receives cases and proceedings by reference. And, as in *Peretz*, that reference may be withdrawn by the district court. If the test is not whether the bankruptcy judge hears a narrow range of subject matter but rather whether the Article III courts retain the "ultimate decision" over the bankruptcy judge's docket, consent should be a sufficient basis for the bankruptcy judge's authority to enter final judgment without constitutional concerns.[136]

The Ninth Circuit made the following observation when it upheld the Magistrates Act in 1983:

> There are compelling reasons for the creation of an infrastructure for determining certain civil cases with the consent of the parties and subject to judicial control. Article III courts have the task of adjudicating an ever-mounting volume of cases. . . . The legislature and the judiciary act responsibly when they provide and explore new, flexible methods of adjudication, especially where the evolution of the innovative mechanism is left in large part under the control of the judiciary itself.[137]

What was true of the federal docket twenty-eight years ago is true of the bankruptcy docket today. Writing for the dissent in *Stern*, Justice Breyer cited the "staggering" volume of bankruptcy cases filed in 2010: almost 1.6 million compared with approximately 280,000 civil and 78,000 criminal cases on the federal district court docket.[138]

Were Congress to amend 28 U.S.C. § 157(c)(2) and expand the scope of consent to all bankruptcy proceedings, the national and local rule committees could implement adequate procedures for ensuring consent is explicit and truly voluntary.

Allowing parties to consent to the bankruptcy judge entering final order or judgment in proceedings that would otherwise require Article III adjudication would eliminate the need for the

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[136] Troy A. McKenzie, *Getting to the Core of Stern v. Marshall: History, Expertise, and the Separation of Powers*, 86 Am. Bankr. L.J. 23, 50 (2012).

[137] *Pacemaker*, 725 F.2d at 547.

[138] *Stern*, 131 S. Ct. at 2630.

bankruptcy judge to submit proposed findings and conclusions to the district court. In addition, if the parties are consenting to resolving their dispute in the bankruptcy court, they will not ask the district court to withdraw the reference. Thus, consent would avoid the procedural hurdles that have the greatest potential for adding time and cost to a bankruptcy case.

Despite all its promises, there are two issues with consent that limit its potential for restoring uniformity to the bankruptcy laws: one inherent and one constitutional. First, consent cannot be compelled. Consent requires agreement of all parties to a dispute and therefore, by its nature, is ad hoc. No court can foist consent on any party. A bankruptcy system predicated on consent of the parties is only slightly better off than a bankruptcy system where bankruptcy judges cannot enter final orders. Bankruptcy cases involve multiple interested parties: the debtor, creditors, third-party guarantors, and third-party defendants. The system operates efficiently and fairly when participation is mandatory. Congress understood this when it enacted BAFJA and empowered bankruptcy judges to decide core proceedings irrespective of consent. A party intent on litigating its dispute in district court based on a genuine desire for an Article III judge or simply to gain leverage in negotiations by delaying final resolution will withhold consent. If this happens, a bankruptcy case will be fractured across two dockets: the consenting parties will resolve their disputes in the bankruptcy court while the non-consenting parties will head to the district court either for an initial trial or review of proposed findings of fact and conclusions of law. Resolving actions against the non-consenting parties will delay the entire case.

The most efficient use of authority-by-consent would require parties to give or withhold their consent at the pleading stage. However, this arguably places an unfair burden on counsel. Counsel has an ethical obligation to preserve client interests, which may cause counsel to err on the side of withholding consent until the development of more information about the case. For example, assume a bankruptcy trustee has just served a complaint on a defendant alleged to have

received a fraudulent transfer prior to the bankruptcy. The defendant's counsel will need to make a tactical choice about whether or not the defendant consents to resolution by a bankruptcy judge. This choice could be informed by a myriad of factors including the facts and circumstances giving rise to the trustee's action, the amount in controversy, whether the defendant has a proof of claim to assert in the bankruptcy, whether the trustee has brought similar suits against other defendants, and any district or bankruptcy court decisions in favor of, or detrimental to, the defendant's position. If there is any doubt that consent could weaken a client's position, counsel has an ethical duty to withhold consent.

Finally, a court could decide that allowing private parties to consent to an Article I bankruptcy judge resolving a proceeding that requires the exercise of judicial power violates the Separation of Powers Doctrine. The Constitution vests the judicial power of the United States exclusively in Article III judges with life tenure and protected salaries. A party can waive its right to an Article III judge. But it is another thing entirely to say that a party can confer judicial power on a non-Article III tribunal. The Separation of Powers Doctrine protects the whole constitutional structure by requiring that each branch retain its essential powers and independence.[139] In *Commodity Futures Trading Commission v. Schor*, the Supreme Court upheld an administrative agency's adjudication of a state law counterclaim with the consent of the parties, but only after concluding that the agency was dealing with "a particularized area of the law," had jurisdiction over only a "narrow class of common law claims," and ultimately left it to the parties whether to invoke the agency forum over the federal court.[140] In general, the Court noted:

> [T]he parties cannot by consent cure the constitutional difficulty for the same reason that the parties by consent cannot confer on federal courts subject matter jurisdiction beyond the limitations imposed by Article III, § 2 . . . When these Article III limitations are at issue, notions of consent and waiver cannot be dispositive because

[139] *See Pacemaker*, 725 F.2d at 544.

[140] *See* 478 U.S. at 852-55.

> the limitations serve institutional interests that the parties cannot be expected to protect.[141]

Scholar Peter B. Rutledge finds support for this position in the text of the Constitution:

> Textually, it is difficult to argue that Article III confers a personal right. Nothing in the text speaks in terms of a 'right' to a decision in a federal forum. . . . The opening articles of the Constitution primarily address the structural organization of our system of government; most of the discussion of rights appears in the Amendments. A few passages in the initial articles, such as the Article III, Section 2 guarantee of a jury in criminal cases, do speak in terms of rights. But those passages merely prove that, even before the drafting and ratification of the Bill of Rights, the framers knew how to draft the Constitution in terms of personal rights. In light of this contrasting language, their failure to draft the Judicial Power Clause in terms of a personal 'right' to a federal forum supports the inference that this clause never was meant to confer a personal right.[142]

If the Supreme Court applies its rationale in *Schor*, it is possible that it could strike down any consent provision included in 28 U.S.C. § 157(c)(2).

Many courts and rule-making committees consider authority-by-consent a viable solution to keeping bankruptcy cases in the bankruptcy courts where they belong in response to *Stern*. In many cases, bankruptcy judges are including a consent requirement in their pre-trial orders. As the bankruptcy system comes to rely on consent to dispose of a growing number of proceedings, the enforceability of consent will be tested in the crucible of constitutional law. As Judge Gerber pointed out in *BearingPoint*:

> [I]t 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. That huge uncertainty presages litigation over that issue with the potential to tie up this case, and countless others, in knots. It also would at least seemingly invite litigants to consent, see how they like the outcome, and then, if they lose, say their consents were invalid.[143]

Accordingly, although it could reduce the number of motions to withdraw the reference and obviate the need for proposed findings and conclusions, an expanded consent provision will only be

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[141] *Id.* at 851.

[142] Peter B. Rutledge, *Arbitration and Article III*, 61 Vand. L. Rev. 1189, 1197-98 (2008).

[143] 453 B.R. at 497.

successful if parties make willing use of it. Even then, the enforceability of consent remains an open question for the losing party to exploit.

C. Grant Bankruptcy Judges Article III Status

In 1977, the House of Representatives Committee on the Judiciary issued a report accompanying HR-8200, the House version of the Bankruptcy Reform Act, that would have created Article III bankruptcy judges thirty-five years ago. It observed:

> The bankruptcy court's general jurisdiction and broad judicial powers make it a true court, unlike specialized administrative tribunals. To the extent that it is a specialized forum, its specialization is unlike that of the Tax Court, where primarily issues under the Internal Revenue Code are decided; or of the Customs Court, or Court of Customs and Patent Appeals, where the range of issues is similarly limited. The nature of the work of the bankruptcy court militates strongly toward its establishment under Article III, because the bankruptcy law itself and the jurisdiction the court must exercise are of national applicability.[144]

Although Congress knew it needed an Article III bankruptcy court to fully realize the potential of the 1978 Reform Act, bankruptcy in the United States has labored under a two-tiered system of authority for nearly thirty-five years.

Since BAFJA in 1984, a growing number of voices have been calling for reform to the bankruptcy system. In the mid-1990s, Congress appointed a National Bankruptcy Review Commission to assess the state of the bankruptcy system. In 1997, the Commission released its Report. Its assessment of the present state of bankruptcy jurisdiction, procedure and administration rings as true today in the wake of *Stern v. Marshall* as it did fifteen years ago:

> The procedural morass of the bankruptcy judicial system is extraordinarily costly and inefficient. The cost is borne by creditors, debtors, and the court and its administration. Article III status is not a panacea, but it is a miracle cure for the majority of jurisdictional ills that currently afflict the bankruptcy court. It would not relieve the system of a motion raising the basic jurisdiction issues, *i.e.*, "related to" jurisdiction. It would, however, relieve it of all of the other jurisdictional motions,

[144] H.R. Rep. 95-595, at 32.

> which would eliminate a great deal of expense for the estate, the creditors, interested third parties, and the system itself in terms of court and administration time.[145]

In his dissenting opinion in *Stern*, Justice Steven Breyer wrote that effective restructuring in bankruptcy requires a single tribunal "'having jurisdiction of the parties to controversies brought before them . . . deciding all matters in dispute, and decreeing complete relief."[146] The fundamental flaw in the previous options outlined above is that they attempt to preserve the status quo put in place by BAFJA in 1984. The structural damage to 28 U.S.C. § 157, however, cannot be repaired by piecemeal amendment. For better or worse, *Stern* has placed the constitutionality of the present allocation of authority within the bankruptcy system into doubt. Courts and litigants continue to operate within the confines of 28 U.S.C. § 157, but the assumptions implicit in the statute have been questioned. As a result, instead of buttressing bankruptcy judge authority, § 157 has become the catalyst for the "jurisdictional ping pong" match we are seeing play out in district and bankruptcy courts around the country.

In order to achieve the most efficient and economic bankruptcy system, Congress should create a United States Bankruptcy Court staffed with bankruptcy judges who have life tenure. Article III status for bankruptcy judges is the only truly effective solution to the problems created by *Marathon*, the allocation of authority under BAFJA, and *Stern*. A bankruptcy judge with Article III status would be able to exercise the judicial power in the full panoply of proceedings coming within her jurisdiction. The 1977 House Report noted: "A court's power to apply the law with finality to particular cases is an empty power without the concomitant power to enforce its order. Conversely, a body that does not exercise judicial power may not enforce its own orders."[147]

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[145] National Bankruptcy Review Commission, *Bankruptcy: The Next Twenty Years*, 742 (1997).

[146] 131 S. Ct. at 2629 (Breyer, J., dissenting) *quoting Katchen v. Landy*, 382 U.S. 323, 335 (1966).

[147] H.R. Report 95-595, at 36.

It is unclear how much of the Bankruptcy Code requires the exercise of the Article III judicial power. Of the Supreme Court decisions that turn on the bankruptcy judge's lack of Article III status, none examine the restructuring of the debtor-creditor relationship in general.[148] Deciding a fraudulent transfer action may require judicial power because fraudulent transfer actions seek to recover property from third-parties. However, judicial power may even be required to adjudicate matters at the core of federal bankruptcy jurisdiction. Consider the automatic stay of 11 U.S.C. § 362(a) that comes into existence the moment a debtor files for bankruptcy. In 2005, Congress amended the automatic stay provision. If a debtor had a previous bankruptcy case dismissed in the year prior to filing the current one, the automatic stay will lift thirty days after the filing. If the debtor had more than one bankruptcy case dismissed in the year prior, the stay does not go into effect at all upon the filing of the current bankruptcy. In either circumstance, the debtor must move to extend or impose the automatic stay by showing through clear and convincing evidence that the current case was not filed in "bad faith."[149] If the bankruptcy judge finds the debtor has met his burden, the judge imposes the automatic stay as to all creditors. At this moment, all the debtor's creditors are enjoined from pursuing their rights against the debtor until the case is dismissed or relief from the stay is granted. The automatic stay that arises in a first bankruptcy filing may be characterized as a legislative injunction arising directly from Congress' own Article I bankruptcy powers. But it is hard to see the order of a bankruptcy judge *imposing* or *extending* the automatic stay as anything other than an exercise of judicial power, which enjoins creditors from pursuing their

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[148] *See Marathon*, 458 U.S. at 71-72 ("[T]he restructuring of debtor-creditor relations, which is at the core of the federal bankruptcy power, must be distinguished from the adjudication of state-created private rights, such as the right to recover contract damages that is at issue in this case. The former may well be a 'public right,' but the latter obviously is not."); *Stern*, 131 S. Ct. at 2614 n.7 ("[In our previous decision in *Granfinanciera*] [w]e noted that we did not mean to 'suggest that the restructuring of debtor-creditor relations is in fact a public right.' . . . Our conclusion was that, 'even if one accepts this thesis,' Congress could not constitutionally assign resolution of the fraudulent conveyance action to a non-Article III court.").

[149] *See* 11 U.S.C. § 362(c).

state law rights.[150] Accordingly, if bankruptcy judges are to preside over all actions arising under the Bankruptcy Code it should be as Article III judges capable of exercising judicial power.

The drafters of bankruptcy reform in the 1970s assumed that the new bankruptcy judges would decide all proceedings arising under federal bankruptcy jurisdiction. Recognizing that bankruptcy in the twentieth century was being handled almost entirely by the bankruptcy judges, HR-8200 sought to establish bankruptcy courts that were independent of the United States district courts. The House Report concluded:

> In sum, the Constitution suggests that an independent bankruptcy court must be created under Article III. Article III is the constitutional norm, and the limited circumstances in which the courts have permitted departure from the requirements of Article III are not present in the bankruptcy context. Even if they were present, the text of the Constitution and the case law indicate that a court created without regard to Article III most likely could not exercise the power needed by a bankruptcy court to carry out its proper functions. In view of Congress' independent obligation, and the Congressional oath, to support the Constitution, the decision on this issue should not simply be thrown to the courts. Congress should establish the proposed bankruptcy court under Article III, with all of the protection that the Framers intended for an independent judiciary.[151]

Stern has awakened the bankruptcy system to the constitutional infirmities existing below the surface of BAFJA. Thirty years after the Supreme Court struck down the Bankruptcy Reform Act's conferral of judicial power on non-Article III bankruptcy judges in *Marathon*, Congress has the opportunity to adopt its own proposals, first set forth in HR-8200, and make bankruptcy judges Article III judges.

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[150] A bankruptcy judge might be able to impose the automatic stay with respect to the debtor's property without exercising the judicial power because—arguably—actions against property of the debtor were historically *in rem* proceedings that came within the summary jurisdiction of the bankruptcy referees under the 1898 Act. *See* Brubaker, *supra* note 13, at 128 ("Under the 1898 Act, there was summary *in rem* jurisdiction in the federal courts to adjudicate all disputes incident to administration of property in the actual or constructive possession of the court (through its officer, the bankruptcy trustee), and this summary *in rem* jurisdiction included adjudication of all creditors' claims against the estate."); *see also Tenn. Student Assistance Corp. v. Hood*, 541 U.S. 440, 446-48 (2004) (discussing a bankruptcy court's *in rem* jurisdiction to determine the dischargeability of a debt). However, the automatic stay also applies to actions by which a party pursues its legal rights against the debtor. *See* 11 U.S.C. § 362(a)(1),(2),(6),(8). These are *in personam* proceedings, and an order enjoining such actions would have historically been entered by a district court judge.

[151] H.R. Rep. No. 95-595, at 39 (1977).

D. Implementation of Article III Bankruptcy Judges

Establishing an Article III bankruptcy court will require a structured transition from the present system. Given the sheer volume of active bankruptcy cases, it is essential that the current bankruptcy judges remain in their offices until the transition is complete. HR-8200 concluded that transition would work best through attrition, where departing bankruptcy judges under the current system would be replaced with Article III bankruptcy judges. To achieve an Article III bankruptcy court today, Congress need only follow its own transition plan set forth in HR-8200.

The HR-8200 transition plan is summarized as follows:

- A five-year transition period
    - During this time the President will make nominations for the new Article III judgeships
    - Current bankruptcy judges can apply for these judgeships
- At the end of the transition period all bankruptcy judges will be retired mandatorily[152]

The 1997 Commission Report developed the idea of transition-by-attrition. Its plan is summarized as follows:

- Replacing current bankruptcy bench with Article III judges
    - Attrition – act of attrition includes:
        - Expiration of the current 14 year term of a sitting bankruptcy judge
        - Resignation
        - Retirement from the bench for any reason prior to the expiration of the statutory term
        - Being sworn-in as an Article III judge
            - Sitting bankruptcy judges can apply for Article III judgeship positions while remaining on the bench
            - Application does not create a vacancy, but appointment of a sitting bankruptcy judge does
        - Death
- Ramifications
    - Fourteen years to develop a first-rate bankruptcy bench without requiring hundreds of immediate appointments
        - Jurisdictional provisions under 28 U.S.C. §§ 1334 & 157 should be transferred on a district-by-district basis to the Article III bankruptcy judge sitting in that district
        - Spreading the appointment power among several Presidents
    - Districts without an Article III bankruptcy judge:
        - Judicial Council of that circuit should be authorized to:

[152] H.R. Rep. No. 95-595, at 11-12.

- Determine the need for an Article III bankruptcy judge in that district and
- If necessary, designate an Article III bankruptcy judge from another district, but within the circuit, to sit in that district
- If there is a need and one has not been appointed, the Chief Justice, upon receiving certificate of necessity from chief judge of the circuit, should be authorized to designate an Article III bankruptcy judge from another circuit to fulfill that request[153]

An Article III bankruptcy court would be capable of operating as presently structured under the current bankruptcy court budget. Of the ninety-four judicial districts in the United States in which bankruptcy courts sit, a bankruptcy clerk's office operates independently of the district court clerk's office in ninety of them (the remaining four districts have a consolidated clerk's office serving both the district and bankruptcy court).[154] Once an Article III bankruptcy court is established, bankruptcy judges and their clerks' offices could continue to operate under current budgetary constraints subject to an appropriate transition period.

The Honorable Conrad Cyr, a bankruptcy judge and later a district judge from the District of Maine who then became a judge for the United States Court of Appeals for the First Circuit, proposed Article III bankruptcy judgeships in 1978 and observed: "The economies which would result from elimination of the serious delays, waste and uncertainty caused by the present jurisdictional limitations would almost certainly exceed the increased costs of funding an Article III bankruptcy court system."[155] Even the *Marathon* decision noted that, outside of the requirements of life tenure protection against salary diminution, Article III judgeships can be flexibly tailored to suit the needs of Congress:

> [S]o long as tenure during good behavior is granted, much room exists as regards other conditions. Thus it would certainly be possible to create a special bankruptcy court under Article III and there is no reason why the judges of that court would have to be paid the same as district judges or any other existing judges. It would also

[153] *See supra*, note 145 at 742-50.

[154] *See* National Conference of Bankruptcy Judges, *Memorandum of the Task Force on Cost Containment Re Clerks' Offices Consolidation*, at 7 (June 21, 2011).

[155] *See* Cyr, *supra*, note 15 at 143.

> be possible to provide that when a judge of that court retired pursuant to statute, a vacancy for a new appointment would not automatically be created. And it would be entirely valid to specify that the judges of that court could not be assigned to sit, even temporarily, on the general district courts or courts of appeals.[156]

Considering that *Stern*-inspired litigation is consuming precious bankruptcy estate assets at the expense of creditors, delaying the resolution of bankruptcy cases, and demanding that the district courts become increasingly involved in the bankruptcy system, congressional action is warranted. Thirty years ago Judge Cyr wrote:

> For far too long the stepchild status of the bankruptcy court as an adjunct of the district court has endured because of irrelevant institutional apprehensions on the part of those not as concerned with the bankruptcy court system and its litigants as with the perpetuation of the federal court caste system, which demeans the bankruptcy court, as well as its judges, without regard to the importance or effectiveness of their function.[157]

Scholar Susan Block-Lieb expressed similar concerns this spring:

> At some point, whether two or twenty-five years from now, it seems likely that Congress will reconsider, for a third time, policy questions concerning the breadth of the authority exercised by bankruptcy courts and the related constitutional question of whether these courts, so constituted, must be vested with life tenure and salary protection. Economic interests require confidence in the constitutionality of bankruptcy courts. Congress should not wait for the next constitutional crisis to react to the Court's decision in *Stern*.[158]

In order for bankruptcy judges to function effectively they need to exercise judicial power. An Article III bankruptcy court would finally be able to fulfill the role Congress contemplated for it when it reformed bankruptcy in the 1970s and restore uniformity to the bankruptcy system.

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[156] *Marathon*, 458 U.S. at 74 n.28 *quoting Hearings on H.R. 31 and H.R. 32 before the Subcommittee on Civil and Constitutional Rights of the House Committee on the Judiciary*, 94th Cong. 2697 (1976) (letter of Paul Mishkin).

[157] *See* Cyr, *supra* note 15, at 147.

[158] Susan Block-Lieb, *supra* note 19, at 59-60.

VII. CONCLUSION AND RECOMMENDATION

In accordance with the above analysis, the NCBJ recommends that the best option to remedy the problems that have arisen in the bankruptcy system by virtue of *Stern v. Marshall* is to provide for Article III status and life tenure for bankruptcy judges. As emphasized by the Supreme Court in *Stern*, bankruptcy judges under the current system are undoubtedly exercising the judicial power of the United States. Article III status is the only solution that will decisively curtail litigation on the scope of the bankruptcy court's authority. Without it, bankruptcy judge orders and judgments will be the subject of further challenge and potential invalidation.

In the event Congress does not believe that Article III status for bankruptcy judges is the best solution, the NCBJ recommends that 28 U.S.C. § 157 be amended to provide that litigants may consent to entry of a final order by a bankruptcy judge, and absent consent a bankruptcy judge may submit proposed findings of fact and conclusions of law to the district court in a matter or proceeding in which the judge lacks authority to enter a final order.

Exhibit A

Notable Decisions Interpreting *Stern v. Marshall*[159]

Response to *Stern* has been anything but uniform. The majority's reasoning has already inspired a volume of bankruptcy and district court decisions. If the bankruptcy judge cannot decide the matter at issue, who can? And according to what process? Since *Stern* was decided on June 23, 2011, approximately 1.2 million new bankruptcy cases have been filed.[160] Active cases exceed that number many times over.[161] The cases that follow represent a tiny sample of the issues litigated every day in the bankruptcy courts. They are normal bankruptcies, with normal issues. Yet, *Stern* has increased the administrative burdens required to resolve these "normal" cases. Given the lack of certainty and disparate rulings, the time is ripe for Congress to act, pursuant to its constitutional mandate, and restore uniformity to the system.

Fraudulent Transfer Actions

1. **Case Name:** *In re Refco Securities Litigation*, No. 11 Civ. 8250(JSR), 2012 WL 1622496 (S.D.N.Y. May 9, 2012).

   Ruling: Bankruptcy courts cannot decide fraudulent transfer claims.

   Summary: The trustee of the Refco Litigation Trust, under the confirmed Chapter 11 plan of Refco, Inc. and its affiliated debtors commenced several fraudulent transfer suits in the bankruptcy court. Bankruptcy Judge Robert Drain ruled that bankruptcy courts may decide fraudulent transfer claims. The defendants appealed to the district court. District Court Judge Jed Rakoff reversed, finding that under *Stern* the bankruptcy courts lack constitutional authority to decide fraudulent transfer claims, but can issue proposed findings and rulings to the district court for review. The court may withdraw the reference if and when a trial is necessary, rather than at this early stage, when the bankruptcy court is intimately familiar with the details.

   ***Stern* Implications:** Bernie Madoff. On June 18, 2012, Judge Rakoff held a hearing to decide whether Bankruptcy Judge Burton Lifland can decide some 300 fraudulent transfer

[159] I would like to acknowledge the work of Joanne Lau and Jaclyn Latessa, interns to the Honorable Frank J. Bailey, in helping me prepare these case studies.

[160] This figure is published by the Administrative Office of the United States Courts and is available online at http://jnet.ao.den/Statistics/Data_File_Exchange.html.

[161] It is important to realize that many cases affected by *Stern* were filed before *Stern*. In fact, many of the most important decisions following *Stern* arise from bankruptcy cases that are several years old.

proceedings filed by trustee Irving Picard in the liquidation of Bernie Madoff's firm. Judge Rakoff withdrew the reference back in November 2011, and has asked the parties to brief the issue of the bankruptcy judge's authority, after *Stern*, to decide the proceedings and whether, alternatively, the judge may issue proposed findings and rulings. Given the stakes in the Bernie Madoff litigation, many investors seeking to avoid trustee Picard's attempts to clawback Ponzi scheme profits will vigorously resist the authority of Bankruptcy Judge Lifland to decide their cases. Investors were pleased with the way Judge Rakoff handled Picard's suit against the New York Mets, cutting the trustee's initial demand of $1 billion back to $386 million. District Judges Rakoff and McMahon have thrown out some $90 billion of Picard's claims to date.[162]

2. **Case Name:** *Burns v. Dennis (In re Southeastern Materials, Inc.*), 467 B.R. 337 (Bankr. M.D.N.C. 2012).

   Ruling: The bankruptcy court can enter final orders on actions against defendant-family members who had filed proofs of claim and enter proposed findings on actions against defendant-family members who had not filed proofs of claim.

   Summary: Southeastern Materials was a family-run company out of North Carolina in the business of manufacturing trusses. Between 2005 and 2009, Southeastern allegedly transferred hundreds of thousands of dollars to the family without consideration. It also transferred hundreds of thousands of dollars to several real estate, manufacturing, and farming ventures operated by family members for no consideration. In September 2009, the $1,116,000 note Southeastern signed in favor of First Bank became due in full and Southeastern filed for bankruptcy relief under Chapter 7 of the Bankruptcy Code. Some—but not all—of the family members filed proofs of claim against Southeastern's bankruptcy estate. None of the family's other business ventures filed proofs of claim. The Chapter 7 Trustee brought fraudulent transfer actions against the brother and sister who ran Southeastern alleging they caused the company to give away its money without adequate consideration, at the expense of its creditors. The Trustee also brought actions against family members and other family-run business ventures for receiving preferential payments at the expense of creditors. Relying on what it called *Stern*'s "two-prong test" the bankruptcy court held that, following *Stern*, a bankruptcy judge can only enter final judgment in actions that: (1) stem from the bankruptcy itself; and/or (2) would necessarily be resolved in adjudicating a creditor's proof of claim. Relying on *Stern*, the court concluded that neither fraudulent transfers nor preference actions stem from the bankruptcy. However, since some of the family members had filed proofs of claim, the fraudulent transfer and preference actions against those creditors became core proceedings in which the bankruptcy judge could enter a final order. The court reached this conclusion by reasoning that resolution of the fraudulent transfer and preference actions would be necessary in deciding whether to allow the proof of claim. This conclusion led the court to sort the Trustee's actions into two categories: (1) those against defendant-family members who had filed proofs of claim; and (2) those against defendant family-members and affiliates who had not. The bankruptcy court concluded it would enter final orders in the former category and submit proposed findings and rulings to the district court in the latter category.

[162] *See* bloomberg.com/news/2012-06-12/bankruptcy-judges-can-t-hear-madoff-suits-defendants-say.html.

***Stern* Implications:** First, if a bankruptcy judge's authority to decide matters turns on whether or not the defendant has filed a proof of claim in the bankruptcy, the defendant can control which forum will ultimately decide the proceeding. A defendant might be persuaded not to file a proof of claim if it will give it leverage to negotiate a more favorable settlement on any fraudulent transfers or preferential payments it may be liable for. Its negotiation position will strengthen the longer it takes for the proceeding to come before a judge with the authority to finally decide it. For example, pre-*Stern*, a defendant in possession of $100,000 that is arguably subject to turnover pending a finding that it received a fraudulent transfer, might offer the bankruptcy trustee $75,000 in settlement. The trustee would happily accept this money if he concludes it would cost more (in estate resources) to litigate the claim to a favorable conclusion. After *Stern*, if the bankruptcy court can no longer decide the fraudulent transfer claim, and instead must submit proposed findings and rulings to the district court to review and perhaps hear further evidence on, the hypothetical litigation costs contemplated by settlement skyrocket. Post-*Stern*, the creditor might offer $50,000 on the same facts. And the trustee just might take it.

Second, the division of proceedings in this case based on whether the defendant filed a proof of claim, causes each defendant-creditor to receive different process. Resolution of the estate's claims against defendants who have not filed proofs of claim will be a longer and more costly affair as the bankruptcy judge's recommendation must be approved by the district court after opportunity for further argument. Defendants who have filed proofs of claim are directly affected by this. In a Chapter 7 bankruptcy, distribution cannot happen until all claims are settled. In larger bankruptcies where claims are traded, the value of these claims will plummet as bankruptcy litigation gets tied in "procedural knots." In short, if we assume *Stern* will lead to an increase of proposed findings and conclusions that a district court must review, resolving bankruptcy cases will take more time and lead to diminishing returns for the creditors.

3. **Case Name:** *Tabor v. Kelly (In re Davis)*, Bankr. No. 05-15794-GWE, 2011 WL 5429095 (Bankr. W.D. Tenn. Oct. 5, 2011).

   Ruling: The bankruptcy judge concluded that she lacked authority to enter a final judgment on fraudulent transfer claims.

   Summary: Cecil Ray Davis was a former state representative, convicted of being the mastermind behind a Ponzi scheme that defrauded hundreds of Dyersburg area residents of more than $30 million. He was placed into an involuntary bankruptcy on December 22, 2005, so that a trustee might attempt to use the powers of the bankruptcy code to recover the money he stole from investors. The trustee filed some 110 adversary proceedings. He filed the current action in July 2007 against defendant Kelly, who is alleged to have received $52,150 from the Ponzi scheme. The trustee's theory of recovery was based on fraudulent transfer and/or preferential transfer payments. After years of failed settlement talks, both parties filed motions for summary judgment. The hearing was held on June 23, 2011—the day the Supreme Court issued its decision in *Stern*. The bankruptcy court requested further briefing on the impact of *Stern*. After completing a thoughtful review of the *Stern* opinion and, noting that 11 U.S.C. § 548(a)(1) "merely codifies the action for fraudulent transfer that has been part of the common law since at least *Twyne's Case*" the bankruptcy judge concluded that she lacked authority to enter a final order on the fraudulent transfer claims. So, too,

preferential transfers were actions, historically brought at common law, to "augment the bankruptcy estate." Moreover, since Kelly had not filed a proof of claim, the bankruptcy judge could not decide the claims while deciding whether to allow a proof of claim. On October 5, 2011, the bankruptcy judge sent a recommendation for partial summary judgment in favor of the trustee (summary judgment was partial because the trustee had not properly briefed his state law fraudulent transfer claims) to the district court. In December 2011, the district court held off on entering any orders pending the bankruptcy judge's recommendation on the remaining state law claims. In May 2012, defendant Kelly moved that the bankruptcy court abstain from hearing the remaining issues pursuant to 28 U.S.C. § 1334(c)(1) as they were all state law claims.

***Stern* Implications:** *Stern* has directly delayed the potential recovery for the victims of Cecil Davis's Ponzi scheme. Over a year ago the bankruptcy judge was prepared to decide the summary judgment motions. Now she is dealing with a motion to abstain, in addition to issuing her recommendation on the merits of the case. Once the complete record is submitted to the district court for comprehensive review, it is unknown how long it will take to render a final decision. If the trustee prevails, he will still have to enforce a turnover order in the bankruptcy court. It should be noted that defendant Kelly's procedural maneuvers based on *Stern* are entirely within his right. His lawyer likely has an ethical obligation to seek whatever relief *Stern* may afford his client. It is misplaced to lay the blame for the current disruption in the bankruptcy system at the foot of zealous advocates. While "mischief" is present, *Stern* itself created the uncertainty within which such mischief may flourish.

4. **Case Name:** *In re Sitka Enters.*, CIVIL 10-1847CCC, 2011 U.S. Dist. LEXIS 90243 (D.P.R. Aug. 12, 2011).

   Ruling: The district court granted defendants' motion to dismiss for lack of subject matter jurisdiction. Bankruptcy courts cannot enter final judgments on fraudulent transfers.

   Summary: The bankruptcy trustee brought actions against the debtors and several family members and business affiliates alleging pre and post-petition fraudulent transfers of a shopping center. The debtor-defendants moved to dismiss under *Stern* for lack of subject matter jurisdiction. The bankruptcy judge denied the motion and the defendants took an interlocutory appeal to the district court. Although the trustee claimed the interlocutory order was non-appealable, the district court noted that the appeal turned on a controlling question of law recently decided by *Stern*. In a 2-page opinion, the district court concluded that resolution of the fraudulent transfer action could not be adjudicated by the bankruptcy court since it lacks constitutional authority under the restrictions placed by Article III. The district court granted the motion to dismiss for lack of jurisdiction and remanded to the bankruptcy court.

   ***Stern* Implications:** First, *Stern* does not address subject matter jurisdiction. The trustee's action should not have been dismissed. If the district court concluded that the bankruptcy judge could not decide the fraudulent transfer claim, then it should have remanded the proceeding and directed the bankruptcy judge to issue proposed findings and rulings. Second, this case presented an exhausting match of jurisdictional ping pong. In a May 25, 2012 ruling, the district court noted the "smorgasbord of motions, appeals and cases filed before the district court questioning the bankruptcy court's orders." After the defendants

appealed the bankruptcy court's denial of their motion to dismiss, the trustee moved to withdraw the reference. But the district court noted that the motion to withdraw the reference would not be ripe until it had decided whether a jury trial was warranted (another issue on separate appeal). Once the district court concluded the bankruptcy court could not decide the fraudulent transfer claim, the bankruptcy court transferred the case to the district court for adjudication. Both the trustee and the defendants appealed this order, too. The trustee argued the bankruptcy court erred in transferring the *entire* bankruptcy case. The defendants argued the bankruptcy court lacked jurisdiction to transfer anything at all, and should be simply dismissed as to all claims. In *De Jesus-Gonzalez v. Wilfredo*, the district court concluded it "cannot find any mechanism that would allow the bankruptcy court to transfer a case from its docket to the district court." Rather, withdrawal of the reference can only be accomplished by motion of a party in interest directly to the district court. The district court concluded that such a motion might now be ripe and remanded the case once again to the bankruptcy court (presumably the next step in this ping pong match will be yet another motion to withdraw the reference).

5. **Case Name:** *Samson v. Blixseth (In re Blixseth)*, Bankr. No. 09-60452-7, 2011 WL 3274042 (Bankr. D. Mont. Aug. 1, 2011).

   Ruling: The bankruptcy court, *sua sponte*, considered its subject matter jurisdiction and concluded that it lacked jurisdiction over fraudulent transfer actions.

   Summary: The Blixseths were married on May 21, 1983, and separated in December 2006. After the wife filed bankruptcy, the Chapter 7 trustee filed a complaint against the husband seeking, among various claims, to recover fraudulent transfers and preferential transfers under the couple's Marriage Settlement Agreement. The bankruptcy court—*sua sponte*—considered its "subject matter jurisdiction" to decide the proceeding in the wake of *Stern*. Finding the fraudulent transfer claim was essentially a common law claim attempting to augment the estate, the court held that it lacked jurisdiction to decide the issue. Moreover, since a fraudulent transfer claim was designated as a "core" proceeding under 28 U.S.C. § 157(b)(2) the court concluded that it was not a "non-core" proceeding over which it could enter proposed findings of fact and conclusions of law pursuant to § 157(c)(1). The court concluded, "[s]ince this Court may not constitutionally hear the fraudulent transfer claim as a core proceeding, and this Court does not have statutory authority to hear it as a non-core proceeding, it may in no case hear the claim." The court gave the parties 14 days to move the district court to withdraw the reference.

   ***Stern* Implications:** *Blixseth* is an outlier. On January 3, 2012, the bankruptcy court modified its order, acknowledging that its earlier decision was "flawed" insofar as it had read *Stern* to deprive a bankruptcy court of subject matter jurisdiction to hear a fraudulent transfer claim. *See In re Blixseth*, 463 B.R. 896, 907 (Bankr. D. Mont. 2012). The vast majority of courts that have considered the issue have concluded that bankruptcy judges may submit proposed findings and conclusions in proceedings that are statutorily "core" but over which they lack the constitutional authority to enter a final judgment. *See In re Extended Stay, Inc.*, 466 B.R. 188 (S.D.N.Y. 2011); *In re Refco Inc.*, 461 B.R. 181, 193 (S.D.N.Y. 2011) (finding the bankruptcy court could still submit proposed findings of fact and conclusions of law to the district court, even though 28 U.S.C. § 157 does not specifically contemplate such a procedure for "core" proceedings and commenting, "[s]uch a result clearly comports with

the directive that when addressing the consequences of holding a statute unconstitutional, courts must impose a remedy that best corresponds to what Congress would have intended if it had known about such holding"). Still, *Blixseth* remains a cautionary tale of the unforeseen consequences of the *Stern* decision.

Motions to Withdraw the Reference

6. **Case Name:** *Wells Fargo Bank, N.A. v. Madan (In re AJ Town Centre)*, No. CV-11-2061-PHX-GMS, 2012 WL 1106747 (D. Ariz. Apr. 2, 2012).

Ruling: Motion to withdraw the reference denied. Bankruptcy court has expertise to decide if certain claims are preempted by the Bankruptcy Code.

Summary: Debtor, AJ Town Centre, LLC ("AJ") was an investment group formed in 2005 to develop central Apache Junction, Arizona. To that end, AJ took out a $20 million loan from Wells Fargo. It acquired more than 100 acres around the historic Grand Hotel in 2002 as part of the "Crossroads Redevelopment Project." The redevelopment, which could be finished by 2020, aims to transform downtown Apache Junction into a modern, urban area. The highlight was to be "Superstition Square," which the city of Phoenix rezoned specifically to accommodate the project. Support was to come from a state redevelopment fund. Slow-paced negotiations with Phoenix ultimately caused AJ to abandon the project. AJ defaulted on the loan and Wells Fargo sued AJ and its principals in state court. AJ then filed bankruptcy and the suit was removed to the bankruptcy court. In August 2010, the bankruptcy court denied Wells Fargo's motion to remand the proceedings against the principals in their role as guarantors to state court, concluding that the predominance of state law issues was outweighed by "the potential for inconsistent results given the mirror image identity of the counterclaims in the [Debtor Adversary Proceeding]--which arose under Title 11 and therefore was properly in the bankruptcy court--to the counterclaims in the Guarantor Adversary Proceeding." A year after the district court denied its motion to remand the proceedings against AJ's principals to state court, Wells Fargo moved to withdraw the reference, citing to *Stern*. The District Court denied the motion nearly six months later. In denying the motion, the District Court noted, "The Bankruptcy Court possesses legal expertise that may help it determine whether certain claims are preempted by the bankruptcy code. Moreover, the Bankruptcy Court may prove more efficient given its factual expertise over allegations common to this action and the related Bankruptcy Proceedings and Debtor Adversary Proceeding."

***Stern* Implications:** A year after the district court denied its motion to remand the proceedings against AJ's principals to state court, Wells Fargo moved to withdraw the reference, citing to *Stern*. The District Court denied the motion nearly six months later. Meanwhile, the adversary proceeding in the bankruptcy came to a standstill. Even though the bankruptcy court had already decided it would not remand and that it would hear the case under its "related to" jurisdiction, submitting proposed findings and rulings to the District Court, the District Court had to decide this motion to withdraw the reference. The costs and delays deplete the bankruptcy estate and reduce returns to creditors. The result of *Stern* is "jurisdictional ping pong" where resources are consumed by litigation over who shall eventually decide the case rather than the substantive issues of the case.

7. **Case Name:** *Weisfelner v. Blavatnik* (*In re Lyondell Chem. Co.*), 467 B.R. 712 (S.D.N.Y. 2012).

   Ruling: Motion to withdraw the reference denied. The bankruptcy court can enter proposed findings of fact and conclusions of law, subject to review by the district court.

   Summary: In April 2009, LyondellBasell Industries ("LBI")—the third largest chemical company in the world—filed for bankruptcy. The bankruptcy court granted the Official Committee of Unsecured Creditors standing to pursue claims arising out of the merger of Lyondell and Basell in July 2009 and this adversary proceeding commenced. The bankruptcy court divided the proceedings into phases with Phase 1 consisting of claims against financing party defendants that needed to be tried prior to LBI's emergence from bankruptcy. Shortly before start of trial, a settlement emerged and the Bankruptcy Court approved the revised settlement and confirmed a plan in March and April, respectively. A Litigation Trust was established to pursue estate claims that had not been settled or otherwise disposed of and Weisfelner was appointed Trustee of Litigation Trust. In July 2010, Litigation Trust brought claims against individuals and corporate entities involved in the Lyondell-Basell merger for fraudulent transfers, preferences, breach of fiduciary duty, and other state law claims. In November 2011, the defendants filed a motion to withdraw the reference with regard to the fraudulent transfer claims, as the parties had agreed the bankruptcy court had final adjudicative authority over the equitable subordination claim, and did not have such authority over the state common law claims. In deciding whether to withdraw the reference the district court considered whether the bankruptcy court could enter final judgment in the fraudulent transfer actions and concluded it could not. Applying the *Orion* Factors, the court also considered the "efficiency, prevention of forum shopping, and uniformity in the administration of bankruptcy law" and concluded these factors were decisive. Bankruptcy court has more knowledge of and familiarity with the case. It can therefore, still enter proposed findings of fact and conclusions of law.

   ***Stern* Implications:** Even though the motion was eventually denied, the motions to withdraw the reference were filed November 2011, but were not adjudicated until March 2012, a four-month delay in the process to examine *Stern* implications. Moreover, one can contrast this decision with others that have gone the other way, demonstrating the lack of uniformity after *Stern*. *See, e.g., Emerald Casino v. Flynn* (*In re Emerald Casino, Inc.*), 467 B.R. 128 (N.D. Ill. 2012) (discussed below).

8. **Case Name:** *Slettin v. Regent Capital Partners, LLC* (*In re Rothstein, Rosenfeldt, Adler, P.A.*), No. 11-62612-CIV, 2012 WL 882497 (S.D. Fla. Mar. 14, 2012).

   Ruling: Motion to withdraw the reference denied, but can be renewed if and when the matter was ready for trial. Bankruptcy courts can still enter proposed findings of fact and conclusions of law in fraudulent transfer actions.

   Summary: Debtor-law firm's CEO conducted a Ponzi scheme. In 2009, a group of creditors commenced the underlying liquidating bankruptcy case by filing an involuntary petition. The Trustee filed the Adversary Proceeding for the avoidance of fraudulent transfers and related relief. The Trustee then filed a motion for preliminary injunction, seeking an order from the bankruptcy court enjoining each of the defendants from

transferring the cash that was the subject of the proceeding. Defendants moved to withdraw the reference, arguing that (1) *Stern* invalidates 28 U.S.C. § 157(b)(2)(H) as a basis for bankruptcy courts to determine the fraudulent transfer cases where, as here, they have not filed a proof of claim against the bankruptcy estate and (2) citing to *Blixseth*, that the bankruptcy judge lacked express statutory authority under 28 U.S.C. § 157 to submit proposed findings and rulings in a "core" proceeding.

The district court concluded that *Stern* does not deprive bankruptcy courts of all authority over fraudulent transfers and they can still issue proposed findings of fact and conclusions of law. The district court reasoned, "At this time, the Court, in its discretion, finds that neither judicial economy nor substantial prejudice to Defendants require the immediate withdrawal of the reference. Withdrawal of the reference at this stage would result in this Court losing the benefit of the bankruptcy court's experience in both the law and facts, and leading to an inefficient allocation of judicial resources." Because the case is still in its early stages, leaving adjudication with the Bankruptcy Court would result in more efficiency in terms of discovery issues, settlement conferences, and motion practice. However, the reference could be withdrawn if and when the matter was ready for trial.

9. **Case Name**: *In re Advanced Beauty Solutions*, BAP No. 11-1183-PaHPe, 2012 WL 603692 (B.A.P. 9th Cir. Feb. 8, 2012).

Ruling: The bankruptcy court denied the creditor's motion to withdraw the reference and noted the creditor's delay tactics.

Summary: Advanced Beauty Solutions ("ABS") developed a personal hair care product called "True Ceramic Pro Infra-Red Ionic Styler," used primarily for straightening or curling hair. The product was plagued with design flaws and defects. ABS filed for Chapter 11 on January 24, 2006. The bankruptcy court approved the sale of all ABS's assets to its manufacturer and creditor, CirTran, on June 7, 2006, in exchange for CirTran's obligation to give the bankruptcy estate royalties on each ABS product sold. CirTran failed to live up to its obligations and the bankruptcy court eventually determined that it owed the estate $1.8 million. Five years of litigation followed, during which time ABS sought to collect. The bankruptcy court issued numerous orders for CirTran to turn over assets to satisfy the debt. Eventually, the bankruptcy court scheduled a hearing to determine the relative debts ABS and CirTran owed to each other. Immediately after *Stern* was decided, CirTran moved to withdraw the entire proceeding from the bankruptcy court. CirTran argued that, under *Stern*, the bankruptcy court lacked jurisdiction to enter the $1.8 million judgment in the first place. The 9th Circuit B.A.P. held that *Stern* is not a jurisdictional decision. Furthermore, CirTran's challenge was made "far too late in the game." When CirTran defaulted under the sale agreement and failed to respond to the proceeding to enforce the agreement, the bankruptcy court entered the $1.8 million judgment. No appeal was taken by CirTran from that judgment. The Court stated: "Given this track record, we conclude that CirTran's latest attempt to avoid its obligations under the Default Judgment are simply too little, too late. CirTran's argument on appeal that the bankruptcy court lacked subject matter jurisdiction to enter the Default Judgment amounts to a prohibited collateral attack on that judgment."

***Stern* Implications:** Even though the Court viewed CirTran's actions as mischievous tactics at delay, it still had to decide the merits of CirTran's motion. The court did not make its

decision until February 2012. ABS, the Chapter 11 debtor has been trying to collect on this debt judgment for 5 years. For CirTran, *Stern* presented another opportunity to delay payment.

10. **Case Name:** *Gecker v. Flynn* (*In re Emerald Casino, Inc.*), 467 B.R. 128 (N.D. Ill. 2012).

    Ruling: Motion to withdraw the reference granted. A bankruptcy judge cannot enter final judgment on state law counterclaims that would bring assets into the bankruptcy estate.

    Summary: Officers and directors of Emerald Casino filed a series of proofs of claim in its Chapter 7 bankruptcy. The trustee filed a series of counterclaims totaling $500 million in damages, including state law claims for breach of contract and breach of fiduciary duty. After completion of the trial, the officers and directors moved to withdraw the reference arguing that the bankruptcy court did not have authority to enter judgment on account of the trustee's counterclaims in light of *Stern*. The district court concluded that *Stern* precluded the bankruptcy judge from entering final judgment on any state law counterclaim that would bring assets into the bankruptcy estate. The court noted that *Stern* may well result in early withdrawal of a reference in any case where it is clear that a trustee will bring common law counterclaims that obviously cannot be resolved as part of the claims allowance process. Considerations of efficiency and familiarity favored leaving the case with the bankruptcy judge who had heard the evidence and appeared to be close to a ruling. The court also noted "[t]he factor of uniformity and efficiency of bankruptcy administration also militates against recusal." However, notwithstanding the completion of the trial before the bankruptcy court, the district court withdrew the reference because such withdrawal could, "even at this late stage," eliminate delay and further cost for the parties. On this point, the court cited a mandamus petition pending in the Seventh Circuit to remove the bankruptcy judge from the case and said it "was not insensitive to the burden of the additional litigation on the recusal issue."

    ***Stern* Implications:** In this case, the district court withdrew the reference because, even though uniformity and efficiency favored keeping it in the bankruptcy court, the opportunities for excessive litigation in the wake of *Stern* negated any efficient, cost-effective resolution by the bankruptcy court in this case. If after *Stern*, the most cost-effective forum is the district court, the bankruptcy system will soon find itself back where reform began in the early 1970s with overburdened district courts and wasteful litigation over authority and jurisdiction.

11. **Case Name:** *Michaelson v. Golden Gate Private Equity, Inc. (In re Appleseed's Intermediate Holdings, LLC)*, Civ. No. 11-807, 2011 U.S. Dist. LEXIS 144315 (D. Del. Dec. 15, 2011).

    Ruling: Motion to withdraw the reference granted. It is uncertain whether bankruptcy courts can enter final judgments in fraudulent transfer actions.

    Summary: After Appleseed's Chapter 11 plan for reorganization was confirmed, remaining causes of action were transferred to a Litigation Trust to be pursued by a litigation trustee. The trustee brought actions against 33 defendants for fraudulent transfer. The district court granted the defendants' motion to withdraw the reference. The district court noted there was uncertainty over whether the bankruptcy judge could enter a final order in a fraudulent

transfer action given the Supreme Court's decision in *Stern*. "To avoid confusion and future collateral attacks on a judgment by the Bankruptcy Court, the prudent action is to withdraw the reference at this juncture." Withdrawing the reference would expedite the bankruptcy process because it would allow parties to "skip the Bankruptcy Court and withdraw the reference and proceed directly to this Court." Most importantly, the Court identified the problem with entering final orders in some claims and submitting proposed findings and conclusions in others: "If this Court did not withdraw the reference, different standards of review would apply to different claims, depending on whether the claim was core or non-core. This could result in the application of different facts to different claims in the same case. For example, if the Bankruptcy Court found a certain fact relevant in both a core and a non-core claim, but this Court found that fact to be erroneous, though not clearly erroneous, then this Court would be required to accept that fact for the core claim and reject that fact for the non-core claim. Uniformity in bankruptcy administration would not be promoted by such an irrational result."

12. **Case Name:** *Fort v. SunTrust Bank (In re Int'l Payment Grp., Inc.)*, Bankr. No. 08-03453-HB, 2011 WL 5330783 (Bankr. D.S.C. Nov. 3, 2011).

    Ruling: Motion to withdraw the reference denied. Although the bankruptcy court does not have authority to enter final judgments here, it can still issue proposed findings of fact and conclusions of law.

    Summary: Debtor, International Payment Group ("IPG") filed for Chapter 7 bankruptcy on June 10, 2008. IPG was in the foreign currency exchange business. SunTrust provided financial services support and filed proofs of claim against IPGs bankrupt estate totaling $30,271. The Chapter 7 Trustee asserted several claims against SunTrust based on state law including breach of contract, breach of fiduciary duty, and violations of the South Carolina Unfair Trade Practices Act, seeking approximately $40 million in damages. In its initial answer to the Chapter 7 Trustee's complaint SunTrust admitted that the bankruptcy court had jurisdiction over the proceedings and that the proceedings were core under 28 U.S.C. § 157(b)(2). After *Stern*, SunTrust moved to dismiss the complaint under Fed. R. Civ. P. 12(b)(1) for lack of subject matter jurisdiction. In its November 2011 decision, the bankruptcy court noted that resolution of SunTrust's proof of claim would not result in a resolution of the disputes raised in the Trustee's suit and that SunTrust "raises valid questions about the referral of the lawsuit to a non-Article III court." The Court concluded that SunTrust's motion to dismiss was more accurately characterized as a challenge to the continued referral of the proceeding to the bankruptcy court and encouraged SunTrust to file a motion to withdraw the reference in the district court. SunTrust did just that. It argued to the district court that *Stern* required mandatory withdrawal of the reference pursuant to 28 U.S.C. § 157(d). The district court disagreed, holding that *Stern* allows the bankruptcy court to hear the proceeding and enter proposed findings of fact and conclusions of law. On April 2, 2012, the district court issued its decision, refusing to withdraw the reference.

    ***Stern* Implications:** The parties in this case were a year-and-a-half into the adversary proceeding in the bankruptcy court before the defendant moved to withdraw the reference. Another five months passed before the district court essentially told them to go back to the bankruptcy court and have their trial. This is an example of the "jurisdictional ping pong

between courts" and leads to "inefficiency, increased cost, delay, and needless additional suffering among those faced with bankruptcy" that Justice Breyer foresaw writing for the dissent in *Stern*. *See* 131 S. Ct. at 2630 (Breyer, J., dissenting). And the IGP liquidation is not over. Once the bankruptcy court holds the trial it will need to issue proposed findings of fact and conclusions of law. Parties will have the opportunity to object to portions of the bankruptcy judge's report and send their objections, along with the report to the district court. The district court must then undertake a de novo review of the portions objected to and may "accept, reject, or modify the proposed findings of fact or conclusions of law, receive further evidence, or recommit the matter to the bankruptcy judge with instructions." *See* Fed. R. Bankr. P. 9033(d). Two years after the Trustee filed his complaint against SunTrust, and four years after IGP filed bankruptcy, the trial is just beginning.

13. **Case Name:** *Development Specialist Inc. v. Akin Gump Strauss Hauer & Feld, LLP*, 462 B.R. 457 (S.D.N.Y. 2011).

    Ruling: Motion to withdraw the reference granted. Since bankruptcy court cannot enter final judgment on claims, it would be more efficient for the district court to hear the claims.

    Summary: As part of the Coudert Brothers' Chapter 11, the plan administrator brought 13 adversary proceedings against law firms seeking to recover fees earned on matters former Coudert lawyers took with them to the new firms. The law firms moved to withdraw the reference. The district court granted withdrawal of the reference. Since 1993, the Second Circuit has considered the factors set forth in *In re Orion Pictures Corp*, 4 F.3d 1095, 1101 (2d Cir. 1003) in deciding whether to withdraw the reference: "whether the claim or proceeding is core or non-core . . . considerations of efficiency, prevention of forum shopping, and uniformity in the administration of bankruptcy law." In addition, courts should now consider the power of the bankruptcy court, in light of *Stern*, to enter final adjudications. This will require an inquiry into whether the rights being adjudicated are: (1) public rights; or (2) will be resolved in ruling on a creditor's proof of claim. If the court does not have the power to adjudicate a claim, "there will be no advantage to allowing the matter to be heard in Bankruptcy Court" because all the bankruptcy judge will do is issue a recommendation subject to de novo review.

    ***Stern* Implications:** Not only does this decision invite novel arguments for withdrawing the reference in an increasing number of proceedings, it also suggests that withdrawal is appropriate whenever the bankruptcy judge *cannot* enter final orders. Such a holding essentially renders 28 U.S.C. § 157(c)(1) (allowing for proposed findings of fact and conclusions of law in non-core proceedings) superfluous.

14. **Case Name:** *Mercury Companies, Inc. v. FNF Sec. Acquisition, Inc.*, 460 B.R. 778 (D. Colo. 2011).

    Ruling: Motion to withdraw the reference denied. The bankruptcy court can enter final judgments, where parties implicitly consented by admitting that the proceedings were core.

    Summary: Mercury Companies, Inc. is a title agency with approximately 20 subsidiaries, founded in Denver, Colorado in 1946. Prior to filing Chapter 11 bankruptcy on August 28, 2008, Mercury enjoyed a 30% share of the Colorado title market. On January 27, 2010,

Mercury brought an adversary proceeding within its bankruptcy against FNF Security Acquisition, Inc. seeking to recover $1.68 million arising out of what Mercury termed a "mistaken transfer" following the sale of several Mercury subsidiaries to FNF.
On August 15, 2011, FNF filed a motion in the district court to withdraw the reference in the adversary proceeding arguing that under *Stern*, the bankruptcy judge lacked the authority to enter a final order and judgment. The district court denied the motion to withdraw the reference finding that the parties had consented to the bankruptcy judge entering final orders by admitting in their initial pleadings that the proceeding was core. The court said:

> [T]he Adversary Proceeding was filed on January 27, 2010, and Defendants waited nearly 19 months, until August 15, 2011, to challenge the authority of the Bankruptcy Judge to enter orders and judgment in the Adversary Proceeding. In the meantime, not only did Defendants consent in their responsive pleadings to the authority of the Bankruptcy Court to enter orders and judgment, but they also heavily litigated the action in the Bankruptcy Court...

Mercury, 460 B.R. at 782. *Stern*, did not breathe new life into FNF's motion because the Supreme Court's holding was "explicitly narrow." *Id.* at 783.

***Stern* Implications:** It is not the holding in this case that is troubling, but rather the potential for similar motions to succeed in other courts. Prior to January 2012, when the Southern District of New York amended its standing order to deal with this issue, district courts lacked a uniform procedure for responding to arguments to withdraw the reference based on *Stern*.

Finality of Bankruptcy Court Orders and Judgments

15. **Case Name:** *Sundale, Ltd. v. Fla. Assocs. Capital Enters., LLC*, No. 11-20635-CIV, 2012 WL 488110 (S.D. Fla. Feb. 14, 2012).

Ruling: The district court concluded that *Stern* is inapplicable, but still conducted a de novo review of the record.

Summary: Following several subordination agreements, the creditors of a bankrupt company commenced an adversary proceeding to determine the extent, validity and priority of their liens in the bankruptcy. The district court took a narrow view of *Stern* concluding it was inapplicable because all the claims could be resolved in the claims allowance process. Nevertheless, the district court felt it should conduct a de novo review of the record, just in case its conclusions about the extent of *Stern* were wrong.

***Stern* Implications:** Even when they conclude the bankruptcy court had authority to enter final orders, district courts are still uncertain as to what standard of review applies in the wake of *Stern*. Out of an abundance of caution, the district court conducted a de novo review noting that its affirming opinion would constitute a "final judgment" that would "cure" any constitutional infirmities with the bankruptcy court's decision. Such a result adds

delay and unwarranted cost to resolving bankruptcy cases and is caused by the uncertainty of the bankruptcy court's authority following *Stern*.

16. **Case Name:** *Calvo v. HSBC Bank, USA*, 199 Cal. App. 4th 118 (Cal. 2d Dist. Ct. App. 2012).

    Ruling: Judgment of dismissal affirmed. Bankruptcy court holdings are not due the same deference as that of Article III courts.

    Summary: Plaintiff challenged a bank's foreclosure in California state court. In affirming the judgment in favor of the bank, the California appeals court relied on state court precedent. When the plaintiff cited a bankruptcy court decision in favor of her position, the court cited to *Stern* and commented "[a] federal bankruptcy court decision interpreting California law, however, is not due the same deference" as holdings of Article III courts.

17. **Case Name:** *Ortiz v. Aurora Health Care, Inc. (In re Ortiz)*, 665 F.3d 906 (7th Cir. 2011).

    Ruling: The bankruptcy court lacks authority to enter a final judgment on the counterclaim. Procedurally, the circuit courts of appeal can only review final judgments of Article III courts. Seventh Circuit Court of Appeals does not have jurisdiction to review matter.

    Summary: Wisconsin healthcare provider Aurora Health Services filed proofs of claim in approximately 3,200 bankruptcy cases in the Eastern District of Wisconsin from 2003-2008. Aurora attached confidential information to the proofs of claim concerning the debtor's medical treatment. Because the proofs of claim were public, groups of debtors began suing Aurora for violating a Wisconsin statute relating to unauthorized disclosure of patients medical records. The bankruptcy judge ruled in favor of Aurora.

    The Seventh Circuit held that although the debtors' counterclaims were "core" under § 157(b)(2)(C), the bankruptcy judge lacked authority under *Stern* to adjudicate the claims because they would not be necessarily resolved in ruling on Aurora's proofs of claim. The Seventh Circuit now found itself in a procedural bind. Having found the bankruptcy judge lacked authority to enter a final judgment in the matter, the court now lacked a statutory basis for appellate jurisdiction. Characterizing the final order as "proposed findings and conclusions" would not help either because 28 U.S.C. § 158(d)(2)(A) does not authorize the circuit courts to review proposed findings and conclusions on direct appeal. Accordingly, the Seventh Circuit was left with no choice but to dismiss the appeals and remand the cases to the bankruptcy court. "Unless and until an Article III judge enters a final judgment, we have no jurisdiction to review these matters." *Id.* at 915.

18. **Case Name:** *In re Coudert Bros., LLP*, App. Case No. 11-2785(CM), 2011 WL 5593147 (S.D.N.Y. Sept. 23, 2011).

    Ruling: The district court judge vacated the bankruptcy judge's dismissal of the case and treated bankruptcy judge's judgment as proposed findings and conclusions subject to the district court's review.

Summary: Retired Partners of Chapter 11 debtor Coudert Brothers, LLP sued the law firm's current partners in state court for conspiring to sell Coudert's assets to other law firms for less than market value in exchange for jobs at said firms. The action was removed to the bankruptcy court. Initially, the bankruptcy judge dismissed the action, ruling that the Retired Partners lacked standing to pursue the claims, which properly belong to the estate. Following *Stern*, the Retired Partners renewed their motion to remand the proceeding to state court. The district court concluded that the Retired Partners' claims involved private rights and, therefore, could not be adjudicated by a bankruptcy judge. Furthermore, even though the Retired Partners had filed proofs of claim in the bankruptcy, allowance of their claims would not necessarily resolve the state court action. This was true, even though Bankruptcy Judge Robert Drain dismissed the action for lack of standing under a theory that the Retired Partners' claims were superseded by the trustee's action. Judge Drain lacked the constitutional authority to do what he did; his *rationale* for doing so did not change that. At this juncture the district court judge found herself in something of a "procedural morass." She had to vacate Judge Drain's order dismissing the Retired Partners' case. But this would mean she could not consider the Retired Partners' appeal on the merits. Her solution was to treat Judge Drain's "final" ruling as a report and recommendation. She gave the parties two weeks to file objections/responses to it.

19. **Case Name:** *Matrix IV, Inc. v. American Nat'l. Bank and Trust Co. of Chicago*, 649 F.3d 539 (7th Cir. 2011).

Ruling: The Seventh Circuit affirmed the bankruptcy court's dismissal of the case on collateral estoppel grounds. The Seventh Circuit did not conclude as to whether bankruptcy court decisions applied in respect to res judicata.

Summary: Stylemaster, a plastic-container company, filed for bankruptcy in 2002. Matrix IV was one of Stylemaster's suppliers. Matrix strenuously opposed a proposed sale of Stylemaster's assets alleging Stylemaster had fraudulently induced it to produce plastic storage containers without ever intending to pay for them, simply to increase its inventory so that a successor company led by Stylemaster insiders could purchase the company's assets at a firesale price in bankruptcy. The bankruptcy court ruled against Matrix on its fraud allegations. The district court and Seventh Circuit affirmed. Matrix then "repackaged" the same allegations bringing a fresh action under RICO and common-law fraud. Matrix sued American National Bank ("ANB") alleging they participated in the fraud by lending Stylemaster money and conspiring to destroy Matrix's lien. The district court dismissed the case on both res judicata and collateral-estoppel grounds, holding that Matrix's RICO and common-law fraud claims were compulsory counterclaims that should have been brought in the bankruptcy proceedings. On appeal, the Seventh Circuit determined that the elements of res judicata or claim preclusion had been established. However, the Court noted at least one Seventh Circuit decision that had reasoned that because a bankruptcy court could not, by itself, adjudicate a noncore claim to finality under 28 U.S.C. § 157(c)(1), a party to a noncore proceeding would not have a "full and fair" opportunity to litigate the claim for purposes of res judicata. In other words, at least one court had questioned, prior to *Stern*, whether bankruptcy jurisdiction must always be core in order to be "competent" for res judicata purposes. Declining to resolve the intra-circuit conflict in this case, the Seventh Circuit affirmed the bankruptcy court's dismissal of the RICO and fraud claims on the narrower ground of collateral estoppel since: (1) the allegations in the new complaint were the same as

those that were *actually litigated* in the § 363 hearing; (2) the bankruptcy court was required to and did address them before entering its order approving the sale; and (3) Matrix was fully represented in the bankruptcy proceedings.

***Stern* Implications:** *Matrix* did not directly involve *Stern*, but the Seventh Circuit suggested that going forward, courts will have to assess *Stern*'s conclusions on the constitutional limitations of bankruptcy court jurisdiction in determining the preclusive effect of bankruptcy judge decisions on non-core matters.

20. **Case Name:** *In re BearingPoint, Inc.*, 453 B.R. 486 (Bankr. S.D.N.Y. 2011).

Ruling: On motion of the trustee of the liquidating trust, Bankruptcy Judge Robert Gerber modified the confirmation order to allow claims against the former officers to be brought in state court, rather than bankruptcy court.

Summary: BearingPoint, Inc. ("BearingPoint") had recently emerged from a Chapter 11 reorganization resulting in a confirmed plan when the Supreme Court decided *Stern.* One of the provisions of the confirmation order was that any claims against BearingPoint's former officers and directors were to be brought in the bankruptcy court. After *Stern*, the trustee of the liquidating trust moved to modify Bankruptcy Judge Gerber's confirmation order to allow state court actions instead. Judge Gerber granted the motion. Judge Gerber noted, "there is a material risk, in my mind, that especially with the inspiration of *Stern v. Marshall*, and the [former officers and directors'] 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. Here, I fear, the additional litigation resulting from my inability to fully rule will have its own *Bleak House* implications, not unlike the *Bleak House* litigation referred to by the *Stern v. Marshall* court itself." In deciding to modify the confirmation order Judge Gerber stated, "I think I erred in assuming that I could try these claims with the efficiency with which I've normally decided cases. I failed to consider how litigants could tie a case up on knots by exploiting their rights to an Article III judge determination when litigation against them is non-core." Although the parties had previously consented to Judge Gerber entering a final order in the trustee's suits against officers and directors, the judge noted

> [I]t 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. That huge uncertainty presages litigation over that issue with the potential to tie up this case, and countless others, in knots. It also would at least seemingly invite litigants to consent, see how they like the outcome, and then, if they lose, say their consents were invalid. The alternative would be almost as bad. After having urged me to retain jurisdiction, and having argued the advantages of my keeping the case, the [defendants] here could move for withdrawal of the reference, or contend that I could only make proposed Findings of Fact and Conclusions of Law to the district court, with a de novo review process thereafter to follow. Any such measures would result in material additional expense and delay.

Id.

***Stern* Implications:** Any future claims against officers and directors in the BearingPoint bankruptcy must now be brought in a state court, unfamiliar with the bankruptcy case. Arguably, Judge Gerber's institutional knowledge of the case, acquired during the bankruptcy proceedings, made him best suited to adjudicate any disputes arising out of the bankruptcy. Perhaps most ironic of all is the fact that future claims will not be heard by an Article III judge anyway; they will be heard in state court. State court judges do not always have the life-tenure and salary protections that the Supreme Court found prohibited bankruptcy judges from deciding the matters at issue in *Marathon* and *Stern*.

Consent to Entry of Final Orders and Judgments by the Bankruptcy Judge

21. **Case Name:** *In re Sunra Coffee, LLC*, Bankr. No. 09-01909, 2011 WL 4963155 (Bankr. D. Haw. Oct. 18, 2011).

Ruling: *Stern* does not impact subject matter jurisdiction here. Even if it did, the parties implicitly consented to the bankruptcy court's jurisdiction.

Summary: Hawaii National Bancshares, Inc. foreclosed on debtor Sunra Coffee's assets and then pursued non-debtor guarantor for the deficiency. On September 23, 2010 the bankruptcy court entered a deficiency judgment against the Guarantor for over $2 million. The Guarantor did not appeal or seek relief from the judgment. In a hearing to determine the extent of the Guarantor's interest in certain property HNB wished to levy an execution on pursuant to its $2 million deficiency judgment, the Guarantor argued for the first time that the bankruptcy court lacked subject matter jurisdiction under *Stern*. After noting that *Stern* does not impact its subject matter jurisdiction, the bankruptcy court found that—even assuming it lacked inherent authority to decide HNB's claims against the Guarantor—it had authority to enter the default judgment because the Guarantor had "consented" by failing to object to the trustee's allegations when they were first made, failing to object to the trustee's motion to remove the state court proceeding to the bankruptcy court, and finally, failing to appeal or seek relief from the judgment. In addition, the Guarantor expressly invoked the court's jurisdiction when he requested an evidentiary hearing to demonstrate that he held no interest in the property HNB wished to levy on.

***Stern* Implications:** In this case the bankruptcy court found a third-party—neither a debtor nor a creditor in the bankruptcy—had implicitly consented to final judgments of the bankruptcy court affecting his legal rights. Other courts have declined to find that anything less than express consent is sufficient to confer authority on a non-Article III court. Until a uniform law of consent is implemented by either statute or the Federal Rules of Bankruptcy Procedure, a party's activities may amount to consent in the view of one court but not another.

Exhibit B

UNITED STATES DISTRICT COURT
DISTRICT OF MASSACHUSETTS

RULE 206. CORE PROCEEDINGS REQUIRING FINAL ADJUDICATION BY THE DISTRICT COURT

If a bankruptcy judge determines that entry of a final order or judgment by a bankruptcy judge would not be consistent with Article III of the United States Constitution in a particular proceeding referred under L.R. 201 and determined to be a core matter under 28 U.S.C. 157, the bankruptcy judge shall hear the proceeding and submit proposed findings of fact and conclusions of law to the district court made in compliance with Fed. R. Civ. P. 52(a)(1) in the form of findings and conclusions stated on the record or in an opinion or memorandum of decision.

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

The district court may treat any order or judgment of the bankruptcy court as proposed findings of fact and conclusions of law in the event the district court concludes that the bankruptcy judge could not have entered a final order or judgment consistent with Article III of the United States Constitution.

Adopted June 5, 2012.

Exhibit C

Proposed Amendments to the Federal Rules of Bankruptcy Procedure

RULE 7008. GENERAL RULES OF PLEADING

(a) APPLICABILITY OF RULE 8 F.R. Civ. P.

Rule 8 F.R. Civ. P. applies in adversary proceedings. The allegation of jurisdiction required by Rule 8(a) shall also contain a reference to the name, number, and chapter of the case under the Code to which the adversary proceeding relates and to the district and division where the case under the Code is pending. In an adversary proceeding pending in a bankruptcy court, the complaint, counterclaim, cross-claim, or third-party complaint shall contain a statement that the pleader does or does not consent to entry of final orders or judgment by the bankruptcy court.

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COMMITTEE NOTE

Subdivision (a) is amended to remove the requirement that the pleader state whether the proceeding is core or non-core and to require in all proceedings that the pleader state whether the party does or does not consent to the entry of final orders or judgment by the bankruptcy court. Some proceedings may satisfy the statutory definition of core proceedings, 28 U.S.C. § 157(b)(2), but remain beyond the constitutional power of a bankruptcy judge to adjudicate finally. The amended rule calls for the pleader to make a statement regarding consent, whether or not a proceeding is termed non-core. Rule 7012(b) has been amended to require a similar statement in a responsive pleading. The bankruptcy judge will then determine the appropriate course of proceedings under Rule 7016.

RULE 7012. DEFENSES AND OBJECTIONS—WHEN AND HOW PRESENTED—BY PLEADING OR MOTION—MOTION FOR JUDGMENT ON THE PLEADINGS

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(b) APPLICABILITY OF RULE 12(B)-(I) F.R. CIV. P.

Rule 12(b)-(i) F.R. Civ. P. applies in adversary proceedings. A responsive pleading shall include a statement that the party does or does not consent to entry of final orders or judgment by the bankruptcy court.

COMMITTEE NOTE

Subdivision (b) is amended to remove the requirement that the pleader state whether the proceeding is core or non-core and to require in all proceedings that the pleader state whether the party does or does not consent to the entry of final orders or judgment by the bankruptcy court. The amended rule also removes the provision requiring express consent before the entry of final orders and judgment in non-core proceedings. Some proceedings may satisfy the statutory definition of core proceedings, 28 U.S.C. § 157(b)(2), but remain beyond the constitutional power of a bankruptcy judge to adjudicate finally. The amended rule calls for the pleader to make a statement regarding consent, whether or not a proceeding is termed non-core. This amendment complements the requirements of amended Rule 7008(a). The bankruptcy judge's subsequent determination of the appropriate course of proceedings, including whether to enter final orders and judgments or to issue proposed findings of fact and conclusions of law, is a pretrial matter now provided for in amended Rule 7016.

RULE 7016. PRETRIAL PROCEDURES

(a) PRETRIAL CONFERENCES; SCHEDULING; MANAGEMENT.

Rule 16 F.R. Civ. P. applies in adversary proceedings.

(b) DETERMINING PROCEDURE.

The bankruptcy court shall decide, on the court's own motion or on the timely motion of a party, whether to hear and determine the proceeding, issue proposed findings of fact and conclusions of law, or take some other action.

COMMITTTEE NOTE

This rule is amended to create a new subdivision (b) that provides for the bankruptcy court to enter final orders and judgment, issue proposed findings and conclusions, or take some other action in a proceeding. The rule leaves the decision as to the appropriate course of proceedings to the bankruptcy court. The court's decision will be informed by the parties' statements, required under Rules 7008(a), 7012(b), and 9027(a) and (e), regarding consent to the entry of final orders and judgment. If the bankruptcy court chooses to issue proposed findings of fact and conclusions of law, Rule 9033 applies.

RULE 9027. REMOVAL

(a) NOTICE OF REMOVAL.

(1) *Where filed; form and content.*

A notice of removal shall be filed with the clerk for the district and division within which is located the state or federal court where the civil action is pending. The notice shall be signed pursuant to Rule 9011 and contain a short and plain statement of the facts which entitle the party filing the notice to remove, contain a statement that upon removal of the claim or cause of action the party filing the notice does or does not consent to entry of final orders or judgment by the bankruptcy court, and be accompanied by a copy of all process and pleadings.

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(e) PROCEDURE AFTER REMOVAL.

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(3) Any party who has filed a pleading in connection with the removed claim or cause of action, other than the party filing the notice of removal, shall file a statement that the party does or does not consent to entry of final orders or judgment by the bankruptcy court. A statement required by this paragraph shall be signed pursuant to Rule 9011 and shall be filed not later than 14 days after the filing of the notice of removal. Any party who files a statement pursuant to this paragraph shall mail a copy to every other party to the removed claim or cause of action.

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COMMITTEE NOTE

Subdivision (a)(1) and (e)(3) are amended to delete the requirement for a statement that the proceeding is core or non-core and to require in all removed actions a statement that the party does or does not consent to the entry of final orders or judgment by the bankruptcy court. Some proceedings may satisfy the statutory definition of core proceedings, 28 U.S.C. § 157(b)(2), but remain beyond the constitutional power of a bankruptcy judge to adjudicate finally. The amended rule calls for a statement regarding consent at the time of removal, whether or not a proceeding is termed non-core.

The party filing the notice of removal must include a statement regarding consent in the notice, and the other parties who have filed pleadings must respond in a separate statement filed within 14 days after removal. If a party to the removed claim or cause of action has not filed a pleading prior to removal, however, there is no need to file a separate statement under subdivision (e)(3), because a statement regarding consent must be included in a responsive pleading filed pursuant to Rule 7012(b). Rule 7016 governs the bankruptcy court's decision whether to hear and determine the proceeding, issue proposed findings of fact and conclusions of law, or take some other action in the proceeding.

RULE 9033. PROPOSED FINDINGS OF FACT AND CONCLUSIONS OF LAW

(a) SERVICE

In a proceeding in which the bankruptcy court has issued proposed findings of fact and conclusions of law, the clerk shall serve forthwith copies on all parties by mail and note the date of mailing on the docket.

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COMMITTEE NOTE

Subdivision (a) is amended to delete language limiting this provision to non-core proceedings. Some proceedings may satisfy the statutory definition of core proceedings, 28 U.S.C. § 157(b)(2), but remain beyond the constitutional power of a bankruptcy judge to adjudicate finally. If the bankruptcy court decides, pursuant to Rule 7016, that it is appropriate to issue proposed findings of fact and conclusions of law in a proceeding, this rule governs the subsequent procedures.