Bankruptcy & Insolvency Litigation
FROM THE SECTION OF LITIGATION BANKRUPTCY & INSOLVENCY LITIGATION COMMITTEE
Winter 2012, Vol. 17 No. 2

ARTICLES

A Survey of Cases Interpreting the Stern Decision

By Omar J. Alaniz – February 15, 2012

This article is the first in a multipart series that will provide an overview of trends in how courts are interpreting Stern v. Marshall.

Judge Laurel M. Isicoff put it best when she stated, "Since its release, a maelstrom of opinions and articles have been written about the scope of *Stern*, ranging from 'much ado about nothing' to 'the end of the bankruptcy world as we know it.'" *BankUnited Fin. Corp. v. Fed. Dep. Ins. Corp. (In re BankUnited Fin. Corp.)*, Adv. No. 10-02872-BKC-LMI, 2011 Bankr LEXIS 4531 (Bankr. S.D. Fla. Nov. 22, 2011).

As of December 1, 2011, there were 184 cases that have discussed or cited to *Stern*. This article corresponds to a chart [PDF] that catalogues all cases that have meaningfully discussed *Stern* from September 1, 2011 through November 30, 2011. For their contributions to the chart, the author wishes to thank Frances A. Smith from Shackelford, Melton & McKinley and Vanessa Gonzalez.

Another chart, which catalogues cases discussing *Stern* prior to September 1, 2011, may be found in a law review article authored by Katie Drell Grissel, "*Stern v. Marshall—Digging for Gold and Shaking the Foundation of Bankruptcy Courts (or Not)*" to be published in the Louisiana Law Review Volume 72, Issue 3. 72 La. L. Rev. ___ (2012).

The topics that are the subject of divergent opinions among bankruptcy practitioners, judges, and commentators relating to *Stern* primarily concern how the decision affects the bankruptcy court's power to adjudicate avoidance actions, state law claims, counterclaims, and various federal bankruptcy issues. As such, the chart to which this article links is organized by those topics and the summary of the topics will be addressed in that order below. Before addressing those topics, however, the article discusses courts' view on subject matter jurisdiction post-*Stern*. The article concludes by discussing (a) courts' views on how *Stern* affects consent, (b) several courts' theory that *Stern* has created a statutory gap for matters "core but unconstitutional," (c) the trend of courts to fashion a common thread among private rights, Seventh Amendment rights, and right to Article III adjudication, and (d) the author's own thoughts on the reaches of *Stern.*

Subject Matter Jurisdiction

In bankruptcy circles, it is practically gauche to say that *Stern's* holding addressed bankruptcy

court subject matter jurisdiction. During the initial post-*Stern* days, commentators assessed *Stern* as changing the landscape of "bankruptcy court jurisdiction." But after some reflection and a closer read of the holding in *Stern*, it is now clear that although the bankruptcy court had subject matter jurisdiction over the debtor's counterclaim under the relevant statutes, the Supreme Court held that the bankruptcy court did not have *constitutional authority* to adjudicate it. Brevity restricts a proper string cite of the cases so observing, but some of those case are: *Kirchner v. Agoglia (In re Refco, Inc.)*,—B.R.—,Adv. No. 07-3060 (RDD), 2011 Bankr. LEXIS 4496, at *5 (Bankr. S.D.N.Y. Nov. 30, 2011); *Reed v. Linehan (In re Soporex, Inc.)*, Adv. No. 11-3306-BJH, 2011 Bankr. LEXIS 4695 (Bankr. N.D. Tex. Nov. 28, 2011); *Goldstein v. Eby-Brown (In re Universal Mktg., Inc.)*, 459 B.R. 573, 577 (Bankr. E.D. Pa. 2011); *Hagan v. Classic Prod. Corp. (In re Wilderness Crossings, LLC)*, Adv. No. 11-80417, 2011 Bankr. LEXIS 5016 (Bankr. W.D. Mich. Nov. 8, 2011).

Putting aside the constitutional analysis, the distinction between subject matter jurisdiction and constitutional authority is significant in practical respects. For example, if *Stern* is read to suggest that the bankruptcy court did not have subject matter jurisdiction over the counterclaim, the bankruptcy court would not have had authority to submit proposed findings of fact and conclusions of law under 28 U.S.C. section 157(c)(1) or to adjudicate the counterclaim with the parties' consent under 28 U.S.C. section 157(c)(2). Nevertheless, some courts view the *Stern* holding to mean that the bankruptcy court can do neither, regardless of subject matter jurisdiction (discussed *infra*).

Avoidance Actions

The hottest topic continues to be whether the bankruptcy court has the constitutional authority to enter final orders in fraudulent conveyance actions. The first few cases to address this issue were: *In re Am. Bus. Fin. Servs.*, 457 B.R. 314 (Bankr. D. Del. July 28, 2011); *Samson v. Blixseth (In re Blixseth)*, Adv. No. 10–00088, 2011 Bankr. LEXIS 2953 (Bankr. D. Mont. Aug. 1, 2011); *In re Innovative Commc'n Corp.*, Adv. No. 08-03004, 2011 Bankr. LEXIS 3040 (Bankr. D.V.I. Aug. 5, 2011); and *Meoli v. The Huntington Nat'l Bank (In re Teleservices Group, Inc.)*, 456 B.R. 318 (Bankr. W.D. Mich. 2011).

The bankruptcy court in *American Business* held that *Stern* was inapplicable to avoidance actions. The bankruptcy court in *Innovative Communications* determined that post-*Stern* a bankruptcy court continues to have the authority to enter final judgments on fraudulent transfer actions under 11 U.S.C. section 548, but that it can only submit proposed findings of fact and conclusions of law on actions filed under 11 U.S.C. section 544(b). The *Teleservices* and *Blixseth* cases both followed an expansive view of *Stern* and determined that bankruptcy courts can no longer adjudicate fraudulent conveyance actions; but *Blixseth* goes further by holding that

the bankruptcy court cannot even submit proposed findings and conclusions. *Blixseth*, 2011 Bankr. LEXIS 2953.

At least 14 cases weighed in on the issue between September 1 and November 30, 2011, and discord persists. Among the cases with the most robust discussion of this topic are: *Heller Ehrman v. Arnold & Porter (In re Heller Ehrman LLP)*,—F. Supp. 2d—, No. C 11-04848 CRB, 2011 U.S. Dist. LEXIS 143223 (N.D. Cal. Dec. 13, 2011); *Tabor v. Kelly (In re Davis)*, Adv. No. 07-05181-L, 2011 Bankr. LEXIS 4762 (Bankr. W.D. Tenn. Oct. 5, 2011); *Refco*, 2011 Bankr. LEXIS 4496; and *Universal Mktg.*, 459 B.R. 573.

The Expansive View

In *Heller Ehrman*, defendants filed a motion to withdraw the reference on various fraudulent conveyance actions. In its report and recommendation, the bankruptcy court reasoned that "the bottom line" is that *Stern's* holding does not prevent bankruptcy judges from entering final judgments on fraudulent transfer claims. *Heller Ehrman v. Arnold & Porter (In re Heller Ehrman LLP)*, Adv. No. 01-3203DM, 2011 Bankr. LEXIS 3764, at *16 (Bankr. N.D. Cal. Sept. 28, 2011). But the district court disagreed—without explicitly saying so—and noted that *Stern* links private rights, Seventh Amendment rights, and the right to Article III adjudication. *Heller Ehrman*, 2011 U.S. Dist. LEXIS 143223. Accordingly, the district court concluded that the reasoning of *Stern* does apply to fraudulent conveyance claims. *See id.* at *7–8. However, the district court did not agree with *Blixseth* and determined that there is no reason why the bankruptcy court cannot hear all pretrial matters and submit proposed findings and conclusions. *See id*. at *16–18; *see also Universal Mktg.*, 459 B.R. at 577 (criticizing *Blixseth*; "[n]othing in . . . *Stern* precludes the bankruptcy court from . . . treating [a fraudulent transfer claim] as a 'related proceeding' and issuing proposed findings of fact and conclusions of law"); *McCarthy v. Wells Fargo Bank (In re El–Atari)*, No. 1:11cv1090, 2011 U.S. Dist. LEXIS 133423, at *9 (E.D. Va. Nov. 18, 2011) (same); *Picard v. Flinn Inv., LLC*,—F. Supp. 2d—, No. 11 Civ. 5223 (JSR), 2011 U.S. Dist. LEXIS 136627, at *26 (S.D.N.Y. Nov. 28, 2011); *Field v. Lindell (In re The Mortgage Store, Inc.)*, Civil No. 11–00439 JMS/RLP, 2011 U.S. Dist. LEXIS 123506 (D. Haw. Oct. 5, 2011).

Other cases supporting the expansive view of *Stern* vis-à-vis avoidance actions are *Davis*, 2011 Bankr. LEXIS 4762; *El–Atari*, 2011 U.S. Dist. LEXIS 133423; and *City Bank v. Compass Bank*, No. EP–11–MC–372–KC, 2011 U.S. Dist. LEXIS 129654 (W.D. Tex. Nov. 9, 2011).

The Narrow View

Perhaps the leader on the narrow side for this period was the *Refco* case. *See Refco*, 2011 Bankr. LEXIS 4496. *Refco* involved both 544(b) and 548 actions. The bankruptcy court noted that both are "arising under" actions unlike the state law counterclaim in *Stern*. Among the reasons for its

holding were that: (1) a fraudulent transfer action flows from a federal regulatory scheme; (2) the pursuit of avoidance claims are a core aspect of the administration of bankruptcy estates since the eighteenth century; (3) courts since *Granfinanciera* continue to hold that bankruptcy courts have constitutional authority to adjudicate fraudulent transfer actions; and (4) language within *Stern* itself signals that the holding is narrow. *See id.* These points are expounded upon in the court's lengthy discussion supporting the narrow view.

Other cases supporting the narrow view for fraudulent conveyance actions include: *Universal Mktg.*, 459 B.R. 573; *Mercury Co., Inc. v. FNF Sec. Acquisition, Inc.*,—F. Supp. 2d—, No. 11-cv-02488-WJM-BNB, 2011 U.S. Dist. LEXIS 125610 (D. Colo. Oct. 31, 2011); *Wilderness Crossings*, 2011 Bankr. LEXIS 5016; *Gugino v. Canyon County (In re Bujak)*, Adv. No. 11-6038, 2011 Bankr. LEXIS 4291 (Bankr. D. Idaho Nov. 3, 2011); *Kelley v. JPMorgan Chase & Co.*, Civil No. 11–193 (SRN/JJG), 2011 U.S. Dist. LEXIS 107427 (D. Minn. Sept. 21, 2011); *Heller Ehrman* (bankruptcy court), 2011 Bankr LEXIS 3764 (though the district court had a broader view as discussed above).

Is 544(b) different from 548?

A particularly interesting question—even within the narrow camp—is whether the analysis of a bankruptcy court's adjudicative power differs between sections 544(b) and 548 actions. *See, e.g.*, *Innovative Commc'n*. Fraudulent transfer law under section 548 may or may not have sufficient characteristics to set it apart from state fraudulent transfer law. But the trustee's avoidance power under section 544(b) is explicitly premised on state law. In *Universal Marketing*, the trustee filed its avoidance action under section 544(b), not under section 548. The bankruptcy court noted the distinction between the trustee's standing under section 544 versus the state law version of the Uniform Fraudulent Transfer Act, which accords remedies to creditors. *Universal Mktg.*, 459 B.R. at 576. The court opined that even though section 544 incorporates state law to provide the "rules of decision," a section 544 claim is a federal bankruptcy cause of action. *Id.*; *see also Bujak*, 2011 Bankr. LEXIS 4291, at *8–9 (Bankr. D. Idaho Nov. 3, 2011) ("absent bankruptcy, Debtor would lack standing to pursue . . . § 544(b) [actions] for the benefit of creditors").

But the rationale in *Universal Marketing* may not address the slippery slope argument that will no doubt be lodged from the expansive view camp. Can Congress just stick anything under title 11 and make it "arising under" title 11 such that the bankruptcy court gains adjudicatory power under section 157(b)(1)? Breach of Contract? Tort? Of course, constitutional issues abound.

Cases on the narrow side of the aisle involving section 544(b) are: *Refco*, 2011 Bankr. LEXIS 4496; *Universal Mktg.*, 459 B.R. 573; and *Bujak*, 2011 Bankr. LEXIS 4291. Though it was decided before September 1, 2011, it is worth mentioning that *In re Safety Harbor Resort & Spa*,

456 B.R. 703, 717 n.74 (Bankr. S.D. Fla. 2011), weighed in on this issue supporting the narrow view.

Preferences

Preferences have not received nearly as much attention as fraudulent conveyances actions between September 1 and November 30, 2011. But the subtopic has also generated some differing views.

In *Bujak*, the trustee filed various avoidance actions including preference actions. The bankruptcy judge focused on the "arising under" and "arising in" nature of the actions and determined that "at best" *Stern's* comments about fraudulent conveyance were dicta. *Bujak*, 2011 Bankr. LEXIS 4291, at *9. The bankruptcy court ultimately determined that it had constitutional authority to hear and determine the avoidance actions. But the creditor in *Bujak* filed a proof of claim. Thus, the Supreme Court would agree that the bankruptcy court had authority to adjudicate the preference claim in *Bujak* but not necessarily because of a narrow interpretation of *Stern*. Rather, section 502(d) and the Supreme Court's holdings in *Katchen v. Landy*, 382 U.S. 323, 329–30 (1966), and *Lagenkamp v. Culp*, 498 U.S. 42, 45 (1990), dictate that result.

Davis was also a case where the trustee filed both fraudulent transfer and preference actions. *Davis* was actually more of a *Granfinanciera* case and in fact goes beyond *Stern*. The defendant did not file a proof of claim, demanded a jury, and did not consent to the bankruptcy court conducting the jury trial. The *Davis* court noted that "*Stern* seems to suggest that a distinction can be drawn between fraudulent conveyance actions, which arise under state common law, and preferential transfer actions, which are created by federal bankruptcy law (*see Stern*, 131 S. Ct. at 2618), but the court in *Granfinaciera* made no such distinction, and in fact noted that actions to recover preferential transfers or fraudulent conveyances were often brought at law in 18th century England." *Davis*, 2011 Bankr. LEXIS 4762, at *35. Accordingly, the bankruptcy court determined that it did not have constitutional authority to hear and determine the matters, but it did submit its report and recommendation to the district court.

Is a possible response to *Davis* that even if preferences were considered actions at law in the eighteenth century in England, such is not the case in American jurisprudence? Or must we always ask ourselves WWAWCI1D (What Would a Westminster Court in 1789 Do)? Subject to one qualification, an entity can prefer all it wants outside of bankruptcy—which isn't the case with fraudulent transfer activities. It is true that the Uniform Fraudulent Transfer Act has a preference-like cause of action for insiders, but that provision was enacted in 1984 and borrowed from bankruptcy law. *See* Peter A. Alces, et al., *Critical Analysis of the New Uniform Fraudulent Transfer Act*, 1985 U. Ill. L. Rev. 527, 555 (1985). Thus, preference liability in American law is

almost entirely a creature of bankruptcy law unlike fraudulent conveyance law, though the author is not conceding that *Stern* impacts fraudulent transfer adjudication.

Withdrawal of the Reference

A recurring trend in the case law is that defendants of avoidance actions are filing motions to withdraw the reference. In most cases, the district courts are unwilling to withdraw the reference regardless of the district court's view of *Stern*. *See, e.g.*, *Kelley v. JPMorgan Chase*, 2011 U.S. Dist. LEXIS 107427 (narrow view); *Heller Ehrman*, 2011 U.S. Dist. LEXIS 143223 (expansive view); *Mortgage Store*, 2011 U.S. Dist. LEXIS 123506 (neutral); *City Bank v. Compass Bank*, 2011 U.S. Dist. LEXIS 129654 (expansive view); *Extended Stay*, 2011 U.S. Dist. LEXIS 131349 (neutral). This is because almost all courts at this point, even the district courts that conclude that a bankruptcy court can no longer enter final judgments on avoidance actions (like *Heller Ehrman*), agree that the bankruptcy court can at a minimum submit proposed findings of fact and conclusions of law. Thus, *Blixseth* appears to have lost steam. *Mortgage Store* and *Extend Stay* are labeled neutral because both courts denied the motion for withdrawal of the reference but punted on whether the bankruptcy court has the power to enter final orders on avoidance actions—leaving that issue to be resolved at a later time.

Conclusion

This topic continues to generate disagreement among bankruptcy and district court judges. Even a strong advocate in the narrow camp cannot deny the "writing on the wall" in *Granfinanciera* and *Stern*. And at least one prominent scholar affirmatively opines that "core jurisdiction over preference and fraudulent conveyance claims is unconstitutional." Ralph Brubaker, *Article III's Bleak House (Part II): The Constitutional Limits of Bankruptcy Judges' Core Jurisdiction*, 31 Bankr. L. Letter No. 9 (2011). But it does not appear that any court on the expansive side has made the affirmative statement that 28 U.S.C. section 157(b)(1) is unconstitutional. If the expansive camp is correct, section 157(b)(1) must be rewritten because there is no question that sections 544(b), 547, and 548 actions are all at least "arising under" actions, albeit also "related to."

State Law Claims

This category of cases is relatively uncontroversial. In *Hill v. New Concept Energy, Inc. (In re Yazoo Pipeline Co., L.P.)*, 459 B.R. 636 (Bankr. S.D. Tex. 2011), the bankruptcy court determined that although it did not have the power to adjudicate various state law claims, it had the authority to enter pretrial orders. In *West v. Avery (In re Noram Resources Inc.)*, Adv. No. 10-03701, 2011 Bankr. LEXIS 4268 (Bankr. S.D. Tex. Nov. 7, 2011), the bankruptcy court determined that it had authority to decide a motion to dismiss even though *Stern* prevented it from adjudicating the merits of the claim—whether directors breached their duty of care through their compensation decisions.

The bankruptcy court in the *Coudert Brothers* bankruptcy case has issued two opinions that contain a relatively expansive reading of *Stern*. *Retired Partners of Coudert Bros. Trust v. Baker McKenzie LLP (In re Coudert Bros. LLP)*, App. Case No. 11-2785 (CM), 2011 U.S. Dist. LEXIS 110425 (S.D.N.Y. Sept. 23, 2011), and *Dev. Specialists, Inc. v. Akin Gump Strauss Hauer & Feld LLP*, No. 11 civ. 5994 (CM), 2011 U.S. Dist. LEXIS 127898 (S.D.N.Y. Nov. 2, 2011). In *Retired Partners of Coudert Brothers Trust*, the district court withdrew the reference on various state law claims. The court concluded that the question of whether a bankruptcy court can finally adjudicate a matter post-*Stern* depends on whether the claim to be adjudicated involves a public or private right. The district court judge was consistent in her views of *Stern* in the *Development Specialist v. Akin Gump* case and was perhaps more emphatic. The court opined that *Stern* goes further than *Marathon* and *Granfinanciera*. 2011 U.S. Dist. LEXIS 127898, at *25. The court wrote, "[o]nly in *Stern* did the Court *actually hold* that a fraudulent conveyance action implicating private rights must be finally determined in an Article III forum." *See id*. at *26 (emphasis added). An almost audible gasp was heard from the narrow camp.

Another interesting case was *Lacey v. BAC Home Loans Serv., LP (In re Lacey)*, Adv. No. 10-1249, 2011 Bankr. LEXIS 4179 (Bankr. D. Mass. Oct. 27, 2011). In this case, the trustee alleged that state-law claims were core under 28 U.S.C. section 157(b)(2)(O)—the "catch-all" provision. After analyzing *Stern*, the bankruptcy court determined that the state-law claims were noncore. Thus, section 157(b)(2)(O) may soon be the new 157(b)(2)(C).

Counterclaims

For the most part, bankruptcy courts are taking a cautious look at particular counterclaims to ascertain their adjudicatory power. Except for avoidance action counterclaims to proofs of claims, the standard employed is that articulated in *Stern*: Is resolution of the counterclaim necessary for resolution of the proof of claim? *See, e.g., Fort v. SunTrust Bank (In re Int'l Payment Group, Inc.)*, Adv. No. 10–80049–HB, 2011 Bankr. LEXIS 4269 (Bankr. S.D.S.C. Nov. 3, 2011). The bankruptcy court in *Oxford Expositions, LLC v. Questex Media Group, LLC (In re Oxford Expositions, LLC)*, Adv. No. 11–01095–DWH, 2011 Bankr. LEXIS 3490 (Bankr. N.D. Miss. Sept. 13, 2011), followed this analysis but also concluded (by negative inference) that if a state law counterclaim must be determined in the process of ruling on a creditor's proof of claim, pursuant to sections 501 and 502 and Federal Rule of Bankruptcy Procedure 3007, then it arises both under the Bankruptcy Code and in the bankruptcy case.

A few recent cases have reaffirmed that not all counterclaims suffer from *Stern*-like infirmities. For example, in *Gorilla Co.*, a district court determined that the bankruptcy court's adjudication of the debtor's counterclaim of unjust enrichment was required to resolve the defendants' proofs of claim related to a non-compete clause and consulting agreement. *Corwin v. Gorilla Co. LLC*

(In re Gorilla Co. LLC), No. CV-10-1029-PHX, 2011 U.S. Dist. LEXIS 101308 (D. Ariz. Sept. 8, 2011). In *Citron*, the bankruptcy court determined its adjudication over the defendant's setoff counterclaim was necessary for the court's determination of various avoidance actions. *Citron v. Harriet Citron (In re Citron)*, Adv. No. 09-8125-jbr, 2011 Bankr. LEXIS 3934 (Bankr. E.D.N.Y. Oct. 6, 2011). However, the counterclaim in *Citron* was not a counterclaim against a creditor's proof of claim. Thus, *Stern* was not particularly at issue, but the test proved persuasive to the bankruptcy court.

Federal Bankruptcy Issues

Stern does not appear to be concerning bankruptcy courts on fundamental bankruptcy issues—though this statement begs the question "What is a fundamental bankruptcy issue?" For example, the bankruptcy court in *In re LLS America*, No. 09-06194, 2011 Bankr. LEXIS 3429 (Bankr. E.D. Wash. Sept. 8, 2011), determined that *Stern* did not prevent it from entering a substantive consolidation order because the matter does not exist outside the context of a bankruptcy proceeding. Without saying so, the bankruptcy court distinguished the "arising in" nature of substantive consolidation from the "related to" nature of the counterclaim in *Stern*. In *In re Ambac Financial Group, Inc.*, 457 B.R. 299 (Bankr. S.D.N.Y. 2011), the bankruptcy court entered an order on a 9019 motion to approve a settlement of shareholder derivative claims. In *In re Washington Mutual, Inc*.,—B.R.—, No. 08-12229 (MFW), 2011 Bankr. LEXIS 3361 (Bankr. D. Del. Sept. 13, 2011), the bankruptcy court determined that *Stern* did not prevent it from entering a confirmation order that included settlement of state law claims under Rule 9019.

One surprising case in the federal bankruptcy issues category is *Naughton*. *See Hagan v. Smith (In re Naughton)*, Adv. No. 11–80237, 2011 Bankr. LEXIS 3762 (Bankr. W.D. Mich. Sept. 6, 2011). In this case, the trustee sought to sell property of the estate under 11 U.S.C. section 363. The bankruptcy court and trustee were concerned about a possible collateral attack on the sale order in light of *Stern*. Accordingly, the bankruptcy court submitted a report and recommendation to the district court to approve the sale. But two months later, the same bankruptcy judge entered a final order on a chapter 13 debtor's claim objection—this time without trepidation and with statements reflecting a narrower view of *Stern* than in the *Naughton* case. *In re Borin*, No. DT 11–03122, 2011 Bankr. LEXIS 4225 (Bankr. W.D. Mich. Nov. 2, 2011).

Consent

The issue of whether parties can still consent to bankruptcy court adjudication post-*Stern* is somewhat open, but the vast majority of courts hold that consent rights are still intact post-*Stern*. Early on in the *Stern* case-law evolution, the court in *Bearing Point* case stated that "it's fair to assume that it will now be argued, that consent, no matter how uncoerced or unequivocal, will never again be sufficient for bankruptcy judges ever to issue final judgments on noncore

matters." *In re Bearing Point, Inc.*, 453 B.R. 486, 496–97 (Bankr. S.D.N.Y. 2011). But a fair reading of the opinion suggests that the bankruptcy court assumed that the creditor (Pierce) consented to bankruptcy court adjudication. However, Justice Roberts acknowledged that while the creditor did consent to the adjudication of his proof of claim (the defamation claim), he did not consent to bankruptcy court adjudication of the counterclaim (the tortious interference claim). *Stern*, 131 S. Ct. at 2614. The bankruptcy court in *Bearing Point* made references to Pierce's consent on the defamation claim but never observed in its opinion that Pierce did not consent on the tortious interference claim. *See* 453 B.R. at 497 n.34. Thus, the court's comments about post-*Stern* consent may have been founded on a faulty premise.

Most courts at this point, however, consistently hold that *Stern* leaves undisturbed the bankruptcy court's ability to adjudicate "related to" matters with the parties' consent. *See, e.g.*, *Mercury Co., Inc. v. FNF Sec. Acquisition, Inc*.,—F. Supp.2d—, No. 11-cv-02488-WJM-BNB, 2011 U.S. Dist. LEXIS 125610 (D. Colo. Oct. 31, 2011); *Bayonne Med. Ctr. v. Bayonne/Omni Dev., LLC (In re Bayonne Med. Ctr.)*, Adv. No. 09-1689, 2011 Bankr. LEXIS 4748 (Bankr. D.N.J. Nov. 1, 2011); *In re Reinke*, Adv. No. 09-01541, 2011 Bankr. LEXIS 4142 (Bankr. W.D. Wash. Oct. 26, 2011); *Hawaii Nat'l Bancshares, Inc. v. Sunra Coffee LLC (In re Sunra Coffee LLC)*, Adv. No. 10-90009, 2011 Bankr. LEXIS 4047 (Bank. D. Haw. Oct. 18, 2011); *Citron*, 2011 Bankr. LEXIS 3934, at *6; *Adams Nat'l Bank v. GB Herdon and Assocs., Inc. (In re GB Herdon and Assocs., Inc.)*, 459 B.R. 148 (Bankr. D.D.C. 2011); *In re Pro-Pac, Inc.*, 456 B.R. 894 (Bankr. E.D. Wis. 2011); *Retired Partners of Coudert Bros. Trust*, 2011 U.S. Dist. LEXIS 110425, at *27–28 (though ultimately determining that consent did not occur in that case); *Oxford Expositions*, 2011 Bankr. LEXIS 3490 (consent in "related to" matters should be no less effective than contractual arbitration agreements); *see also* Ralph Brubaker, *Article III's Bleak House (Part II): The Constitutional Limits of Bankruptcy Judges' Core Jurisdiction*, 31 Bankr. L. Letter No. 9, at 18–19 (2011). For example, in *Mercury Co*., the district court determined that the parties consented to bankruptcy court adjudication by litigating the action in bankruptcy court for 19 months and admitting in pre-*Stern* pleadings that the fraudulent transfer actions were "core." 2011 U.S. Dist. LEXIS 125610.

A related topic is what does *Stern* mean for the magistrate consent statute (i.e., 28 U.S.C. section 636(c))? The bankruptcy consent statute in 28 U.S.C. section 157(c)(2) and the magistrate consent statute in 28 U.S.C. section 636(c)(1) are arguably so similar in nature that any pronouncements on the constitutionality of one statute should apply by analogy to the other. *In re Olde Prairie Block Owner, LLC*, 457 BR 692, 701 (Bankr. N.D. Ill. 2011). Nearly every circuit has determined that the magistrate statute is constitutional (*see* Grissell law review article cited above for a thorough discussion). The Supreme Court in *Roell v. Withrow*, 538 U.S. 580, 582 (2003), held that consent under section 636(c)(1) can be implied from a party's conduct during litigation. However, the district court in *Retired Partners of Coudert Brothers Trust* opined that

implied consent is not enough in bankruptcy courts post-*Stern*. 2011 U.S. Dist. LEXIS 110425, at *33.

The Fifth Circuit in *Technical Automation Servs. v. Liberty Surplus Ins.*, Case No. 10-20640, issued a *sua sponte* order asking the parties to address the constitutionality of the magistrate statute in light of *Stern*. Oral argument was heard on December 5, 2011. No ruling has been issued as of the date of this article. For a great discussion of why the magistrate consent statute is constitutional, see Judge Kennedy's opinion in *Pacemaker Diagnostic Clinic of Am., Inc. v. Instromedix, Inc*., 725 F.2d 537 (9th Cir. 1984) (en banc). For the opposing view, see Judge Posner's dissent in *Geras v. Lafayette Display Fixtures, Inc.*, 742 F.2d 1037, 1045 (7th Cir. 1984).

Statutory Gap: A New Third Category of Core Matters?

Traditionally, bankruptcy practitioners and courts have ascertained a court's authority to adjudicate matters by determining whether a matter is "core" or "noncore." Several courts question whether *Stern* creates a new category of matters: core but unconstitutional. *See, e.g.*, *Soporex*, 2011 Bankr. LEXIS 4695, at *14–19; *Refco*, 2011 Bankr. LEXIS 4496; *but see Mortgage Store*, 2011 U.S. Dist. LEXIS 123506, at *18 (no new category exists because "to the extent Congress runs afoul of the Constitution by granting the power to enter final judgments on particular 'core' proceedings . . . those proceedings [are] no longer part of that definition."); *see also* Ralph Brubaker, *Article III's Bleak House (Part I): The Constitutional Limits of Bankruptcy Judges' Core Jurisdiction*, 31 Bankr. L. Letter No. 8, at 12 (2011). The potential anomaly could be significant. If a matter is a core proceeding, 28 U.S.C. section 157(b)(1) allocates adjudicatory power to the bankruptcy court. If the matter is noncore, then Congress has allocated adjudicative power to the district court, but the bankruptcy court may still hear the matter and submit proposed findings and conclusions—unless the parties consent in which case the bankruptcy court regains its adjudicatory power. *See* 28 U.S.C. § 157(c). But post-*Stern*, it is clear that there may be matters that are statutorily defined as "core" in section 157(b)(2) that are not properly allocable to the bankruptcy for final determination, perhaps unless the parties consent. For this third category, can the bankruptcy court submit proposed findings and conclusions to the district court? The authority to submit proposed findings and conclusions in section 157(c)(1) appears to be limited to matters that are "not a core proceeding."

Here, again, courts diverge but the majority (for now) hold that a bankruptcy court can submit proposed findings and conclusions. *Blixseth* may have been the first post-*Stern* court to rule that the statutory gap prevented it from issuing proposed findings of fact and conclusions of law in a fraudulent transfer proceeding. As discussed above, *Heller Ehrman* and *Universal Marketing* specifically disagree with *Blixseth* on this point. Perhaps there is a distinction between a matter that is solely "related to" but statutorily core like the counterclaim in *Stern* and a matter such as a

fraudulent transfer claim which is not only "related to" and statutorily "core," but also "core" because it is an "arising under" claim.

In *Soporex*, the bankruptcy court opined that "it is absurd to think that simply because Congress did not anticipate the Supreme Court's ruling in *Stern* . . . that the bankruptcy courts can now do nothing with respect to these types of claims." *Soporex*, 2011 Bankr. LEXIS 4695, at *17; *see also Refco*, 2011 Bankr. LEXIS 4496, at *6. The bankruptcy court in *Universal Marketing* echoed similar sentiments:

> I fail to see how Congress' express, unambiguous delegation of subject matter jurisdiction in 'related proceedings' is vitiated by the absence of an explicit mechanism for the issuance of proposed findings of fact and conclusions of law in cases in which Congress may have exceeded its constitutional authority in designating proceedings as 'core.'

Universal Mktg., 459 B.R. at 580.

Interestingly, the issue of consent should be undisturbed even if there is a third new category of "core but unconstitutional." 28 U.S.C. section 157(c)(2) allows parties to consent to bankruptcy court adjudication on "related to" matters. Unlike section 157(c)(1), section 157(c)(2) does not mention "core" or "noncore" proceedings, and therefore to the extent there is a statutory gap with respect to section 157(c)(1), no such gap exists in (c)(2).

The Tie That Binds

One last issue permeating among the case law is the notion that the new test to determine whether the bankruptcy court has constitutional authority to adjudicate a matter is to determine whether the claim involves a private right or whether the matter carries with it a Seventh Amendment right. *Davis* held that all three (i.e., private rights, Seventh Amendment rights, and Article III rights) are inescapably bound. *Davis*, 2011 Bankr. LEXIS 4762, at *35. In other words, if the claim involves a private right, then the defendant has a jury trial right, and the bankruptcy court would not have constitutional authority to adjudicate the matter. Of course, even assuming, as *Davis* does, that a preference claim involves private rights, the bankruptcy court will have the constitutional authority to determine the preference action if the defendant files a proof of claim. *See Katchen*, 382 U.S. at 329–30; *Lagenkamp*, 498 U.S. at 45. As *Stern* recognizes, the statutory glue of 11 U.S.C. section 502(d) tethers the claimant to the bankruptcy court. *Stern*, 131 S. Ct. at 2616–17.

Davis also latches on to the notion that post *Stern* if the civil proceeding has the primary purpose of augmenting the bankruptcy estate, rather than resolving claims against the estate, it is a matter of a private right that must be determined by an Article III court. *Davis*, 2011 Bankr. LEXIS 4762, at *36. Indeed, such would have been the case under the Bankruptcy Act where bankruptcy referees could not determine plenary matters such as matters that augment the estate. What *Davis* perhaps calls for, then, is a return to the summary/plenary jurisdictional scheme of the Bankruptcy Act. But to get to the result of *Davis*, a bankruptcy court would have to ignore section 157(b)(1), which allocates to the bankruptcy court the authority to determine "arising under" matters or determine that section 157(b)(1) is unconstitutional. Several "arising under" matters are actions to augment the estate. To this *Davis* responds, "[t]he mere fact that a civil proceeding arises under the bankruptcy laws does not determine which court has authority to hear and finally determine it." *Id*. at *42. But following *Davis* to its logical conclusion, the allocation set up by congress in 28 U.S.C. section 157(b)(1) would have to be disrupted and the statute rewritten (This point is discussed further below.) Certainly, the Supreme Court's language in *Granfinanciera* and *Stern* would lead a betting person to wager that this will happen some day. The question remains should courts make that predetermination?

Author's Note

After a review of several cases and the *Stern v. Marshall* case itself, the author continues to query whether *Stern* does any more than inform us that the core proceeding list in 28 U.S.C. section 157(b)(2) is an unreliable guide to ascertain the bankruptcy court's adjudicative power and foretell a day of reckoning. The holding in *Stern* perhaps strengthens—rather undermines—the jurisdiction, referral, and allocation scheme of 28 U.S.C. sections 157 and 1334. The counterclaim in *Stern* was a "related to" matter because adjudication of the claim would have a conceivable impact on the estate. But the counterclaim did not also "arise under" title 11, nor was it a claim "arising in" a title 11 case. Congress allocated to bankruptcy judges the power to adjudicate core proceedings "arising under" title 11 and "arising in" a title 11 case under 28 U.S.C. section 157(b)(1) but not "related to" matters. The bankruptcy court can hear "related to" matters but not determine them unless the parties consent. *See* 11 U.S.C. § 157(c). Thus, and putting aside section 157(b)(2) for the moment, following the statutory trail of sections 1334(b) to 157(a) to 157(b)(1) to 157(c) leads to the same result in *Stern*—the bankruptcy court was only allocated the authority to submit proposed findings of fact and conclusions of law on the counterclaim to the district court absent the parties' consent.

But section 157(b)(2) adds an additional, perhaps unnecessary, rule to the game. Section 157(b)(1) allocates the "arising under" and "arising in" adjudicatory power to the bankruptcy court, but the phrase "core proceedings" precedes the phrases "arising under" and "arising in." Section 157(b)(2) provides a non-exhaustive list of examples that are core proceedings. But is this list necessary? Justice Roberts writes that there is no such thing as a core proceeding that is not "arising under" or "arising in" *Stern*, 131 S. Ct. at 2604. Well-established case law has

placed parameters on those phrases. The list is perhaps a precertified list of what matters are "arising under" and "arising in." But as *Stern* indicates, Congress has slipped in (perhaps inadvertently) "related to" matters in the section 157(b)(2) list. Certainly, the counterclaim in *Stern* highlights this issue with respect to section 157(b)(2)(C). But it is no stretch to imagine that other items in the section 157(b)(2) list may carry the same *Stern*-like concerns. *See, e.g.*, *Lacey*, 2011 Bankr. LEXIS 4179 (ruling that a claim alleged to be core under section 157(b)(2)(O) was in fact noncore).

The issue that the author sees with an expansive reading of *Stern* is that going beyond the holding of *Stern* requires rewriting, or ignoring, federal statutes that the Supreme Court has not held should be rewritten. A bankruptcy practitioner asking the bankruptcy court to determine that it does not have the constitutional authority to adjudicate a fraudulent transfer action is asking the bankruptcy court to disregard section 157(b)(1) or hold that it is unconstitutional. There is no question that a fraudulent transfer action "arises under" title 11 whether under section 544(b) or section 548(b). It might be that based on the language in *Stern* and *Granfinanciera* that the Supreme Court will rule some day that section 157(b)(1) is unconstitutional, but it has not yet done so. For the same reason, a bankruptcy court that determines it cannot adjudicate a "related to" matter when the parties consent to such adjudication would have to ignore section 157(c)(2) to arrive at such result. As discussed above, courts disagree on how far *Stern* and *Granfinanciera* reach to the bankruptcy court's authority to adjudicate fraudulent transfer actions. To a lesser extent, courts disagree on the consent issue, but the vast majority of cases have determined that *Stern* does not affect section 157(c)(2) (see *infra*).

Prior to *Stern*, courts interpreted 28 U.S.C. section 157 as drawing a "core" versus "noncore" line between what the bankruptcy court can and cannot adjudicate. Perhaps *Stern* can be interpreted to mean that the real line is between "arising under" and "arising in" matters on the one hand and "related to" matters on the other. Indeed, a lot of time is perhaps unnecessarily spent analyzing public versus private rights and Seventh Amendment rights. If the matter is a "related to" matter (and not "arising in" or "arising under"), the analysis can stop there because in any imaginable case, the same result will occur under the statute as in *Stern*. Where there is robust debate is in whether *Stern* affects the bankruptcy court's authority to adjudicate chapter 5 causes of action because of their "arising under" nature. It appears that the expansive camp believes that section 157(b)(1) is also unconstitutional and treats it as such, though none of the expansive post-*Stern* cases, to the author's knowledge, explicitly state so. It will be interesting to see what the next installment of *Stern* cases will deliver on this issue.

Keywords: bankruptcy, litigation, Stern, Marshall, jurisdiction, core, noncore

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