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STERN V. MARSHALL: THE EARTHQUAKE THAT HIT THE BANKRUPTCY COURTS AND THE AFTERSHOCKS THAT FOLLOWED

*Jolene Tanner**

Stern v. Marshall is arguably the biggest decision to affect the bankruptcy courts in almost thirty years and has ramifications well beyond what the U.S. Supreme Court likely considered. Anna Nicole Smith, the appellant in the case, will be remembered not only for the imprint that she left on pop culture, but also for rattling an entire legal institution. This case wound its way through both state and federal judiciaries and twice reached our country's highest court. The second time that it heard the case, the Court held that although bankruptcy courts, as Article I courts, could enter final judgments on certain state-law counterclaims under 28 U.S.C. § 157(b), they could not constitutionally enter final judgments under Article III of the Constitution. While bankruptcy judges have created ways to temporarily address the conundrum that Stern created, potential long-term effects of the ruling could be devastating to the way that bankruptcy courts operate. It may take years, or perhaps decades, to fully comprehend Stern's impact on the federal judiciary.

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I. INTRODUCTION

On June 23, 2011, the U.S. Supreme Court issued a 5–4 decision that rattled an entire judicial institution, calling into question the authority of bankruptcy courts. *Stern v. Marshall*¹ is arguably the biggest decision to affect the bankruptcy courts in almost thirty years² and has ramifications well beyond what the Court considered.³ The Court's holding in *Stern* caused judges, practitioners, scholars, and litigants⁴ to question bankruptcy judges' authority and the sanctity of the bankruptcy courts. This decision sent shockwaves through the entire bankruptcy community. Key players in the

1. 131 S. Ct. 2594 (2011). The Court held that bankruptcy judges cannot enter final judgments on state-law counterclaims by a debtor against a third-party claimant. *Id.* at 2620.

2. *See, e.g.*, *Med. Educ. & Health Servs. Inc. v. Indep. Municipality of Mayaguez* (*In re Med. Educ. & Health Servs. Inc.*), 459 B.R. 527, 548–49 (Bankr. D.P.R. 2011) (“[T]he [Stern] decision was as momentous a constitutional ruling on [the bankruptcy] courts’ authority as was the Justices’ decision in the 1982 case of *Northern Pipeline Construction Co. v. Marathon Pipe Line Co.* nullifying an earlier congressional law against those courts’ powers.” (citing *N. Pipeline Constr. Co. v. Marathon Pipe Line Co.*, 458 U.S. 50 (1982) (plurality opinion))); Event Notice, Fin. Lawyers Conference, *Stern v. Marshall: Anna Nicole, Stripped of Legacy, Forces Bankruptcy System to Rerun Marathon* (Oct. 6, 2011), available at <http://www.financiallawyers.org/2011mtgs.htm> (“The Supreme Court’s opinion in *Stern v. Marshall* [is] undoubtedly the most important bankruptcy decision in 29 years [and] . . . this ‘narrow’ holding is disrupting bankruptcy litigation around the country.”); Interview with Anne Wells, Associate Clinical Professor of Law, Loyola Law Sch. L.A., in L.A., Cal. (Oct. 13, 2011) (“No [U.S. Supreme Court] decision, since *Marathon*, has challenged the authority of the bankruptcy courts in the way that *Stern* has.”); Interview with the Honorable Sheri Bluebond, Bankr. Judge, Cent. Dist. of Cal., in L.A., Cal. (Sept. 7, 2011) (explaining the hype surrounding this decision and that there are not many Supreme Court decisions on bankruptcy); Press Release, UCLA Sch. of Law, Professor Klee Publishes Emerging Issues Analysis on *Stern v. Marshall* (June 30, 2011), available at <http://www.law.ucla.edu/news-media/Pages/News.aspx?NewsID=1868> (discussing Professor Kenneth Klee’s emerging issue analysis on *Stern* and stating that *Stern* is “the most important Supreme Court bankruptcy decisions in 29 years, which provides important restrictions on the scope of bankruptcy court jurisdiction”). Anne Wells has served as an editorial board member of the California Bankruptcy Journal for thirteen years, has published several bankruptcy articles, and teaches bankruptcy law at Loyola Law School Los Angeles. Interview with Anne Wells, *supra*. Judge Bluebond serves on the U.S. Bankruptcy Court for the Central District of California; she was appointed by the U.S. Court of Appeals for the Ninth Circuit in 2001. Interview with the Honorable Sheri Bluebond, *supra*.

3. For example, the Fifth Circuit Court of Appeals will consider the constitutionality of magistrate judges’ ability to enter final judgments in certain matters. *See infra* Part IV.B.

4. For example, a *Stern* issue was raised before Judge Ahart. Interview with the Honorable Alan M. Ahart, Bankr. Judge, Cent. Dist. of Cal., in Woodland Hills, Cal. (Sept. 30, 2011). Judge Ahart serves on the U.S. Bankruptcy Court for the Central District of California; he was appointed by the U.S. Court of Appeals for the Ninth Circuit in 1988 and reappointed to a second fourteen-year term in 2002. *Id.*

bankruptcy community have been trying to decipher the case and its impact on bankruptcy courts, prompting several blog posts⁵ and circuit-wide seminars.⁶ Within a few months of the ruling, more than one hundred courts—including bankruptcy courts⁷ and district courts⁸ in every circuit, some circuit courts of appeals,⁹ and some state courts¹⁰—cited *Stern* in an attempt to understand the impact of

5. See, e.g., ANDREW GOTTFRIED, MORGAN LEWIS, *STERN V. MARSHALL: NARROW HOLDING, BROADER IMPLICATIONS!* 1 (2011), available at http://www.morganlewis.com/pubs/RestructLF_Stern-v-Marshall_22july11.pdf (explaining that the *Stern* decision will likely result in future litigation over the issue of bankruptcy judges' power and may limit their right to enter final judgments on certain issues).

6. For example, on September 9, 2011, the U.S. Bankruptcy Court for the Central District of California in Los Angeles hosted a panel discussion for bankruptcy judges and practitioners regarding the impact of *Stern*. Interview with the Honorable Sheri Bluebond, *supra* note 2. On October 6, 2011, the Financial Lawyers Conference hosted a panel discussion titled “*Stern v. Marshall: Anna Nicole, Stripped of Legacy, Forces Bankruptcy System to Rerun Marathon*,” to address the implications of *Stern* on the bankruptcy courts. Event Notice, Fin. Lawyers Conference, *supra* note 2. On October 7, 2011, the Los Angeles County Bar Association, Commercial Law and Bankruptcy Section held a meeting entitled “The Meaning and Impact of *Stern v. Marshall*.” *The Meaning and Impact of Stern v. Marshall*, L.A. CNTY. BAR ASS'N (Oct. 7, 2011), <http://onlinestore.lacba.org/calendar/#ViewCalendarEvent.cfm?1=1&CalendarEventID=3756>.

7. For example, in response to *Stern*, a bankruptcy judge in the Seventh Circuit held that he may enter final judgments on five counterclaims that were filed against the claim of a secured creditor, where each of the counterclaims were either “necessarily resolved in order to rule on the creditor’s claim, . . . or the parties have consented to final adjudication by a Bankruptcy Judge . . .” *In re Olde Prairie Block Owner, LLC*, 457 B.R. 692, 694 (Bankr. N.D. Ill. 2011) (citations omitted). In the D.C. Circuit, a bankruptcy judge lifted the final judgment that it entered on a forbearance agreement because, in light of *Stern*, it did not have constitutional authority to enter a final judgment on a defendant’s counterclaim. *Adams Nat’l Bank v. GB Herndon & Assocs., Inc. (In re GB Herndon & Assocs., Inc.)*, 459 B.R. 148, 154 (Bankr. D.D.C. 2011). The court reasoned that “in the interest of justice and out of deference for the doctrine of separation of powers, [it would] lift final judgment, and . . . transfer the Counterclaims to a court with the constitutional authority to hear them.” *Id.*

8. For example, a district court in the Third Circuit cited *Stern* to emphasize the importance of separation of powers. *Hollander v. Ranbaxy Labs. Inc.*, No. 10-793, 2011 WL 2787151, at *3 (E.D. Pa. July 18, 2011). In the Eleventh Circuit, a district court described the tension between core and non-core proceedings in light of *Stern*. *Colony Beach & Tennis Club, Ltd. v. Colony Beach & Tennis Club Ass’n (In re Colony Beach & Tennis Club Ass’n)*, 456 B.R. 545, 551 n.3 (M.D. Fla. 2011).

9. For example the Third Circuit cited the dissent in *Stern* to support the proposition that the circuit court reviews the bankruptcy court’s “factual findings for clear error.” *In re Taylor*, 655 F.3d 274, 282 (3d Cir. 2011). The Fifth Circuit explained that the case before the court had been briefed and argued before the Court issued the *Stern* decision. The court held that, on remand, the district court was to “determine in the first instance whether *Stern* has applicability to further proceedings in th[e] matter.” *Sigillito v. Hollander (In re Hollander)*, 438 F. App’x. 274, 278 n.1 (5th Cir. 2011).

10. For example, a California state court of appeal cited *Stern* to support its assertion that the bankruptcy court’s interpretation of California law should not be given the same deference that a

the case.¹¹ But long before the bankruptcy world was thrown into a frenzy by the Court's decision, the case began as a love story.

On June 27, 1994,¹² Vickie Lynn Marshall ("Vickie"), a twenty-six-year-old woman, married J. Howard Marshall II ("Howard"), an eighty-nine-year-old man.¹³ Vickie was known to the public as Anna Nicole Smith,¹⁴ a Playboy Playmate with a career in acting and modeling.¹⁵ She appeared in numerous magazines, including as the cover model of *Playboy* magazine in March 1992 and as the centerfold Playmate of the Month in May 1992, and appeared on television as a Guess Jeans model.¹⁶ Howard was said to be one of the richest people in Texas,¹⁷ having made his fortune in the oil business.¹⁸ This love story was short lived, however, because Howard died in 1995, soon after he and Vickie were married.¹⁹ Unbeknownst to the players in this tale, this marriage would result in

district court's interpretation of the law should be given. *Calvo v. HSBC Bank USA, N.A.*, 130 Cal. Rptr. 3d 815, 819 n.2 (Ct. App. 2011). A dissenting justice on the Ohio Supreme Court cited *Stern* to support his opinion that tortious interference with a contract and abuse of process claims before the state court, in which neither party in the tort claims "is the bankruptcy debtor and in which resolution of the litigation will not affect the bankruptcy estate," are not preempted by the federal bankruptcy law. *PNH, Inc. v. Alfa Laval Flow, Inc.*, 958 N.E.2d 120, 128 (Ohio 2011) (Lanzinger, J., dissenting).

11. *See, e.g.*, *Matrix IV, Inc. v. Am. Nat'l Bank & Trust Co.*, 649 F.3d 539, 542 (7th Cir. 2011) (explaining that *Stern* "suggests that resolving the conflict may be a bit more complicated than the case law presently admits. Because collateral estoppel—issue preclusion—blocks this new suit in its entirety, [the court] affirm[s] on this narrower ground of decision and leave the resolution of the conflict for a future case in which it will actually matter"); *In re Safety Harbor Resort and Spa*, 456 B.R. 703, 705 (Bankr. M.D. Fla. 2011) ("The Supreme Court merely held [in *Stern*] that Congress exceeded its authority under the Constitution in one isolated instance by granting bankruptcy courts jurisdiction to enter final judgments on counterclaims that are not necessarily resolved in the process of ruling on a creditor's proof of claim. Nothing in *Stern* limits a bankruptcy court's jurisdiction over other 'core' proceedings.").

12. *Marshall v. Marshall (In re Marshall)*, 253 B.R. 550, 561 (Bankr. C.D. Cal. 2000), *adopted as modified by* 275 B.R. 5 (C.D. Cal. 2002), *vacated*, 392 F.3d 1118 (9th Cir. 2004), *rev'd*, 547 U.S. 293 (2006), *rev'd*, 600 F.3d 1037 (9th Cir. 2010), *aff'd sub nom. Stern v. Marshall*, 131 S. Ct. 2594 (2011).

13. *Id.* at 554. Vickie was Howard's third wife. *Stern*, 131 S. Ct. at 2601.

14. *Stern*, 131 S. Ct. at 2601.

15. *In re Marshall*, 253 B.R. at 554.

16. *Id.*

17. *Stern*, 131 S. Ct. at 2600.

18. *See* David G. Savage, *Supreme Court Rejects Anna Nicole Smith Case*, L.A. TIMES, June 24, 2011, at AA2 (describing Howard as an "oil tycoon").

19. *See Stern*, 131 S. Ct. at 2601. Howard died on August 4, 1995, of heart failure. *Marshall v. Marshall (In re Marshall)*, 392 F.3d 1118, 1123 (9th Cir. 2004), *rev'd*, 547 U.S. 293 (2006), *rev'd*, 600 F.3d 1037 (9th Cir. 2010), *aff'd sub nom. Stern v. Marshall*, 131 S. Ct. 2594 (2011).

the sensationalization of their romance,²⁰ more than a decade of litigation,²¹ and aftershocks that the bankruptcy courts will likely feel for decades to come.²²

In 1995, prior to Howard's death, Vickie filed suit in Texas state probate court (the "Probate Court") and asserted that E. Pierce Marshall ("Pierce"), Howard's son,²³ "fraudulently induced J. Howard to sign a living trust that did not include her, even though [Howard] meant to give her half his property."²⁴ The Probate Court found that Howard's 1982 trust, as amended, and his last will and testament were valid and had not been fraudulently forged or altered.²⁵ The Probate Court also found that Howard had not agreed to give Vickie half of his estate, nor did he intend to give Vickie a gift from his 1982 trust or a bequest in his will.²⁶

Howard passed away on August 4, 1995,²⁷ and Vickie was not included in his will.²⁸ On January 25, 1996, Vickie filed for bankruptcy.²⁹ Pierce filed a proof of claim in the bankruptcy proceeding, claiming that Vickie defamed him because her lawyers told the press that Pierce fraudulently gained control of his father's assets.³⁰ Vickie answered by asserting truth as a defense and subsequently filed a counterclaim alleging that Pierce tortiously interfered with the gift that she was expecting from Howard.³¹ The

20. See, e.g., *From the Archives: Anna Nicole Smith Weds J. Howard Marshall II* (1994), PEOPLE.COM (Feb. 9, 2007, 3:30 PM), http://www.people.com/people/article/0,,1536410_20011436,00.html (describing Vickie's marriage to Howard). This article was originally published on August 1, 1994. *Id.*

21. Before Howard's death, Vickie filed her suit against Pierce in Texas state probate court. *Stern*, 131 S. Ct. at 2601. The Supreme Court rendered its final decision in 2011. *Id.* at 2594.

22. See discussion *infra* Part IV.B.

23. *Stern*, 131 S. Ct. at 2601. Pierce was the ultimate beneficiary of Howard's will. *Marshall*, 547 U.S. at 300.

24. *Stern*, 131 S. Ct. at 2601.

25. *Marshall v. Marshall* (*In re Marshall*), 392 F.3d 1118, 1123 (9th Cir. 2004), *rev'd*, 547 U.S. 293 (2006), *rev'd*, 600 F.3d 1037 (9th Cir. 2010), *aff'd sub nom.* *Stern v. Marshall*, 131 S. Ct. 2594 (2011).

26. *Id.*

27. *Marshall v. Marshall* (*In re Marshall*), 253 B.R. 550, 553 (Bankr. C.D. Cal. 2000), *adopted as modified by* 275 B.R. 5 (C.D. Cal. 2002), *vacated*, 392 F.3d 1118 (9th Cir. 2004), *rev'd*, 547 U.S. 293 (2006), *rev'd*, 600 F.3d 1037 (9th Cir. 2010), *aff'd sub nom.* *Stern v. Marshall*, 131 S. Ct. 2594 (2011).

28. *Marshall*, 547 U.S. at 300.

29. *Id.*

30. *Id.* (citing *In re Marshall*, 275 B.R. at 9).

31. *Id.* at 301 (citing *In re Marshall*, 275 B.R. at 9).

U.S. Bankruptcy Court for the Central District of California (the “Bankruptcy Court”) granted summary judgment for Vickie on Pierce’s defamation claim³² and awarded Vickie “\$449,754,134, less whatever she receives from the probate of [Howard’s] estate.”³³ Her total award included more than \$400,000,000 in compensatory damages and \$25,000,000 in punitive damages.³⁴ The award triggered a lengthy legal dispute between Vickie and Pierce³⁵ that would eventually come before state and federal courts in Louisiana, Texas, and California.³⁶

Then on June 20, 2006, Pierce died,³⁷ followed by Vickie’s untimely death on February 8, 2007,³⁸ from a drug overdose.³⁹ Despite the parties’ deaths, the executor of each respective estate continued the litigation, ultimately resulting in the case coming before the U.S. Supreme Court.⁴⁰ It was the second time that the dispute between the parties had reached the Court.⁴¹ By then, the media had already sensationalized the case,⁴² and numerous blog posts⁴³ and legal articles⁴⁴ were written on the proceedings.

32. *Marshall v. Marshall* (*In re Marshall*), 264 B.R. 609, 616 (Bankr. C.D. Cal. 2001); *In re Marshall*, 253 B.R. at 556 n.16.

33. *In re Marshall*, 253 B.R. at 553.

34. *Stern v. Marshall*, 131 S. Ct. 2594, 2601 (2011).

35. In his opinion, Justice Roberts states that “the history of this litigation is complicated.” *Id.* at 2600.

36. *Id.*

37. See Zeke Minaya, *Texas Oilman E. Pierce Marshall, 67, Dies*, HOUS. CHRON. (June 23, 2006, 5:30 AM), <http://www.chron.com/business/energy/article/Texas-oilman-E-Pierce-Marshall-67-dies-1885586.php>.

38. Howard Breuer et al., *Anna Nicole Smith Dead*, PEOPLE.COM (Feb. 8, 2007, 3:35 PM EST), http://www.people.com/people/article/0,,1536410_20011223,00.html.

39. Linda Deutsch, *Inside Anna Nicole Smith’s Death Room: Duffel of Cash, Bottles of Drugs & More*, HUFFINGTON POST (Aug. 5, 2010, 8:39 PM), http://www.huffingtonpost.com/2010/08/05/inside-anna-nicole-smiths_n_672336.html (explaining that Vickie was found dead in her hotel room in Florida).

40. *Stern*, 131 S. Ct. at 2600 n.1.

41. *Id.* at 2600 (“[T]his is the second time [the Court has] had the occasion to weigh in on this long-running dispute over . . . the fortune of J. Howard Marshall.”).

42. See, e.g., ANDREW GOTTFRIED, *supra* note 5 (explaining that the *Stern* decision will likely result in future litigation over the issue of bankruptcy judges’ power and may limit their right to enter final judgments on certain issues); Savage, *supra* note 18 (recounting the history of Vickie and Howard’s relationship and the lengthy litigation between Vickie and Pierce); see also *Anna Nicole Smith’s Estate Loses \$300 Million Court Fight*, CNN JUSTICE (Mar. 19, 2010), http://articles.cnn.com/2010-03-19/justice/anna.nicole.estate_1_texas-probate-court-vickie-lynn-marshall-pierce-marshall?s=PM:CRIME (explaining that the court of appeals dismissed the \$474 million judgment that the bankruptcy court awarded to Vickie); Irin Carmon, *Ruling Against Anna Nicole Smith’s Heirs, Chief Justice Quotes Dickens*, JEZEBEL (June 23, 2011, 4:35 PM),

Chief Justice Roberts opened his majority opinion by describing the case in the words of Charles Dickens:

This “suit has, in course of time, become so complicated, that . . . no two . . . lawyers can talk about it for five minutes, without coming to a total disagreement as to all the premises. Innumerable children have been born into the cause: innumerable young people have married into it;” and, sadly, the original parties “have died out of it.” A “long procession of [judges] has come in and gone out” during that time, and still the suit “drags its weary length before the Court.”⁴⁵

The divided Court in *Stern* held that “[t]he Bankruptcy Court below lacked the constitutional authority to enter a final judgment on a state law counterclaim that is not resolved in the process of ruling on a creditor’s proof of claim.”⁴⁶

This Comment addresses the Court’s decision on the jurisdiction of the federal bankruptcy courts and the earthquake that this decision caused in the federal courts and in the bankruptcy community. Part II briefly summarizes bankruptcy court jurisdiction and the relevant code and case law. Part III explains *Stern*’s convoluted procedural background, including the cases before the Bankruptcy Court, Probate Court, U.S. District Court for the Central District of California (the “District Court”), U.S. Court of Appeals for the Ninth Circuit, and Supreme Court. It also addresses the Supreme Court’s reasoning regarding the two issues in the case: “(1) whether the Bankruptcy Court had the statutory authority under 28 U.S.C.

<http://jezebel.com/5814941/ruling-against-anna-nicole-smiths-heirs-chief-justice-quotes-dickens> (“The Supreme Court ruled against Anna Nicole Smith, posthumously, in a case that concerned the jurisdictions of the various courts entangled in the dispute over J. Howard Marshall’s \$1.6 billion estate.”).

43. See, e.g., *Anna Nicole Smith and Charles Dickens . . . and the Supreme Court*, CAFFEINATED POL. (June 24, 2011), <http://dekerivers.wordpress.com/2011/06/24/anna-nicole-smith-and-charles-dickens-and-the-supreme-court/> (discussing Chief Justice Roberts’s use of a Charles Dickens quote in the opinion and the Court’s ultimate holding); Peter Lattman, *Law Blog Obit: Anna Nicole’s Arch-Nemesis, E. Pierce Marshall*, WALL ST. J. BLOG (June 26, 2006, 8:39 AM), <http://blogs.wsj.com/law/2006/06/26/law-blog-obituary-anna-nicoles-arch-nemesis-e-pierce-marshall/> (discussing the Court’s holding in 2006 regarding Vickie and Pierce’s dispute).

44. See, e.g., ANDREW GOTTFRIED, *supra* note 5.

45. *Stern*, 131 S. Ct. at 2600 (alteration in original) (citing CHARLES DICKENS, *Bleak House*, in *WORKS OF CHARLES DICKENS* 1, 4–5 (1891)).

46. *Id.* at 2620.

§ 157(b) to issue a final judgment on Vickie's counterclaim; and (2) if so, whether conferring that authority on the Bankruptcy Court is constitutional."⁴⁷ Part IV analyzes the effects of the Court's ruling on current jurisprudence and the practical effect that this decision has had, and will have, on bankruptcy courts and federal district courts. It begins by addressing the short-term remedies to the problems that *Stern* has created within the bankruptcy community and addresses the unanticipated long-term consequences of *Stern* and the politicization of the federal judiciary.

II. THE LEGAL BACKDROP

Title 11 is the portion of the United States Code that specifically governs bankruptcy. Bankruptcy court jurisdiction is formally vested in the district courts that have "original and exclusive jurisdiction of all cases under title 11."⁴⁸ Congress has divided bankruptcy proceedings into three categories: (1) "cases under title 11"; (2) core "proceedings arising under title 11"; and (3) cases "related to a case under title 11."⁴⁹ District courts may refer such proceedings to the bankruptcy judges in their districts.⁵⁰ Bankruptcy judges have jurisdiction to hear and enter final judgments in "all core proceedings arising under title 11, or arising in a case under title 11."⁵¹ A final judgment is binding on the parties⁵² and subject to review only if a party chooses to appeal.⁵³ In addition, 28 U.S.C. § 157(b)(2) enumerates sixteen examples of core proceedings, though it explains that core proceedings are not limited to those that are enumerated in the code.⁵⁴ The enumerated core proceedings include "counterclaims by the estate against persons filing claims against the estate."⁵⁵ The

47. *Id.* at 2600.

48. 28 U.S.C. § 1334(a) (2006).

49. *Id.* § 157(a).

50. *Id.* This is "how the Bankruptcy Court in this case came to preside over Vickie's bankruptcy proceedings." *Stern*, 131 S. Ct. at 2603.

51. 28 U.S.C. § 157(b)(1).

52. *N. Pipeline Constr. Co. v. Marathon Pipe Line Co.*, 458 U.S. 50, 85–86 (1982) (plurality opinion).

53. *Stern*, 131 S. Ct. at 2603–04.

54. 28 U.S.C. § 157(b)(2).

55. *Id.* § 157(b)(2)(C).

bankruptcy judge makes the determination whether a proceeding is considered to be a core proceeding under § 157(b)(2).⁵⁶

In *Granfinanciera, S. A. v. Nordburg*,⁵⁷ the Court held that, as a statutory matter, a proceeding's "core" status authorizes bankruptcy judges to enter final judgment in the proceeding.⁵⁸ If a bankruptcy judge determines that a proceeding "is not a core proceeding[,] . . . the bankruptcy judge shall submit *proposed* findings of fact and conclusions of law to the district court."⁵⁹ The district court then hears the case de novo and enters a final judgment.⁶⁰ The Bankruptcy Reform Act of 1978 (the "1978 Act") provided that bankruptcy judges are appointed by the President, serve fourteen-year terms, can be removed by the judicial council for misbehavior, and do not have fixed salaries.⁶¹ The 1978 Act gave bankruptcy courts jurisdiction over "civil proceedings arising under Title 11 or arising in or related to cases under Title 11."⁶²

However in *Northern Pipeline Construction Co. v. Marathon Pipe Line Co.*,⁶³ the Court held that the jurisdictional provisions of the 1978 Act were unconstitutional⁶⁴ because "Art[icle] III bars Congress from establishing legislative courts to exercise jurisdiction over all matters related to those arising under the bankruptcy laws."⁶⁵ The Court enumerated two principles based on the holdings of *Crowell v. Benson*⁶⁶ and *United States v. Raddatz*⁶⁷ for determining "the extent to which Congress may constitutionally vest traditionally judicial functions in non-Art[icle] III officers"⁶⁸: (1) Congress has "substantial discretion to prescribe the manner in which that right

56. *Id.* § 157(b)(3).

57. 492 U.S. 33 (1989).

58. *Id.* at 50.

59. 28 U.S.C. § 157(e)(1) (emphasis added).

60. *Id.*

61. *Id.* §§ 151–154 (Supp. IV 1976); Bankruptcy Reform Act of 1978, 28 U.S.C. § 1471(b) (Supp. IV 1976), *declared unconstitutional* by *N. Pipeline Constr. Co. v. Marathon Pipe Line Co.*, 458 U.S. 50 (1982) (plurality opinion).

62. 28 U.S.C. § 1471(b).

63. 458 U.S. 50 (1982).

64. *Id.* at 56–57.

65. *Id.* at 76. This holding of unconstitutionality did not affect the use of administrative agencies as adjuncts, as first upheld in *Crowell v. Benson*, 285 U.S. 22, 89 (1932). *Marathon*, 458 U.S. at 69.

66. 285 U.S. 22 (1932).

67. 447 U.S. 667 (1980).

68. *Marathon*, 458 U.S. at 80.

may be adjudicated” when it “creates a substantive federal right”;⁶⁹ and (2) “the functions of the adjunct must be limited in such a way that ‘the essential attributes’ of judicial power are retained in the Art[icle] III court.”⁷⁰

In response to *Marathon*, the Bankruptcy Act of 1984 (the “Bankruptcy Code”) provides that bankruptcy judges are to be appointed by the court of appeals for the circuit in which the district is located.⁷¹ Currently, bankruptcy is statutorily governed by the Federal Rules of Bankruptcy Procedure, the Bankruptcy Code, and portions of the United States Code.

III. STATEMENT OF THE CASE: THE EARTH BEGINS TO TREMBLE

For the first time since *Marathon*, the Court issued a decision that greatly affected bankruptcy courts’ jurisdiction.⁷² In *Stern*, the Court held that, although bankruptcy judges can enter final judgments on state-law counterclaims by a debtor against a third-party claimant, they cannot constitutionally enter these judgments.⁷³ The Court faced these issues after almost a decade of litigation during which the case wound its way through the Probate Court, Bankruptcy Court, District Court, Ninth Circuit, and Supreme Court.

A. Procedural History

In 2000, the Bankruptcy Court issued its multimillion-dollar ruling against *Pierce*.⁷⁴ In post-trial proceedings, he argued that the Bankruptcy Court lacked jurisdiction over Vickie’s state-law counterclaim because the counterclaim was not a “core proceeding”

69. *Id.*

70. *Id.* at 81.

71. 28 U.S.C. § 152(a) (2006).

72. *See, e.g.,* *Med. Educ. & Health Servs. Inc. v. Indep. Municipality of Mayaguez (In re Med. Educ. & Health Servs. Inc.)*, 459 B.R. 527, 549 (Bankr. D.P.R. 2011) (calling *Stern* a “momentous” constitutional ruling on the bankruptcy courts’ authority).

73. *Stern v. Marshall*, 131 S. Ct. 2594, 2620 (2011).

74. *Marshall v. Marshall (In re Marshall)*, 253 B.R. 550, 561–62 (Bankr. C.D. Cal. 2000) (awarding Vickie almost \$500 million), *adopted as modified by* 275 B.R. 5 (C.D. Cal. 2002), *vacated*, 392 F.3d 1118 (9th Cir. 2004), *rev’d*, 547 U.S. 293 (2006), *rev’d*, 600 F.3d 1037 (9th Cir. 2010), *aff’d sub nom. Stern v. Marshall*, 131 S. Ct. 2594 (2011).

under 28 U.S.C. § 157(b)(2)(C).⁷⁵ The Bankruptcy Court entered a final judgment on the matter, granting Vickie monetary relief and asserting that Vickie's counterclaim was a "core proceeding"; thus the court said that it had "the power to enter judgment" on the matter.⁷⁶ Pierce appealed the Bankruptcy Court judgment to the District Court.⁷⁷ The District Court held that Vickie's counterclaim was not a core proceeding,⁷⁸ though it ruled that the Bankruptcy Court did have federal subject-matter jurisdiction over Vickie's counterclaim.⁷⁹ It reasoned that, in light of *Marathon*, it "would be unconstitutional to hold that any and all counterclaims are core."⁸⁰ The Bankruptcy Court's judgment was thus vacated and viewed as proposed, rather than as final.⁸¹ The District Court awarded Vickie compensatory damages of \$44,292,767.33 and punitive damages of \$44,292,767.33.⁸²

Meanwhile, the Probate Court had already entered a judgment in Pierce's favor after conducting a jury trial.⁸³ The District Court did not give that judgment preclusive effect and heard the matter de novo.⁸⁴ The Probate Court and the Bankruptcy Court reached contrary decisions on the merits of the case.⁸⁵ On appeal from the District Court, the Ninth Circuit applied the "probate exception to federal court jurisdiction," reversed the District Court's award, and remanded the case, instructing the District Court to issue an "order

75. *Stern*, 131 S. Ct. at 2601.

76. *Id.* at 2602.

77. *In re Marshall*, 275 B.R. 5.

78. *Marshall v. Marshall (In re Marshall)*, 264 B.R. 609, 632 (C.D. Cal. 2001) (arguing that the court may not categorize a counterclaim as "core" when the claim "is only somewhat related to the claim against which it is asserted, and when the unique characteristics and context of the counterclaim place it outside of the normal type of set-off or other counterclaims that customarily arise").

79. *Id.* at 633.

80. *Id.* at 630 (citing *N. Pipeline Constr. Co. v. Marathon Pipe Line Co.*, 458 U.S. 50, 79 n.31 (1982) (plurality opinion)).

81. *Id.* at 633; *Stern*, 131 S. Ct. at 2602.

82. *In re Marshall*, 275 B.R. at 58.

83. *Stern*, 131 S. Ct. at 2602.

84. *Id.* at 2602–03.

85. *Id.* at 2600.

directing the bankruptcy court to vacate its judgment against [Pierce] individually.”⁸⁶

The Supreme Court issued its first decision on the dispute on May 1, 2006,⁸⁷ reversing the decision of the Ninth Circuit and remanding the case for further proceedings.⁸⁸ On remand, the Ninth Circuit held that Vickie’s counterclaim against Pierce for “tortious interference with an inter vivos gift [was] not a ‘core proceeding.’”⁸⁹ The Ninth Circuit explained that its relevant case law only permits a bankruptcy judge to adjudicate a claim that satisfies a two-step approach: (1) the claim must fit within Congress’s definition of a core proceeding; and (2) the claim must arise under or arise in Title 11.⁹⁰

The Ninth Circuit held that the District Court erred in not giving preclusive effect to the Probate Court’s decision on relevant legal and factual findings; the “probate court’s judgment was the earliest final judgment entered on matters relevant” to the District Court proceeding.⁹¹ The Ninth Circuit reasoned that allowing the Bankruptcy Court to rule on counterclaims that are factually and legally unrelated to the claim that is asserted against the bankruptcy estate would be too broad a reading of § 157(b)(2)(C) and contrary to *Marathon*.⁹² Thus, the Ninth Circuit reversed and remanded the case.⁹³

86. *Marshall v. Marshall* (*In re Marshall*), 392 F.3d 1118, 1137 (9th Cir. 2004), *rev’d*, 547 U.S. 293 (2006), *rev’d*, 600 F.3d 1037 (9th Cir. 2010), *aff’d sub nom.* *Stern v. Marshall*, 131 S. Ct. 2594 (2011).

87. *Marshall*, 547 U.S. at 293.

88. *Id.* at 315.

89. *Marshall v. Stern* (*In re Marshall*), 600 F.3d 1037, 1064 (9th Cir. 2010), *aff’d*, 131 S. Ct. 2594 (2011).

90. *Id.* at 1055 (referencing *In re Harris*, 590 F.3d 730, 737–41 (9th Cir. 2009)).

91. *Id.* at 1064.

92. *Id.* at 1057 (citing *N. Pipeline Constr. Co. v. Marathon Pipe Line Co.*, 458 U.S. 50, 87 (1982) (plurality opinion) (“[T]he broad grant of jurisdiction to the bankruptcy courts contained in 28 U.S.C. § 1471 (1976 ed., Supp. IV) is unconstitutional.”)). *Marathon* held that “Article I bankruptcy courts could not constitutionally hear a state law breach of contract claim when the debtor was the plaintiff.” Kenneth N. Klee, *Emerging Issues: Stern v. Marshall*, 2011 EMERGING ISSUES 5743, 5743 (2011). In *Thomas v. Union Carbide Agricultural Products Co.*, the Court limited the holding in *Marathon* by stating that it “establishes only that Congress may not vest in a non-Article III court the power to adjudicate, render final judgment, and issue binding orders in a traditional contract action arising under state law, without consent of the litigants, and subject only to ordinary appellate review.” 473 U.S. 568, 584 (1985). Congress’s restructuring of the Bankruptcy Code post-*Marathon*, to conform with the Court’s suggestion that the unconstitutionality of Congress’ broad grant of Article III powers could be remedied simply by

The Supreme Court again granted certiorari on September 28, 2010.⁹⁴ Because both parties had died during the litigation of the case, the parties in the decision were Vickie's and Pierce's respective estates.⁹⁵

*B. Reasoning of the
U.S. Supreme Court*

In its opinion, the Court addressed two issues: “(1) whether the Bankruptcy Court had the statutory authority under 28 U.S.C. § 157(b) to issue a final judgment on Vickie's counterclaim; and (2) if so, whether conferring that authority on the Bankruptcy Court is constitutional.”⁹⁶

1. The Bankruptcy Court's
Statutory Authority

The Court reasoned that under 28 U.S.C. § 157(b)(2)(C), “Vickie's counterclaim against Pierce for tortious interference [was] a ‘core proceeding.’”⁹⁷ According to Court jurisprudence, a bankruptcy judge may enter final judgment on the core matters in a proceeding.⁹⁸ However, the Court explained that “[a]s written, § 157(b)(1) is ambiguous,”⁹⁹ though the Court read the statute as saying that “core proceedings are those that arise in a bankruptcy case or under title 11.”¹⁰⁰

“providing that ancillary common-law actions . . . be routed to the United States district court of which the bankruptcy court is an adjunct,” is commonly referred to as the “Marathon Fix.” See Geraldine Mund, *A Look Behind the Ruling: The Supreme Court and the Unconstitutionality of the Bankruptcy Act of 1978*, 78 AM. BANKR. L.J. 401, 420 (2004) (quoting *Marathon*, 458 U.S. at 92).

93. *In re Marshall*, 600 F.3d at 1065.

94. *Stern v. Marshall*, 131 S. Ct. 63, 63 (2010).

95. *Stern*, 131 S. Ct. at 2600 n.1.

96. *Stern*, 131 S. Ct. at 2600. The issue of statutory authority arises because Vickie's claim was an “otherwise non-core tort cause of action asserted as a compulsory counterclaim to a creditor's nondischargability complaint and proof of claim against the debtor.” Klee, *supra* note 92, at 1.

97. *Stern*, 131 S. Ct. at 2604.

98. See *Granfinanciera, S.A. v. Nordberg*, 492 U.S. 33, 34 (1989) (“[T]he Seventh Amendment entitles a person who has not submitted a claim against a bankruptcy estate to a jury trial when sued by the bankruptcy trustee to recover an allegedly fraudulent monetary transfer.”).

99. *Stern*, 131 S. Ct. at 2604.

100. *Id.* at 2605.

In this case, the Court agreed with the Ninth Circuit that the Bankruptcy Court, under § 157(b)(2)(C), could enter a final judgment on Vickie's counterclaim against Pierce for tortious interference because of Pierce's consent.¹⁰¹ The Court found that Pierce consented to the Bankruptcy Court's resolution of his defamation claim¹⁰² because he did not object in any court that § 157(b)(5)¹⁰³ prohibited the Bankruptcy Court from deciding his claim.¹⁰⁴

The Court reasoned that if Pierce objected to the Bankruptcy Court's authority to decide the defamation claim, he should have promptly communicated that objection.¹⁰⁵ His failure to do so forfeited any argument that he did not consent.¹⁰⁶

2. The Constitutionality of the Bankruptcy Court's Authority

As to the second issue, the Court held that, although a bankruptcy court is statutorily permitted to enter a final judgment on a counterclaim,¹⁰⁷ allowing the Bankruptcy Court to enter a final judgment on Vickie's counterclaim was unconstitutional under Article III of the Constitution.¹⁰⁸ The Court addressed the similarities between the 1978 Act and the Bankruptcy Code.¹⁰⁹

In *Stern*, the Court held that a portion of the Bankruptcy Code is unconstitutional in that a bankruptcy court lacks the "constitutional authority to enter a final judgment on a state law counterclaim that is

101. *Id.* at 2606.

102. *Id.* 28 U.S.C. § 157(c)(2) provides that parties may consent to a bankruptcy judge's entry of a final judgment in a non-core case. 28 U.S.C. § 157(c)(2) (2006).

103. *Stern*, 131 S. Ct. at 2606. Section 157(b)(3) states that "[t]he bankruptcy judge shall determine, on the judge's own motion or on timely motion of a party, whether a proceeding is a core proceeding under this subsection or is a proceeding that is otherwise related to a case under title 11." 28 U.S.C. § 157(b)(3). This imposes an affirmative duty on the bankruptcy judges to determine whether the matter is core or not. *Heller v. Arnold & Porter (In re Heller)*, No. 08-32514DM, Adv. No. 10-3203DM, 2011 WL 4542512, at *5 (Bankr. N.D. Cal. Sept. 28, 2011).

104. *Stern*, 131 S. Ct. at 2608 (explaining the Court's previous holdings in cases such as *Exxon Shipping Co. v. Baker*, where the court "recognized 'the value of waiver and forfeiture rules' in 'complex' cases" (quoting *Exxon Shipping Co. v. Baker*, 554 U.S. 471, 487 n.6, 488 (2008))).

105. *Id.*

106. *Id.*

107. *Id.*

108. *Id.*

109. *Id.* at 2611.

not resolved in the process of ruling on a creditor's proof of claim."¹¹⁰ The Court further held that § 157(b)(2)(C) "unconstitutionally delegates the judicial power of the United States to non-Article III bankruptcy judges" by giving them jurisdiction to enter final judgments on common-law counterclaims.¹¹¹

Further, the Court noted the distinction between "public rights" and "private rights."¹¹² It reasoned that Vickie's counterclaim did not fall into the public rights exception as the Court had enumerated in prior opinions.¹¹³ The Court explained that the case "involve[d] the most prototypical exercise of judicial power: the entry of a final, binding judgment by a court with broad substantive jurisdiction, on a common law cause of action, when the action neither derive[d] from nor depend[ed] upon any agency regulatory regime."¹¹⁴

The Court explained that "[i]n ruling on Vickie's counterclaim, the Bankruptcy Court was required to and did make several factual and legal determinations."¹¹⁵ It added that the counterclaim "is in no

110. *Id.* at 2620.

111. Klee, *supra* note 92, at 3.

112. *Stern*, 131 S. Ct. at 2612–13 (referring to the distinction made in *Crowell*, where public rights were defined as those arising "between the Government and persons subject to its authority in connection with the performance of the constitutional functions of the executive or legislative departments" and private rights were defined as those that are "of the liability of one individual to another under the law as defined" (quoting *Crowell v. Benson*, 285 U.S. 22, 51 (1932))). The public rights exception was first enumerated in *Murray's Lessee v. Hoboken Land & Improvement Co.*, 59 U.S. 272, 284 (1855). *Id.* at 2611. Subsequent case law extended the public rights exception to cases "where the Government is involved in its sovereign capacity under . . . [a] statute creating enforceable rights." *Id.* at 2613 (citations omitted). The Court in *Marathon* cited *Bakelite* to support the proposition that the public rights exception extended "only to matters that historically could have been determined exclusively by" the Executive and Legislative Branches. *N. Pipeline Constr. Co. v. Marathon Pipe Line Co.*, 458 U.S. 50, 68 (1982) (plurality opinion) (citing *Ex parte Bakelite Corp.*, 279 U.S. 438, 458 (1929)). The Court subsequently rejected these prior definitions of public rights that limited the exception only to actions that involved the government as a party. *Stern*, 131 S. Ct. at 2613. It redefined the public rights exception as a "right [that] is integrally related to particular federal government action." *Id.* (citations omitted).

113. *Stern*, 131 S. Ct. at 2614.

114. *Id.* at 2615. The Court continued that if "such an exercise of judicial power may nonetheless be taken from the Article III Judiciary simply by deeming it part of some amorphous 'public right,' then Article III would be transformed from the guardian of individual liberty and separation of powers we have long recognized into mere wishful thinking." *Id.*

115. *Id.* at 2617. The Court related Vickie's counterclaim to the fraudulent conveyance action in *Granfinanciera, S.A. v. Nordberg*, 492 U.S. 33, 56 (1989), and held that "Congress may not bypass Article III simply because a proceeding may have some bearing on a bankruptcy case." *Id.* at 2618 (emphasis omitted). The question is rather "whether the action at issue stems from the bankruptcy itself or would necessarily be resolved in the claims allowance process." *Id.*

way derived from or dependent upon bankruptcy law; it is a state tort action that exists without regard to any bankruptcy proceeding.”¹¹⁶ In addition, the Court held that the Bankruptcy Court also had to rule on questions of Texas state tort law that had never come before the Supreme Court of Texas.¹¹⁷ Further, because Vickie’s counterclaim did not fall within the public rights exception, it would have been unconstitutional for the Bankruptcy Court to issue a final judgment on her claim.¹¹⁸

In his concurrence, Justice Scalia agreed with the majority’s interpretation of Article III precedent.¹¹⁹ However, he stated that the public rights exception only applies to conflicts where at least one party is the government.¹²⁰

3. The Dissent: A Finding of Constitutionality

Justice Breyer’s dissent¹²¹ argued that the majority misinterpreted and misrepresented some Court precedent.¹²² The dissent enumerated five factors that the Court should have considered in determining whether the notion of separation of powers, inherent in the Constitution, had been violated.¹²³ The dissent concluded that “any intrusion on the Judicial Branch” would be “de minimis,” and, thus, the Bankruptcy Code is constitutional.¹²⁴

116. *Id.* at 2618.

117. *Id.*

118. *Id.*

119. *Id.* at 2620 (Scalia, J., concurring).

120. *Id.*

121. Justice Breyer was joined by Justice Ginsburg, Justice Sotomayor, and Justice Kagan. *Id.* at 2621 (Breyer, J., dissenting).

122. *Id.* at 2622. The dissent argued that the majority should have put less emphasis on statements made in *Murray’s Lessee* and the plurality opinion in *Marathon*, and that it should have applied the Court’s approach in *Crowell, Thomas*, and *Schor*. *Id.* (citing cases).

123. *Id.* at 2625–26. Breyer listed these factors as

(1) the nature of the claim to be adjudicated; (2) the nature of the non-Article III tribunal; (3) the extent to which Article III courts exercise control over the proceeding; (4) the presence or absence of the parties’ consent; and (5) the nature and importance of the legislative purpose served by the grant of adjudicatory authority to a tribunal with judges who lack Article III’s tenure and compensation protections.

Id. at 2626 (stating, further, that the majority “disregard[ed]” the controlling precedent of *Commodity Futures Trading Commission v. Schor*, 478 U.S. 833 (1986)).

124. *Id.* at 2629.

IV. THE IMPACT
OF *STERN*: PICKING
UP THE PIECES

Stern called into question bankruptcy judges' fitness to "hear and determine" cases¹²⁵ and left unresolved the question of "whether the bankruptcy courts lack constitutional authority to resolve objections to claims, and, if the bankruptcy courts do have such power, whether they" have the constitutional authority to "adjudicate state law counterclaims for purposes of defense or offset in determining the allowance of claims."¹²⁶ The holding in *Stern* has left a gap in the law on how to deal with core proceedings that do not "arise under" Title 11 or "in" a Title 11 case.¹²⁷ No statute directly addresses the issue of the nature of the counterclaim that arose in *Stern*.¹²⁸ Congress may rewrite the statute to "clearly cover [the type of] counterclaim" that was involved in *Stern* "as being a part of a non-core matter" as defined in the existing statute;¹²⁹ however, the Court's decision likely will not result in a dramatic change until and unless bankruptcy courts continue to be stripped of their "constitutional authority" to enter final judgments in certain matters.¹³⁰

A. A Short-Term Fix

Despite the hype surrounding the decision,¹³¹ one possible approach to the conundrum that the *Stern* decision created would be

125. Interview with Dan Schechter, Professor of Law, Loyola Law Sch. L.A., in L.A., Cal. (Oct. 4, 2011). Dan Schechter teaches bankruptcy, property, and secured transactions at Loyola Law School Los Angeles. *Id.* He has also served as a consultant and given expert testimony in numerous bankruptcy cases. *Id.*

126. Klee, *supra* note 92, at 5.

127. Judge Montali has called these proceedings "unconstitutional core." *Heller v. Arnold & Porter (In re Heller)*, No. 08-32514DM, Adv. No. 10-3203DM, 2011 WL 4542512, at *3 (Bankr. N.D. Cal., Sept. 28, 2011).

128. *Stern*, 131 S. Ct. at 2604.

129. Interview with the Honorable Alan M. Ahart, *supra* note 4.

130. Interview with Dan Schechter, *supra* note 125.

131. Interview with the Honorable Sheri Bluebond, *supra* note 2 (stating that "hype is a good word" to describe the reaction to *Stern* within the bankruptcy community); *see also* *Liberty Mut. Ins. Co. v. Citron (In re Citron)*, No. 08-71442, Adv. No. 09-8125, 2011 WL 4711942, at *1 n.1 (Bankr. E.D.N.Y. Oct. 6, 2011) (describing the reaction to *Stern* as noise, and explaining that decisions have supported "broad, narrow, and middle-of-the-road interpretations" of *Stern*); *In re Heller*, 2011 WL 4542512, at *1 (explaining the "flurry of activity" that resulted throughout the country after *Stern*); *Meoli v. Huntington Nat'l Bank (In re Teleservices Grp., Inc.)*, 456 B.R.

to treat compulsory counterclaims that cannot constitutionally be treated as core claims as having “come off the list of core [matters] and become non-core,”¹³² despite the fact that the statute does not technically provide for this categorization.¹³³ Thus, a bankruptcy judge “would treat the matter as non-core and make proposed findings to the district court.”¹³⁴

The Bankruptcy Code allows bankruptcy courts to issue final rulings on certain core proceedings.¹³⁵ For a proceeding that is deemed non-core, bankruptcy judges may enter proposed findings in the form of reports and recommendations.¹³⁶ Thereafter, the parties have the opportunity for a district court to hear the matter on a de novo basis under 28 U.S.C. § 157(c)(1).¹³⁷ If this is not done, the parties waive their ability to appeal.¹³⁸

If, as the Court has held, bankruptcy courts are not permitted to hear counterclaims that do not “[s]tem from the bankruptcy itself,”¹³⁹ then the federal district courts would have to hear a counterclaim on the merits on a de novo basis, substantially increasing federal district

318, 323 (Bankr. W.D. Mich. 2011) (“[B]ombshell does fairly describe *Stern’s* impact upon the more practical issue of how bankruptcy judges are to perform what the Code still calls [bankruptcy judges] to do.”).

132. Interview with the Honorable Sheri Bluebond, *supra* note 2.

133. *Stern*, 131 S. Ct. at 2604 (“Nowhere does § 157 specify what bankruptcy courts are to do with respect to the category of matters that Pierce posits—core proceedings that do not arise under Title 11 or in a Title 11 case.” (emphasis omitted)); Interview with the Honorable Sheri Bluebond, *supra* note 2.

134. Interview with the Honorable Sheri Bluebond, *supra* note 2. “In reality, the bankruptcy court will ‘hear’ without determining the various controversies that they used to ‘hear and determine.’” Interview with Dan Schechter, *supra* note 125. Post *Stern*, “the bankruptcy judges will issue ‘reports’” as opposed to final judgments. *Id.*; see also, Standing Order of Reference Re: Title 11 (S.D.N.Y. Feb. 1, 2012) (“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.”).

135. 28 U.S.C. § 157(b)(1) (2006) (explaining that bankruptcy judges may enter orders and judgments on core proceedings).

136. FED. R. BANKR. P. 9033.

137. 28 U.S.C. § 157(c)(1). “A bankruptcy judge may hear a proceeding that is not a core proceeding but that is otherwise related to a case under title 11.” *Id.* In this non-core proceeding, the bankruptcy judge submits “proposed findings of fact and conclusion of law to the district court,” which enters a final judgment on the matter after it conducts a de novo review of “those matters to which any party has timely and specifically objected.” *Id.* The appeal must be done within fourteen days of the entering of the bankruptcy judge’s order. FED. R. BANKR. P. 9033.

138. FED. R. BANKR. P. 9033.

139. *Stern v. Marshall*, 131 S. Ct. 2594, 2618 (2011).

court judges' already heavy caseloads.¹⁴⁰ In many bankruptcy proceedings, one party has a compulsory counterclaim against the other and the counterclaim does not fall into one of the three categories that § 157(a) designates.¹⁴¹ However, as a practical matter, "bankruptcy courts will hear the matter, issue a report and recommendation," and the district court will most likely adhere to the recommendation without a full hearing; thus, *Stern* is unlikely to result in a "huge increase in the workload of the district courts."¹⁴²

The *Stern* decision has the potential to create a "game of jurisdictional ping-pong between courts," leading to "inefficien[cies], increased cost, [and] delay . . . [for] those faced with bankruptcy"¹⁴³ as the parties "litigate the appropriate forum for the adjudication of their dispute."¹⁴⁴ However, these adverse effects would be reduced if "bankruptcy judges treat these matters as non-core and make proposed findings to the district court."¹⁴⁵

Another issue that *Stern* left unresolved is the extent to which the problem may be remedied by consent. Under 28 U.S.C. § 157(c)(2), parties may consent to a bankruptcy judges' entry of final judgments in non-core cases.¹⁴⁶ This leaves the decision of

140. *Id.* at 2630 (Breyer, J., dissenting).

141. *See id.* (referencing *Bankr. Servs., Inc. v. Ernst & Young (In re CBI Holding Co.)*, 529 F.3d 432 (2d Cir. N.Y. 2008); *In re Winstar Commc'ns, Inc.*, 348 B.R. 234 (Bankr. Del. 2005); *In re Ascher*, 128 B. R. 639 (Bankr. N.D. Ill. 1991); *In re Sun W. Distribs., Inc.*, 69 B.R. 861 (Bankr. S.D. Cal. 1987)).

142. Interview with Dan Schechter, *supra* note 125. For example, in the Sixth Circuit, a district court judge adopted the bankruptcy court judge's recommendation in the case. *Reed v. Johnson*, No. 1:11-cv-884, 2011 U.S. Dist. LEXIS 107517, at *1 (W.D. Mich. Sept. 21, 2011). The bankruptcy judge issued the recommendation to the district court under the Federal Rules of Bankruptcy Procedure 9033(a) after "the Bankruptcy Judge concluded he lacked jurisdiction to enter a final order." *Id.* However, where a bankruptcy judge issued a final judgment on a dismissal of claims, a district court in the Second Circuit, in light of *Stern*, converted the judgment to a recommendation. *Retired Partners of Coudert Bros. Trust v. Baker & McKenzie LLP (In re Coudert Bros. LLP)*, No. 11-2785 (CM), Adv. No. 08-1472, 2011 U.S. Dist. LEXIS 110425, at *6-7 (S.D.N.Y. Sept. 22, 2011).

143. *Stern*, 131 S. Ct. at 2630 (Breyer, J., dissenting).

144. Interview with the Honorable Sheri Bluebond, *supra* note 2.

145. *Id.*; *see* Interview with the Honorable Alan M. Ahart, *supra* note 4 (explaining that when he renders an opinion on a matter that raises a *Stern* problem, he will state in the opinion that he is making "findings of fact or conclusions of law," and if it is found that he does not have constitutional authority to handle the particular matter, then the decision should be treated as "a recommendation for purposes of the district court to hear the matter on a de novo basis").

146. 28 U.S.C. § 157(c)(2) (2006). Rule 7012(b) of the Federal Rules of Bankruptcy Procedure states that in an adversary proceeding,

where certain matters are adjudicated up to the parties in the adversary proceeding.¹⁴⁷ If consent does not solve the problem that *Stern* presented, however, the “entire underpinning of the ‘*Marathon* fix’ does not work, and bankruptcy judges will not be able to hear any non-core cases.”¹⁴⁸

Thus, bankruptcy judges are left to operate in something of a black hole, not knowing exactly where these *Stern*-type counterclaims fall statutorily or how and when to issue final orders.¹⁴⁹ In order to continue functioning as a judicial institution, bankruptcy courts must continue to hear these matters and issue decisions unless Congress changes the statute or the Supreme Court decides otherwise.¹⁵⁰ Bankruptcy judges must “continue to believe that all [*Stern*] does is move ‘it’ from core to non-core.”¹⁵¹ What “it” is composed of “will be subject to some litigation” in order to determine how broadly *Stern* reaches.¹⁵² If bankruptcy courts do not move the “it” from the list of core matters to the list of non-core matters, the entire bankruptcy system will not work, and bankruptcy judges will be left “staring down the abyss.”¹⁵³ Although *Stern* caused an earthquake within the bankruptcy courts, as a practical matter, the decision’s most significant short-term impact may merely be an increase in the number of “motions to dismiss,” “motions to

[a] responsive pleading shall admit or deny an allegation that the proceeding is core or non-core. If the response is that the proceeding is non-core, it shall include a statement that the party does or does not consent to entry of final orders or judgment by the bankruptcy judge. In non-core proceedings final orders and judgments shall not be entered on the bankruptcy judge’s order except with the express consent of the parties.

FED. R. BANKR. P. 7012(b).

147. Interview with the Honorable Sheri Bluebond, *supra* note 2.

148. *Id.*

149. See *Meoli v. Huntington Nat’l Bank (In re Teleservices Grp., Inc.)*, 456 B.R. 318, 323 (Bankr. W.D. Mich. 2011) (enumerating Judge Hughes’s frustration that *Stern* “offers virtually no insight as to how to recalibrate the core/non-core dichotomy so that [he] can again proceed with at least some assurance that [he] will not be making the same constitutional blunder with respect to some other aspect of Authority Section 157(b)(2)”).

150. Interview with the Honorable Sheri Bluebond, *supra* note 2.

151. *Id.*; see also *Heller v. Arnold & Porter (In re Heller)*, No. 08-32514DM, Adv. No. 10-3203DM, 2011 WL 4542512, at *7 (Bankr. N.D. Cal. Sept. 28, 2011) (explaining that bankruptcy judges have the power to “handle all pre-trial matters and motions” in non-core cases and, should a case be determined unconstitutional but core, it should be treated as non-core). In non-core cases, the district court should treat the bankruptcy court’s findings of fact as “proposed” findings. Interview with the Honorable Sheri Bluebond, *supra* note 2.

152. Interview with the Honorable Sheri Bluebond, *supra* note 2.

153. *Id.*

abstain” from hearing a matter, or “motions to withdraw the reference” filed with regard to certain bankruptcy matters.¹⁵⁴

However, if the Court continues down the road on which it has been traveling, it may later hold that bankruptcy judges no longer have the power to enter final judgments on fraudulent transfer¹⁵⁵ and preference avoidance litigation.¹⁵⁶ These two actions are frequently filed in a bankruptcy case¹⁵⁷ and are two of the “fundamental policies underlying the [bankruptcy] code.”¹⁵⁸

Similarly, if lower courts construe *Stern* broadly to mean that bankruptcy judges do not have the constitutional power to enter final judgments in preference and fraudulent transfer actions, bankruptcy courts’ ability to adjudicate two of the most frequently filed adversary proceedings will be significantly affected.¹⁵⁹ If bankruptcy

154. Both Judge Ahart and Judge Bluebond explain that more motions to withdraw the reference will likely be filed in the district court under 28 U.S.C. § 157(d). Interview with the Honorable Alan M. Ahart, *supra* note 4; Interview with the Honorable Sheri Bluebond, *supra* note 2. For example, in a bankruptcy court in the Eighth Circuit, the defendant timely brought a motion for relief from a judgment entered by the bankruptcy court pursuant to the Federal Rules of Bankruptcy Procedure 9023. *Badami v. Sears Cattle Co. (In re AFY, Inc.)*, No. BK10-40875-TLS, Adv. No. A10-4062-TLS, 2011 WL 3800041, at *1 (Bankr. D. Neb. Aug. 18, 2011). The court granted the defendant’s relief from judgment, and recommended to the “District Court for the District of Nebraska that it withdraw the reference of [the] adversary proceeding to enter a final judgment on the plaintiff’s” claim for collection of an account receivable and consider the bankruptcy court’s previous order on the matter as “proposed findings of fact and conclusions of law.” *Id.* at *3.

155. “Fraudulent transfer law is one of the oldest forms of legal creditor protection, tracing its roots to the ancient Statute of Elizabeth, enacted in 1571.” GREENBAUM DOLL & MCDONALD PLLC, *Preferences and Fraudulent Transfers Under Bankruptcy Code: A Primer in Pain*, in THE AMERICAS RESTRUCTURING AND INSOLVENCY GUIDE 2008/2009, at 107 (2008/2009), available at http://www.americasrestructuring.com/08_SF/p107-115%20Preferences%20and%20fraudulent%20transfers.pdf. Fraudulent transfers are governed by 28 U.S.C. §§ 544(b) and 548. GREENBAUM DOLL & MCDONALD PLLC, *supra*, at 107.

156. See, e.g., ANDREW GOTTFRIED, *supra* note 5 (explaining that *Stern* could be extended to remove bankruptcy courts’ power to enter final judgments in “fraudulent transfer and preference avoidance litigation,” resulting in “most of the avoidance actions [transferring] from the bankruptcy courts to the district courts”); Interview with the Honorable Sheri Bluebond, *supra* note 2 (explaining that depending on how broadly *Stern* is interpreted, bankruptcy courts’ authority to hear preference and fraudulent transfer actions may be called into question as well).

157. ANDREW GOTTFRIED, *supra* note 5 (describing the volume of fraudulent transfer and preference avoidance litigation).

158. GREENBAUM DOLL & MCDONALD PLLC, *supra* note 155 (referencing *Cent. Va. Cmty. Coll. v. Katz*, 546 U.S. 356 (2005)).

159. See *Heller v. Arnold & Porter (In re Heller)*, No. 08-32514DM, Adv. No. 10-3203DM, 2011 WL 4542512, at *1 (Bankr. N.D. Cal., Sept. 28, 2011). Judge Montali issued a recommendation sua sponte regarding motions to withdraw the reference with relation to a fraudulent transfer proceeding before him. *Id.* He argued that if the district court allowed the

judges are not able to render final judgments in two of the most common claims, district courts will have to hear and issue final judgments in such matters. Having district court judges hear these matters is problematic for two reasons: (1) the district courts already have overcrowded dockets;¹⁶⁰ and (2) many times district courts lack the necessary familiarity with the Bankruptcy Code.¹⁶¹

*B. Long-Term
Consequences of Stern*

The Supreme Court itself stated that the decision would “not change all that much”¹⁶² and that the question presented in *Stern* is a “narrow” one.¹⁶³ Some courts have followed this narrow interpretation of bankruptcy judges’ power.¹⁶⁴ However, despite the Court’s specific language about its narrow holding, other bankruptcy courts have interpreted *Stern* broadly and declined to enter a final judgment on actions not explicitly enumerated as unconstitutional in *Stern*.¹⁶⁵

withdrawal of the reference, it “would amount to an unnecessary extension of the narrow holding in *Stern*, [and] would be an inefficient use of judicial resources by overburdening the district court and foregoing the services of a bankruptcy court ready, willing and able to do its job.” *Id.*; Interview with the Honorable Sheri Bluebond, *supra* note 2 (explaining that the “logical consequences” flowing from the reasoning of the Court in *Stern* have the potential to be “pretty horrific”); *see also* Kelley v. JPMorgan Chase & Co., Nos. 11-193, -194, -196, -197, 2011 WL 4403289, at *6 (D. Minn. Sept. 21, 2011) (explaining that *Stern* does not require withdrawal of the reference in preference and fraudulent transfer actions).

160. In 2010, bankruptcy courts had almost 1.6 million filings. The district courts had a docket of around 280,000 civil cases and 78,000 criminal cases. *Stern v. Marshall*, 131 S. Ct. 2594, 2630 (2011) (Breyer, J., dissenting).

161. *See* Interview with Dan Schechter, *supra* note 125 (explaining that bankruptcy is a specialized and difficult area where federal law and intricate state law intersect).

162. *Stern*, 131 S. Ct. at 2620.

163. *Id.* at 2613.

164. *See, e.g., In re Safety Harbor Resort and Spa*, 456 B.R. 703, 719 (Bankr. M.D. Fla. 2011) (“[T]his Court agrees with the *Stern* Court that the decision in *Stern* ‘does not change all that much.’” (quoting *Stern*, 131 S. Ct. at 2620)).

165. *See, e.g., Meoli v. Huntington Nat’l Bank (In re Teleservices Grp., Inc.)*, 456 B.R. 318, 320 (Bankr. W.D. Mich. 2011) (concluding that the bankruptcy court did not have the authority to enter a final judgment in a multimillion-dollar fraudulent transfer claim). The Ninth Circuit invited amicus curiae to submit supplemental briefs addressing whether *Stern* prohibited “bankruptcy courts from entering a final, binding judgment on an action to avoid a fraudulent conveyance” and, if so, whether a bankruptcy court may “hear the proceeding and submit a report and recommendation to a federal district court in lieu of entering a final judgment.” *Exec. Benefits Ins. Agency v. Arkison (In re Bellingham Ins. Agency, Inc.)*, 661 F.3d 476, 476 (9th Cir. 2011).

Courts have extended *Stern* beyond the bankruptcy courts to question the authority of magistrate judges. For example, the Fifth Circuit sua sponte directed parties to brief the issue of

whether the reasoning in *Stern* applies to magistrate judges, which, like bankruptcy judges, are not Article III judges[,] and whether, under *Stern*, a magistrate judge can enter final judgment in a case tried to a magistrate judge by consent under 28 U.S.C. § 636(c) where jurisdiction is based on diversity of citizenship and state law provides the rule of decision.¹⁶⁶

It is unlikely that the Court anticipated that the constitutionality of magistrate judges' ability to enter final judgments on certain matters would be called into question because of its holding in *Stern*.¹⁶⁷

Additionally, a broad interpretation of *Stern* could affect the authority of other Article I courts. One such Article I court is the U.S. Tax Court (the "Tax Court").¹⁶⁸ Theoretically, the Tax Court could fall within the public rights exception¹⁶⁹ because it adjudicates disputes between the government and taxpayers as private citizens;¹⁷⁰ thus, the Tax Court may continue to issue binding decisions.¹⁷¹ However, if *Stern* is construed broadly to mean that bankruptcy judges' status as Article I judges per se renders them unable to constitutionally issue final decisions, this reasoning could be

166. *Technical Automation Servs. Corp. v. Liberty Surplus Ins. Corp.*, No. 10-20640, at *2 (5th Cir. Sept. 9, 2011) (requesting that the parties submit briefs to the magistrate judges).

167. *See* Interview with Dan Schechter, *supra* note 125 ("The minority did a much better job [of considering the consequences of the *Stern* decision] than the majority did. . . . It seemed that the majority was simply mechanically applying the language of the statute and mechanically applying its view of Article III, rather than considering the role of the bankruptcy courts within the federal system."); Interview with the Honorable Alan M. Ahart, *supra* note 4 (explaining that "there is no indication in the majority opinion that the *Stern* court" considered the impact that the decision would have on magistrate judges).

168. I.R.C. § 7441 (2006). The Tax Court is composed of nineteen judges, *id.* § 7443(a), who are "appointed by the President, by and with the advice and consent of the Senate," *id.* § 7443(b), and who serve fifteen-year terms, *id.* § 7443(e).

169. *See supra* note 112.

170. *See About the Court*, UNITED STATES TAX COURT, <http://www.ustaxcourt.gov/about.htm> (May 25, 2011) ("When the Commissioner of Internal Revenue has determined a tax deficiency, the taxpayer may dispute the deficiency in the Tax Court before paying any disputed amount.").

171. *See Freytag v. Comm'r of Internal Revenue*, 501 U.S. 868, 891 (1991) (upholding the constitutionality of the Tax Court and its ability to exercise "judicial power").

extended to the Tax Court. In sum, *Stern* has caused aftershocks¹⁷² that have reached further than the Court likely considered.¹⁷³

*C. Politicization of
the Judiciary*

One way to subdue these aftershocks is to make bankruptcy judges Article III judges, which would vest them with the same constitutional authority that district court judges have and the corresponding ability to enter final judgments in both core and non-core matters. Unlike bankruptcy judges, Article III judges enjoy tenure during good behavior and salary protection.¹⁷⁴ The Court has expressed that central to our government is the concept of separation of powers within the tripartite government, where each branch has constitutionally enumerated powers.¹⁷⁵ Article III, Section 1, of the Constitution states that “[t]he judicial Power of the United States, shall be vested in one Supreme Court, and in such inferior Courts as the Congress may from time to time ordain and establish.”¹⁷⁶ The Court has confirmed that Congress cannot “withdraw from judicial cognizance any matter which, from its nature, is the subject of a suit at the common law, or in equity, or admiralty.”¹⁷⁷

Bankruptcy judges are currently appointed by the circuit courts¹⁷⁸ in an apolitical, merit-based screening process.¹⁷⁹ District

172. “The case already has caused enormous confusion in the federal courts.” Erwin Chemerinsky, *Enormous Confusion*, NAT’L LAW JOURNAL (Aug. 29, 2011), <http://www.law.com/jsp/nlj/PubArticleNLJ.jsp?id=1202512531253&slreturn=1>.

173. See *Stern v. Marshall*, 131 S. Ct. 2594, 2620 (2011) (holding that Congress exceeded its power “in one isolated respect,” but failing to address the broader implications of this excess of power).

174. U.S. CONST. art. III, § 1; *Stern*, 131 S. Ct. at 2600.

175. See, e.g., *United States v. Nixon*, 418 U.S. 683, 704 (1974) (discussing federal courts’ powers and the concept of separation of powers); see also *Bond v. United States*, 131 S. Ct. 2355, 2365 (2011) (discussing the importance that separation of powers has in the protection of “each branch of government from incursion by the others”); THE FEDERALIST NO. 78, at 466 (Alexander Hamilton) (Clinton Rossiter ed., 1961) (the Framers considered separation of powers an integral part of the Constitution, and “the judiciary [must] remain[] truly distinct from both the legislature and the executive”).

176. U.S. CONST. art. III, § 1.

177. *Murray’s Lessee v. Hoboken Land & Improvement Co.*, 59 U.S. 272, 284 (1855).

178. Bankruptcy judges are appointed by the court of appeals for the circuit in which the district is located. 28 U.S.C. § 152(a) (2006).

179. Interview with the Honorable Sheri Bluebond, *supra* note 2; see also NINTH JUDICIAL CIRCUIT, INFORMATION AND APPLICATION MATERIALS FOR APPLICANTS TO A FOURTEEN-YEAR TERM AS UNITED STATES BANKRUPTCY JUDGE, at ii (2011), available at <http://www.caeb.us>

court judges are nominated by the President and confirmed by the Senate.¹⁸⁰ The process is inherently intertwined with the two political branches of the government—the executive and legislative branches. If bankruptcy judges were required to be confirmed by the Senate, the appointment process would become more politicized and less efficient.¹⁸¹ A bankruptcy judge’s office “is really not a partisan office and the issue[s within bankruptcy] cut so many ways” that you can appoint someone from one political party or another “and not be sure that means they are going to be pro creditor or pro debtor.”¹⁸² It seems unlikely, “however, that, in the current political climate, legislation to create a few hundred additional Article III judgeships would ever be adopted absent any other viable alternative for resolving a jurisdictional crisis in the bankruptcy arena.”¹⁸³

Thus, it is unlikely that bankruptcy judges will become Article III judges any time in the near future.¹⁸⁴ An “absolute crisis in the federal judiciary” will have to arise before bankruptcy judges will become Article III judges.¹⁸⁵ A general notion exists within the federal judiciary that “many members of the Article III judiciary are protective of their status and would not be supportive of a general expansion of the Article III status of the bankruptcy judges.”¹⁸⁶

V. CONCLUSION

In an effort to maintain the system of checks and balances that are enshrined in the Constitution, the Supreme Court in *Stern* held a

courts.gov/documents/Employment/BJApplication-2011.pdf (explaining that the Ninth Circuit uses an open-selection merit process in appointing bankruptcy judges.)

180. *Federal Judges Frequently Asked Questions*, U.S. COURTS, <http://www.uscourts.gov/Common/FAQS.aspx> (last visited Oct. 13, 2011).

181. “Currently, at least in California, when there is an opening [on the bankruptcy bench] or even in advance of when there is going to be an opening, in order to have there be no gap in coverage,” the Ninth Circuit appoints somebody through a “merit screening process and politics does not enter into it, nor should it.” Interview with the Honorable Sheri Bluebond, *supra* note 2.

182. *Id.*

183. *Id.*; see also Interview with Dan Schechter, *supra* note 125 (explaining that, given the “present political climate,” it is unlikely that bankruptcy courts will be made Article III courts).

184. Interview with Dan Schechter, *supra* note 125; Interview with the Honorable Alan M. Ahart, *supra* note 4.

185. Interview with Dan Schechter, *supra* note 125.

186. *Id.*

portion of the Bankruptcy Code unconstitutional.¹⁸⁷ The Court arguably preserved the sanctity of the “judicial power” by preventing “other branches of the Federal Government” from “confer[ring] the Government’s ‘judicial Power’ on entities outside Article III.”¹⁸⁸ In this effort to protect the “integrity of judicial decisionmaking,”¹⁸⁹ the Court created an earthquake within the bankruptcy system that called into question the sanctity of bankruptcy courts and their ability to enter decisions on matters that they have been hearing for centuries. While bankruptcy judges have created ways to temporarily address the conundrum that *Stern* created, potential long-term effects of the ruling could be devastating to the way that bankruptcy courts currently operate. It may take years or perhaps decades to fully comprehend *Stern*’s impact on the federal judiciary. This tale that began as a love story has caused aftershocks throughout the bankruptcy community and entire federal judiciary—tremors that will likely reverberate for decades to come.

187. *Stern v. Marshall*, 131 S. Ct. 2594, 2620 (2011) (“The Bankruptcy Court below lacked the constitutional authority to enter a final judgment on a state law counterclaim that is not resolved in the process of ruling on a creditor’s proof of claim.”).

188. *See id.* at 2609 (“Article III could neither serve its purpose in the system of checks and balances nor preserve the integrity of judicial decisionmaking if the other branches of the Federal Government could confer the Government’s ‘judicial Power’ on entities outside Article III.”).

189. *Id.* at 2597.