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### Stern v. Marshall Panel

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The Honorable James E. Massey

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## ***STERN V. MARSHALL PANEL***

*Bernard Bo Bollinger*<sup>\*</sup>

*Daniel Bussel*<sup>\*\*</sup>

*The Honorable James E. Massey*<sup>\*\*\*</sup>

**MR. ZISHOLTZ:** Welcome back. We're going to go ahead and get started again with our second panel. We have our exclusive *Stern v. Marshall* panel, and I'm sure we're going to learn a lot from our panel here today. I'd like to introduce our moderator, Mr. Bo Bollinger. Bo is a shareholder at Buchalter Nemer and is joining us all the way from Los Angeles, California. Bo is Chair of Buchalter Nemer's Insolvency and Financial Solutions Practice Group and a member of the firm's Board of Directors. He is also Co-Chair of the firm's Continuing Legal Education Committee. Bo regularly represents creditors and acquirers in real estate-related bankruptcy cases, including multiple engagements for one of the largest real estate development companies in southern California. Bo earned his J.D. at Loyola Law School and received his B.A. from the University of Southern California. Thank you, Bo, for joining us, and we're excited for this panel.

**MR. BOLLINGER:** Thank you, Jeremy. Good morning, everybody. Let me take a second to introduce the rest of the esteemed panel here. To my far right is the Honorable James E. Massey. Judge Massey graduated from Emory here in 1965 for undergrad, went to Columbia Law School in 1968, practiced law for about 25 years, and then became a judge in 1993. He tried to retire a few years ago and was asked to come back. He was recalled and is still sitting on the bench here in Atlanta, so I know a number of you are probably familiar with Judge Massey.

We also have on the panel, to my immediate right, Daniel Bussel. Dan is a member of Klee, Tuchin, Bogdanoff & Stern, a graduate of the University of Pennsylvania and Stanford Law School. He clerked for the Honorable Sandra Day O'Connor and the Honorable Stephen Breyer. He is currently a professor at U.C.L.A. Law School teaching bankruptcy, commercial law, and contracts. He's been an expert consultant and witness in numerous bankruptcy-related

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matters, participated in the preparation of *amicus curiae* briefs, and he also submitted briefs on behalf of the Marshall estate in the Supreme Court case in *Stern*, so he's pretty intimately familiar with these issues, as you might imagine.

I should also start—because each of us is still involved in issues and the impact of *Stern*—I need to give you a disclaimer that we're all involved in these types of matters. We have partners at our firms who are involved in all sides of these issues, so while we'll talk today about these issues, we are just talking about them for discussion purposes. Nothing of what we say is really for affirmation—

**MR. BUSSEL:** Or should be held against us.

**MR. BOLLINGER:** Or should be held against us. So we're happy to talk about these issues, but particularly Judge Massey is not giving an advisory opinion from this panel this morning.

The way I thought we'd organize this is to have Dan talk for a few minutes about *Stern*, its procedural history, and background. Then we'll go through a discussion of some of the cases that we have in the materials. If you have those materials handy, it might be a little bit helpful for you because we're going to go through them in the order that they're presented in the materials. We're not going to talk about all of them, but we are going to go through those, and it might help you to have that synopsis in front of you. Then after we finish the discussion of six or eight of those cases, Judge Massey will talk about some of the practical implications—how *Stern* might impact practitioners. I think some of the law students here have *Stern* as one of their moot court issues, and so we might have questions about that. We should have about ten minutes at the end to address questions. When we do those questions, I've been asked to have people who are interested in asking questions to walk up to the microphone and ask the questions from the microphone. So when we get to that point, please prepare yourself to get up and walk to those microphones.

I also have one additional disclaimer. If you think that we're going to solve this issue for you today, you are sorely mistaken. We are glad to talk about it, but as you're going to find out, it's really a mess, and it's something that is going to take a long time before these issues are truly resolved. As a practitioner, I'm sure you have a lot of questions that we're just not going to be able to answer for you, although we can give you the different sides of these particular issues.

So with that said, Dan, why don't you go ahead and give us the background about *Stern*?

**MR. BUSSEL:** Thank you, Bo. First, I want to thank the Emory people for putting on this panel. It's a great pleasure for me personally to be on the panel, and particularly to talk about *Stern v. Marshall*<sup>1</sup> in a law school setting because I remember thirty years ago when the *Marathon*<sup>2</sup> case came down, I was in law school, and the same sort of confusion, distress, and panic on the part of much of the bankruptcy community descended on us all. It really motivated my interest in bankruptcy at the very beginning because I remember how high profile the issues were back then.

As Bo says, I think the takeaway lessons are that, one, for the immediate future, the Supreme Court clearly has created a litigation nightmare for everybody in the bankruptcy community, and it's something that we're going to be dealing with for at least several years—probably more than several years going forward. The second point is that we're starting to get some pretty clear idea of how the issues are settling out at the bankruptcy court and the district court level, and Bo is going to talk some more about that after I finish my background talk. But nobody knows where the courts of appeal and ultimately the Supreme Court are going to come out on the host of issues that have been raised in the wake of the Supreme Court's decision in *Stern v. Marshall*, and so there's just a lot of uncertainty and speculation about how it's all going to settle out.

I guess the final point is, *Stern v. Marshall* illustrates how sorely we miss Justice Sandra Day O'Connor because it's pretty clear, based on her jurisprudence in the late 1980s and early 1990s, that the 5-4 would've gone the other way if you substitute O'Connor for Alito.

Okay, with that being said, let's talk for a minute on how we got to where we are. You really have to go back, unfortunately, to the Bankruptcy Act of 1898<sup>3</sup> to have any real understanding of these issues. The jurisdictional underpinnings of the Bankruptcy Act of 1898, there was a fundamental division in the statutes (statutory, not constitutional) between so-called summary and plenary jurisdiction, and so the basic framework was that, to the extent that there were proceedings dealing with the property of the estate, there

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<sup>1</sup> *Stern v. Marshall*, 131 S. Ct. 2594 (2011).

<sup>2</sup> *N. Pipeline Constr. Co. v. Marathon Pipe Line Co.*, 458 U.S. 50 (1982).

<sup>3</sup> Bankruptcy Act of 1898, Pub. L. No. 696, 30 Stat. 544 (repealed 1978).

was a kind of *in rem* jurisdiction that the then-bankruptcy referees had over the property. They could dispose of the property and deal with the property and deal with distribution of the property and settle claims against the property, but pretty much everything else that involved certainly third parties, that didn't involve creditors and that couldn't be characterized in one way or another as dealing with the *res*, with the property that was in the bankruptcy estate and indeed augmenting the estate was, to the extent that there was jurisdiction to do it, the jurisdiction was so-called plenary jurisdiction. That meant that the suit had to proceed before the federal district judge or even the state court, but not in front of the referee.

The system struggled with this distinction between summary and plenary jurisdiction for eighty years. It was a very difficult issue at the margins to determine whether any particular proceeding would be characterized as summary or plenary. One of the great advances in the 1978 Code<sup>4</sup>—one of the crown jewels of the Code—was the complete reworking and repair of the jurisdictional underpinnings of the bankruptcy system—the creation of a freestanding bankruptcy court and the vesting of this very broad jurisdiction to handle all the matters before the bankruptcy judge.

There was thought given during that reform effort about whether we need to worry about Article III. The decision was made not to appoint the bankruptcy judges as Article III judges, but rather use Congress's inherent power under Article I to constitute the courts with non-Article III judges. And so the new jurisdictional provisions were tested in litigation all over the country, and in 1982 or 1983, the Supreme Court finally was faced with the issue in the *Marathon*<sup>5</sup> case of whether or not the jurisdictional provisions of the Bankruptcy Reform Act of 1978 were constitutional. In a stunning but confusing plurality decision in *Marathon*, the Court said no, that the vesting of the full breadth of the bankruptcy jurisdiction constituted a vesting of the judicial power of the United States in these new bankruptcy courts, and the judicial power of the United States under Article III of the Constitution had to be vested in judges nominated by the President, confirmed by the Senate, and appointed for life.

And so there was panic. The Supreme Court actually stayed its judgment in *Marathon*—it stayed it twice in order to give the system an opportunity to adjust. The hope was that Congress would reconstitute the jurisdictional

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<sup>4</sup> Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549.

<sup>5</sup> *Marathon Pipe Line Co.*, 458 U.S. 50.

underpinnings of the court in a way that was consistent with the ruling in *Marathon* during the period of the stay. Congress didn't act, and so eventually the stay lapsed and the judiciary moved in to kind of fill the gap by constituting what probably was an un-Constitutional emergency rule under the auspices of the Judicial Conference of the United States that created, for the first time, this distinction between core and non-core jurisdiction.

Eventually, in 1984, Congress essentially adopted the emergency rule as a statute with some modification, but essentially codified this distinction between core proceedings and non-core proceedings.<sup>6</sup> The decision that was made in both the emergency rule and in the BAFJA in the 1984 amendments was to construe *Marathon* very narrowly. And so the notion was, well, the Supreme Court has said that we cannot take an action that is based on state law, that is against a non-creditor of the estate, and likely has a jury trial right attached to it—we can't vest that in the bankruptcy court. That kind of suit, we understand, has to go to the federal district court. Basically everything else that the bankruptcy judges do, we're going to characterize as a core proceeding. And so they have this long enumeration that people are, I assume, generally familiar with in the statute of all the different kinds of matters that can arise in a bankruptcy case and characterizes all of those as core proceedings.

So obviously, BAFJA was tested in the bankruptcy courts and in the district courts and in the courts of appeal as to whether or not it really conformed to *Marathon*, whether this very narrow reading of *Marathon*—that *Marathon* was really about just this one particular kind of lawsuit that couldn't proceed in the bankruptcy court—was really a proper interpretation of the decision.

The conclusion in the bankruptcy courts and the district courts and the courts of appeal at that time was uniformly, yes, it works. In fact, there was kind of a relief that we're kind of past the *Marathon* issue. And people felt especially comfortable with that because of these two O'Connor decisions, *Schor*<sup>7</sup> and *Thomas*,<sup>8</sup> that came down in the late 1980s that seemed to back away. Remember, *Marathon* was just a plurality decision; the membership of the Court had changed, and *Schor* and *Thomas* indicated that the Court, or at least the majority of the Court, had turned into a much more pragmatic and functional analysis of Article III. And the analysis in those cases, albeit dealing

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<sup>6</sup> See Bankruptcy Amendments and Federal Judgeship Act of 1984, § 104(a), Pub. L. No. 98-353, 98 Stat. 340.

<sup>7</sup> *Commodity Futures Trading Comm'n v. Schor*, 478 U.S. 833 (1986).

<sup>8</sup> *Thomas v. Union Carbide Agric. Prods. Co.*, 473 U.S. 568 (1985).

not with bankruptcy but dealing with administrative agencies, to the extent that the vesting of this additional jurisdiction in the non-Article III adjudicator didn't implicate Article III values, didn't undermine the independence of the federal judiciary in some material way, and had a good, practical rationale. It was okay, and so people kind of breathed a sigh of relief and moved on. People stopped testing the jurisdictional predicate of the BAFJA or the constitutionality of the BAFJA. People accepted the statute pretty much as it was written as establishing the allocation of jurisdiction between the bankruptcy court and the federal district court.

There were subsequent events in the Supreme Court. There was the *Granfinanciera*<sup>9</sup> case in the early 1990s. In *Granfinanciera*, the Supreme Court said, well, the Seventh Amendment jury trial right has to, in order to preserve jury trial as a viable institution, go through this exercise of analyzing whether any particular lawsuit is best analogized to a common law action in 1791. And we look at fraudulent transfer law, and fraudulent transfer law is very ancient, and so fraudulent transfer law looks to us like an action at law. And so the framers, in 1791 when they said jury trial rights shall be preserved in the federal system, that means they're fraudulent transfer. They would've thought fraudulent transfer fell into that category. And so that was somewhat disturbing to people—that now the thought that we'd have to have jury trials, maybe even in Article I courts, and there was a dispute as to whether you could do it in the bankruptcy court or in the federal district court. And people essentially came to the solution that, well, to the extent that there was actually going to be a jury trial, if there was a jury trial right, that jury trial had to be conducted in the federal district court, but basically everything short of that could be done in the bankruptcy court.

And it turned out that the system was pretty stable at this point because people really didn't want jury trials in fraudulent transfer actions or in most of the other kinds of litigation that occurred regularly in the bankruptcy court. And so unless you had a lawsuit that was a *Marathon* lawsuit that was a purely non-core lawsuit, or you had a jury trial, the proceeding would take place before the bankruptcy judge, and the bankruptcy judge could finally resolve it. It turned out that there was very little non-core litigation, very few reports and recommendations, and very little withdrawal of the reference except in the narrow category of cases where people not only had jury trial rights but chose to exercise them.

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<sup>9</sup> *Granfinanciera, S.A. v. Nordberg*, 492 U.S. 33 (1989).

So that's pre-*Stern*. So what happens in *Stern v. Marshall*, without going through the whole *Bleak House* explanation of what happened in *Stern v. Marshall*, which could consume easily an hour and a half just going through the facts to much amusement, but still, I think you've probably all been there by now. What happened is that Pierce Marshall filed a proof of claim in Anna Nicole Smith's California bankruptcy based on defamatory statements that she had made regarding his conduct towards her (his stepmother, I guess) in connection with the trust that was created by her husband and his father. Anna Nicole counterclaimed with a tort claim asserting that she had been wronged by Pierce in connection with the trust. Under basic civil procedure, this is a compulsory counterclaim because it arises out of the same nucleus of operative facts, so it's deemed a compulsory counterclaim under the Rules.<sup>10</sup>

The bankruptcy court went ahead and disallowed the defamation claim and found it was without merit and gave judgment to Anna Nicole, then went on to adjudicate the counterclaim and gave further judgment to her for affirmative recovery of something like \$450 million. So it comes up to the Supreme Court of the United States now for the second time, and the disposition of the claim itself is not in the case anymore—not challenged. The only issue is the counterclaim judgment. What the Supreme Court says is, well, we read the statute, and the statute is very clear that jurisdiction over counterclaims is vested in the bankruptcy court and we're not going to rewrite the statute. The statute says this is core and that it should proceed in the bankruptcy court, but judgment on the counterclaim was still, even though it was characterized as a statutory matter as a court proceeding, an exercise of the judicial power of the United States, and therefore, the right to enter a final judgment on such a matter had to be vested in the federal district court.

And so, unless—and the “unless” is whether it falls within one of three exceptions. Well, of the three exceptions, two of them are obviously not applicable. There's an historical exception for territorial courts; the bankruptcy court is not a territorial court. That's not going to work. There was an exception for courts martial, but this is not a military case. And then there was this sort of vague exception for matters of public right. And so the question is, could you fit the counterclaim into that exception as a matter of public right?

What the Supreme Court says in *Stern v. Marshall* is, no, it's not a matter of public right because this is a claim for affirmative recovery and it is not

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<sup>10</sup> See generally FED. R. CIV. P. 13(a).



necessary to the adjudication of a claim against the estate. It does not deal with something that is currently the *res* of the bankruptcy. And we know that it's not necessary to the adjudication of the claim because the claim was disallowed before they ever got to the counterclaim, so clearly it wasn't necessary to determine whether or not the claim was valid because you'd already taken care of that and you could've moved on, and yet you went ahead and adjudicated this additional matter that constituted an exercise of judicial power.

So why is this so disruptive? Why is this so destabilizing? And the answer to that, I think, is that it explodes what had been the consensus about the validity of the narrow interpretation of *Marathon* codified in the 1984 amendments and subsequently upheld by every court in the system below the Supreme Court of the United States.

And so the key elements of that are, well, it's not just about state law anymore—state law claims. And the reason it seems that it's not just about state law anymore is because the court assimilates the Seventh Amendment holding in *Granfinanciera* to the standard for Article III judicial power and says, well, it's the same test. And so in *Granfinanciera*, there was a jury trial right and it had to take place in a federal district court, and *Granfinanciera* involved a federal transfer action under § 548 of the Bankruptcy Code<sup>11</sup> which was a matter of federal law, not a matter of state law.

And the second aspect of it is that it exploded this idea that, well, if it wasn't an action against a creditor—that was an essential part of what the problem was in *Marathon* because in *Stern v. Marshall*, Marshall was a creditor. He filed a claim. And so to say that, well, *Marathon* is just about state law and just about actions against non-creditors isn't really viable after *Stern v. Marshall*. So we find out now thirty years later that BAFJA just doesn't work. The purported allocation of jurisdiction between federal district court and bankruptcy court is not consistent with the Constitution. And so the definition of core sweeps in things that are matters that are not of public right and therefore not within the authority of the bankruptcy court.

So what is within the authority of the bankruptcy court now in the wake of *Stern v. Marshall*? That's the million dollar question. There are really two competing views out there that are polar opposites, and then there's a lot of attempt to strive toward some sort of middle ground. So what are the polar

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<sup>11</sup> 11 U.S.C. § 548 (2006).

views? The most intellectually coherent view is the view expressed by Justice Scalia in his concurrence. Justice Scalia says, look, the matter of public right exception is rooted in *Martin v. Hunter's Lessee*,<sup>12</sup> back from the 19th century. And what it was, was a logical deduction from the sovereign immunity of the United States. And so the notion was that, if the government authorizes a suit against itself, it is waiving sovereign immunity. Since it could choose not to be sued at all, it can elect which forum the suit will proceed in, and it can assign the matter to a non-Article III forum because it was privileged to say there shouldn't be any litigation of this nature at all against the United States.

When you're talking about "of public right," what that means to Justice Scalia is, it involves the government. And so if that's the definition of what is "of public right," and if the only exceptions are territorial courts, courts martial, and "of public right," then almost nothing that goes on in bankruptcy is of public right. Maybe, he says, maybe because of the long history here, I'd be willing to look the other way on processing claims against the estate. And beyond that, it's all about adjudicating private rights among private parties, and so it's all exercises of judicial power, and it all has to be vested in an Article III court. There's no applicable exception.

It's theoretically coherent. It is extremely impractical as a view. It's really calling for essentially an abolition of the decision to vest broad jurisdiction in the bankruptcy courts and allow bankruptcy judges to handle the cases.

The other view that's out there is the view probably espoused by the other people on this panel, which we'll characterize as the bankruptcy lawyers' view. The bankruptcy lawyers' view is that a matter of public right is everything that's in the Bankruptcy Code and everything that is related to a bankruptcy case except those things which the Supreme Court has specifically told us are not matters of public right. So they've told us in *Marathon* that if you have a state law action against a non-creditor, that's a non-core action. That's a matter of private right. Well, we'll say that that's outside the bankruptcy judge's jurisdiction.

Now we've heard in *Stern v. Marshall* that, as to counterclaims and counterclaims only, if there's a counterclaim that calls for affirmative recovery that is not necessary to the adjudication, then as to that kind of an action, it's report and recommendation, and it has to go to a district judge. Maybe because of the discussion of *Granfinanciera*, maybe we would be willing to concede,

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<sup>12</sup> *Martin v. Hunter's Lessee*, 14 U.S. 304 (1816).

although I'm not really sure that the bar is completely there yet, but we'd be willing to concede that a fraudulent transfer action is outside the core jurisdiction, at least if it's against a non-creditor. Because remember, *Granfinanciera* is a non-creditor. There was no proof of claim filed by the defendant in *Granfinanciera*. Everything else is okay for the bankruptcy court to determine. And again, Bo will talk about the cases in more detail, but essentially that's where the current cases are coming out. The bankruptcy courts and the district courts have basically concluded that we're going to read *Stern v. Marshall* as narrowly as possible.

And so then the million dollar question is, what will the courts of appeal say? The virtue of the bankruptcy lawyers' view is that it's very practical. It's extremely practical. It is theoretically incoherent. There's no logic that drives you to the conclusion that the *Stern v. Marshall* cause of action is outside the constitutional core jurisdiction, but everything else is in. There's no explanation as to why that should be so, other than the Supreme Court has said it is so.

And so the question is, is there an intellectually coherent way, without going all the way to the Scalia position of saying nothing except matters that actually involve the government are public right, that allows you to draw a line that puts *Stern v. Marshall* on one side and most of the things that we really care about that the bankruptcy system does on a daily basis on the right side of the line? And so this is going to be the project of the courts of appeal, whether they're going to be able to draw that line or whether they're going to fold into one of the two existing positions. I don't think the Scalia view is ultimately going to prevail because it's so impractical that I just don't think it's going to go there. But if there is a middle way that emerges, I think it's very hard on an intellectual basis to adopt this very, very narrow interpretation of *Stern v. Marshall*.

And so what are the possibilities here? Well, one possibility is to come up with a kind of functional view that ties Article III values in some way to a division of jurisdiction that leaves *Stern v. Marshall* on one side and most things on the other side. And nobody has really successfully come up with a theory. There doesn't seem to be a theory out there that ties independence of the federal judiciary and separation of powers values to that division of responsibility. Because after all, what is the separation of powers value that's implicated by allowing a tort claim to be adjudicated by a non-Article III adjudicator? Most tort claims in our system are adjudicated by non-Article III

adjudicators. They're determined by state judges who don't have Article III protection. They're determined by juries. They're determined by arbitrators. So it's hard to see what's so important to separation of powers that would say, "Oh, yes, that's got to be on that side of the line, everything else on the other side of the line." So it seems to be a broader principle.

So the other possibility that's put forward for drawing a line in a meaningful way is to look back to tradition and say, well, we don't have an intellectual line, but we have 100 years of practice. And what that essentially means is going back. And it's the reason I started with the 1898 Act and summary versus plenary jurisdiction, going back to what was the division of authority between the referees in bankruptcy under the 1898 Act and the district court judges.

So it seems that the Supreme Court is comfortable with that. And the reason it seems they're comfortable with that is they rely, in *Stern v. Marshall*, on *Katchen v. Landy*,<sup>13</sup> which is one of the great cases dealing with this summary/plenary division. Nobody really understood exactly how *Katchen v. Landy* was applied. It was a confusing mess. But anyway, that was the landmark case. And the court says, we're not touching *Katchen v. Landy*. And so the suggestion is made that where the line really is, going forward, is dust off your 14th Edition of *Collier's*,<sup>14</sup> look at the jurisdictional provisions under the 1898 Act, read the old cases and figure out whether your action would've been summary or plenary under the old system. And if it was summary under the old system, you're okay. And if it was plenary under the old system, you have a problem. It may no longer be within the authority of the bankruptcy judge to finally determine the matter.

I see I've burned a lot of time. Why don't I let you go?

**MR. BOLLINGER:** Thank you, Dan. Thank you for that eloquent explanation. Now let's see how all of that works in practice. I also want to refer again to the materials. The materials start at page forty-three. What we've done with those materials is we have categorized the types of cases by matter, so that if you in practice have a particular type of issue, you can see if there are cases that have come down on those issues.

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<sup>13</sup> *Katchen v. Landy*, 328 U.S. 323 (1966).

<sup>14</sup> COLLIER ON BANKRUPTCY (14th ed. 1978).

I also want to sort of give you a little bit of a timeline because some of these cases were decided at different points in that timeline. *Stern* was decided June 23rd of 2011. So we're about eight months out from *Stern*. So as we go through each of these cases that I'm going to focus on, I'll talk about where they are in that timeline and how if that impacted the analysis at all.

The first case that we're going to talk about is the one under chapter 11 plan confirmation issues. That's *In re Safety Harbor Resort & Spa*.<sup>15</sup> It's a Middle District of Florida case, August 30th, 2011, so we're talking about ten weeks after *Stern*. In this case, it concerns plan confirmation and some of the elements of a plan. There was a two-day evidentiary hearing on plan confirmation. The court approved the plan but did not approve the release of non-debtor guarantors. Instead, he put in place a lock-up provision, a four-year stay on actions of the guarantee, but the guarantors couldn't transfer assets during that time period. So the question was whether or not this lock-up provision, this element of the plan, was within the court's jurisdiction under *Stern*. The court goes through a long, detailed analysis. This is the one that goes through *Stern* on almost a point-by-point basis, and determined that ultimately *Stern* should be interpreted narrowly and that the lock-up provision was an integral part of the plan and thus falls within core jurisdiction under 28 U.S.C. § 157(b)(2)(L).<sup>16</sup> The court also described the concept of consent and ended up concluding that, because these guarantors had the controlling interest in the plan proponent, they in fact had consented to the jurisdiction of the court.

So, Judge Massey or Dan, any thoughts about this case and how this sort of fits in the broad spectrum of *Stern*?

**MR. BUSSEL:** Well, we haven't really talked about consent, but the consent ruling has to be right in this case because what happens in this case is you had people who are promoting a plan of reorganization, and they put it forward, and they want the bankruptcy judge to approve it. And when the bankruptcy judge does something that they don't like in respect of the confirmation of the plan, all of a sudden they say, oh, *Stern v. Marshall*. You don't have the authority to do it anymore. And I think that under any kind of rational view of the way the system has to operate, that can't work. If a plaintiff or a plan proponent is seeking affirmative relief, it may be for the defendant or an opposing party to raise *Stern v. Marshall*, but I don't see how they can come in

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<sup>15</sup> *In re Safety Harbor Resort & Spa*, 456 B.R. 703 (Bankr. M.D. Fla. 2011).

<sup>16</sup> 28 U.S.C. § 157(b)(2)(L) (2006).

and say, after they find out that it's not going their way, that the bankruptcy court doesn't have authority. So in that sense, I think the case was kind of over-determined.

If you take away the consent issue, the underlying *Stern v. Marshall* issue is a very interesting issue because now the question is, okay, this is not a counterclaim. This is not under (C); this is under (L). So does *Stern v. Marshall* have any application to (L)? Well, the bankruptcy lawyers will say, "No, (L) was a different letter than (C)."<sup>17</sup> But there's no explanation as to why. It's just it's a different letter. And so that's sort of my quick take on it. Did you have a view, Judge Massey?

**JUDGE MASSEY:** Well, I'll talk a little bit more in a minute if I've got some time about consent, but I think there's some reason to be concerned about how you determine whether consent is given. If you're interested in making sure that you get a final judgment in the bankruptcy court, the best way to do that is to get the other side to explicitly—in writing—say that they have consented to the bankruptcy judge making the determination. It wouldn't be enough to say, "I consent to the bankruptcy judge's jurisdiction." I think *Stern v. Marshall* makes it clear that the court is looking at subject matter jurisdiction differently than allocating the job of making the final judgment between the district judge and the bankruptcy judge.

**MR. BUSSEL:** How do you provoke the other side to consent to the jurisdiction?

**JUDGE MASSEY:** You're going to have to talk them into it. Maybe you provoke them into it by proposing a settlement that they can't refuse, such that you don't even need to get there. Maybe you have the ability to delay the thing long enough so that it really hurts the other side and so you say, "Okay, you won't consent. I'm going to see to it that we stay in this court as long as we can and then stay in the district court as long as we can. You may get your judgment, but it will be ten years from now."

**MR. BOLLINGER:** We have at least one other case here that talks about the issue of consent, and the concept, almost, of forum shopping—that *Stern* shouldn't permit you to go with the bankruptcy judge as long as you like the rulings, but as soon as you don't, you raise the *Stern* flag and say, well, I want

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<sup>17</sup> See *id.* § 157(b)(C), (L).

a new judge. So that seemed to be the case in that case, also in the *Bayonne Medical Center*<sup>18</sup> case that we'll talk about.

Let's talk for a second first about non-dischargeability, and the *Ford Motor Credit Co. v. Franceschini* case.<sup>19</sup> That's a bankruptcy case out of Texas in 2012, this year, and this was a situation where the owner of some car dealerships transferred about \$1.6 million to family members, despite those assets being encumbered by Ford Motor Credit's liens. The court held that those transfers were non-dischargeable because they were done willfully and maliciously. The court concluded that the right to discharge is established by the Bankruptcy Code and is central to the public bankruptcy scheme, and bankruptcy courts have the authority to make such decisions pursuant to their *in rem* jurisdiction. So that is the concept of non-dischargeability. But what about actually determining the amount of the non-dischargeable claim? Judge Massey, I know you—

**JUDGE MASSEY:** That's the problem. That's the *Stern* problem with regard to § 523 claims.<sup>20</sup> The creditor may not agree to that. They may think that they've got a better shot in state court in front of the jury in getting a big judgment. And quite often you see cases filed where there's litigation that is based on alleged fraud or defalcation while acting in a fiduciary capacity, or some sort of willful and malicious injury. If you get into that, for example, in the context of defamation, figuring out exactly what the damages are is not an easy thing, and it's usually something that's decided by a jury. So one of the concepts that I would urge you to think about in analyzing whether a core issue might really be a non-core issue—and this is not the only thing—but is this the sort of thing that normally would get decided somewhere else, and it doesn't really matter too much to creditors or to the estate what the amount is. If you looked at it that way, you might conclude that, if there's dispute over the amount, it would have to be tried elsewhere.

**MR. BUSSEL:** For the historians among you, under the 1898 Act, the non-dischargeability action was a matter of summary jurisdiction, but the determination of the amount was plenary suit. So that feeds right into this

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<sup>18</sup> *Bayonne Med. Ctr. v. Bayonne/Omni Dev., LLC (In re Bayonne Med. Ctr.)*, No. 07-15195 (MS), 2011 Bankr. LEXIS 4748 (Bankr. D.N.J. Nov. 1, 2011).

<sup>19</sup> *Ford Motor Credit Co. v. Franceschini (In re Franceschini)*, No. 10-30550, 2012 Bankr. LEXIS 156 (Bankr. S.D. Tex. Jan. 12, 2012).

<sup>20</sup> 11 U.S.C. § 523 (2006) (listing debts that are exempt from discharge).

argument that *Stern v. Marshall* essentially constitutionalizes the division of jurisdiction that existed before the Bankruptcy Code was enacted.

**JUDGE MASSEY:** Let me tell you one quick idea about this, just as a practice concept. Let's say that the parties have tried the case to the jury in the state court—no interrogatories to the jury. There were two claims. One was contract and one was tort. The defendant files bankruptcy, and the claim is that the tort claim is a fraudulent claim—the defendant committed fraud. So they would want you to rule that the debt is non-dischargeable because there's an issue of preclusion, of claim preclusion, of collateral estoppel. The defendant cannot come back and re-try it the second time. The judge could certainly try the question of: if you had to start all over again and determine whether or not the fraud claim was such that the debt for fraud would be non-dischargeable. That doesn't determine the amount of the claim. Now what do you do? You've got to go back in state court and have another trial all over again to determine how much of the judgment was for contract damages and how much of it was for fraud damages. It's a mess.

**MR. BUSSEL:** If that's what the Constitution requires.

**MR. BOLLINGER:** It's a mess. That's the circumstance that we're in. I think we'll switch over to the fraudulent transfer claims that Dan talked about. We only have two cases listed in these materials that have gotten to the court of appeals level. One of them is the *Executive Benefits Insurance Co. v. Arkison* case,<sup>21</sup> Ninth Circuit, November 4th of 2011. All this is, is the statement that the appellate court has taken this and they asked for arguments to address the following questions: does *Stern v. Marshall* prohibit bankruptcy courts from entering final binding judgment in a fraudulent conveyance action? And if so, may the court hear the proceeding and submit a report and recommendation to the district court in lieu of entering a final judgment? Dan, any thoughts about why it is they'd ask for briefing, and any predictions on how you think this might go?

**MR. BUSSEL:** Well, Judge Kosinski is on the panel. He's the chief judge on the Ninth Circuit. Judge Kosinski has a deep and abiding interest in bankruptcy matters generally. I'd be very surprised if he wasn't thinking very hard about finding that the fraudulent transfer actions were outside the jurisdiction. There were a number of *amicus* submitted in response to this public call for

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<sup>21</sup> Exec. Benefits Ins. Agency v. Arkison (*In re Bellingham Ins. Agency, Inc.*), 661 F.3d 476 (9th Cir. 2011).



briefing—actually one by one of the people that worked with me on *Stern v. Marshall*. And so they've gotten the briefs now, and it's in front of the Ninth Circuit. My guess is that there will be a decision relatively soon. His chambers works pretty quickly, so I anticipate within a short period of time there will be a Ninth Circuit holding. If I had to bet on it, I would say that probably it's going to be that fraudulent transfer actions are not within the core jurisdiction, or the constitutional core, whatever you want to call it.

**MR. BOLLINGER:** It would just be nice to have some ruling of some kind for us to be able to follow. Maybe we're getting there eventually.

**MR. BUSSEL:** That may not be the one that most people want.

**MR. BOLLINGER:** The issue of judicial efficiency really comes up in the *Adelphia Recovery Trust* case,<sup>22</sup> decided on January 30th of 2012. In that situation, there were seven years of litigation over a fraudulent transfer claim, and then *Stern* came up and the question was, could this judge enter a final judgment? And the court, citing *Granfinanciera*, said, it's a private right. *Stern* clearly implied that the bankruptcy court lacks constitutional authority to enter final judgment on the fraudulent conveyance claims entered here. And then it goes through an analysis, ultimately determining that withdrawing the reference—he determined that he could enter proposed findings of fact and conclusions of law in the manner authorized by 28 U.S.C. § 157(c)(1)<sup>23</sup> because withdrawing the reference due to uncertainty caused by *Stern* is a drastic remedy that will hamper judicial efficiency. Having to redo seven years worth of trial—when the bankruptcy judge has all of the history of these cases—just doesn't seem to make sense as a matter of judicial economy. Any thoughts about that?

**JUDGE MASSEY:** If it's unconstitutional, it's unconstitutional. You can't just wink at it if you want to have a Constitution that means anything. Part of the problem is that figuring out what the Constitution means is not all that easy, and what the methodology is for interpreting it is not all that easy. I think what we've seen over the last few years with regard to the majority on the Court is that the concept that you can look at a statute like the Bankruptcy Code and analyze any constitutional problems based on some sort of pragmatic approach, it seems at this point to be out. What's odd to me is that when you

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<sup>22</sup> *Adelphia Recovery Trust v. FLP Group, Inc.*, No. 11 Civ. 6847 (PAC), 2012 U.S. Dist. LEXIS 10804 (S.D.N.Y. Jan. 30, 2012).

<sup>23</sup> 28 U.S.C. § 157(c) (2006).

go back to the *Marathon* case, there were three justices in dissent: Chief Justice Burger, Justice White, and Justice Powell. They were probably the three most conservative, or certainly among the most conservative members of the Court, and they were willing to uphold the statute when bankruptcy judges were to be appointed by the President, and anything that even smelled like bankruptcy could come in front of a bankruptcy judge.

**MR. BUSSEL:** Totally flipped. In *Marathon*, the principal author of the opinion was Justice Brennan, the most liberal justice we've had in two generations.

**JUDGE MASSEY:** So now we're back. It's the other way around. It's just odd.

**MR. BUSSEL:** It's funny, the ideological—

**JUDGE MASSEY:** It's just hard to figure out.

**MR. BUSSEL:** Doesn't consent go a ways here, though? These people have litigated for seven years on the assumption that the bankruptcy judge is going to render a final judgment. At some point, isn't there some implicit waiver here, based on conduct?

**MR. BOLLINGER:** You would think that there would be, but if you look at the *Bayonne Medical Center* case,<sup>24</sup> which is the next one, it's the same situation. Here, the plaintiff brought the action in the bankruptcy court, saw that things weren't going their way, and they all of a sudden raised *Stern* and said, "I don't want the bankruptcy judge to deal with this." And so the court said, "There's consent here. How can you just do this blatant forum shopping? There's consent here." But then he started to think about whether or not consent was effective, and he basically punted on the issue. He said, "What I'm going to do is, I'm going to conclude that there is jurisdiction, but if it is ultimately determined that there was no jurisdiction, then this order can be considered findings of fact and conclusions of law that then can be approved under § 157(a)(1)." What about this concept of just sort of pushing the issue to the next level? Does that make sense? Does that help anybody?

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<sup>24</sup> *Bayonne Med. Ctr. v. Bayonne/Omni Dev., LLC (In re Bayonne Med. Ctr.)*, No. 07-15195 (MS), 2011 Bankr. LEXIS 4748 (Bankr. D.N.J. Nov. 1, 2011).

**JUDGE MASSEY:** The question, though, is what the court is going to do with it when it gets there, particularly if you've got a lot of money involved and you want it to stick.

Since we're running out of time, I'm going to move ahead with one little thing that I was going to talk about, which is a 2003 Supreme Court case called *Roell v. Withrow*.<sup>25</sup> In that case, a full-time magistrate judge, under a statute that permitted magistrate judges to try cases, was assigned a civil rights case under 42 U.S.C. § 1983 brought by three prisoners against the prison staff for allegedly not taking care of their medical needs in violation of the Eighth Amendment. During the preliminary hearing, the magistrate judge told one of them that the district judge could preside over the case and that person agreed, and then later in writing confirmed that. Without waiting for any other decision, the district judge referred the whole thing to the magistrate judge for the final disposition. The referral order, which I presume the plaintiffs got, said that it would be vacated if nobody consented. One of the three gave a written consent and the other two didn't say anything.

The case went all the way to the jury, and I don't remember who won, but there was an appeal and, because the thing was treated as if a district judge had rendered the appeal, it went to the Fifth Circuit. The Fifth Circuit said, "Was there consent?" They sent it back down to answer that. The magistrate judge said, "Well, there was no express consent, and I think there needed to be express consent, so I just wasted my time trying that case." And the district court adopted that report and recommendation; it went up to the circuit and the circuit affirmed. It was appealed to the Supreme Court, and the Supreme Court reversed, 5–4. They said there was consent, and it's got kind of this participation idea, and that there had to be some practical understanding of all of this.

And here's the wrinkle. The wrinkle is that among the four were Scalia, Thomas, and Kennedy. Stephens was also one of the dissenters. Chief Justice Rehnquist was in the majority, as was Justice Souter, and of course they're off now. So if it's going to be perceived as—if Chief Justice Roberts and Justice Alito were to throw in with the other three—then anything short of a written consent ahead of time wouldn't work. Dan and I have talked about this, and I tend to agree with Dan. I think that the Chief Justice is going to be a little more

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<sup>25</sup> *Roell v. Withrow*, 538 U.S. 580 (2003).

pragmatic, perhaps, on this issue. But it just goes to show how hard it is to figure out what you have to do.

**MR. BUSSEL:** The other issue you have is, does consent even work? Because after all, we're in a law school, where you learn that you can't create federal jurisdiction by consent. That's a fundamental principle of federal jurisdiction. Subject matter jurisdiction cannot be conferred by the parties. It can only be conferred by the statute.

**MR. BOLLINGER:** It can be raised any time.

**MR. BUSSEL:** And it can be raised any time. You can't waive it. You can raise it on appeal, even though you didn't raise it below. And so the question is, is there a viable consent doctrine? If you go that far and you say, even consent doesn't work, you've really ripped a big hole in the fabric of the system. Because to lie in the weeds and take an adverse judgment and not raise the issue and then raise it on appeal, and be able to press it on appeal, is extremely disruptive.

**JUDGE MASSEY:** I'll tell you that Congress has been very generous with the judiciary over the years, but every year for the last six, seven, eight years, the Judicial Conference has gone to great lengths to try to save money in lots of different ways. The Conference is very concerned about the possibility of major cuts to the budget. That's not going to affect the salaries of Article III judges, but it could affect how long it takes to get a case through the federal system. If consent were not possible, then I don't see how you could avoid having another 1,500 or so Article III judges, and the Article III judges don't particularly want that and neither does Congress, so hopefully the Court will take that practical advice to mind.

**MR. BUSSEL:** Well, we promised them an opportunity to ask questions. We're kind of running late. Do you want to throw it open to the floor?

**MR. BOLLINGER:** Judge Massey, do you have any other practical tips you want to bring up quickly before we go to questions?

**JUDGE MASSEY:** One thing that I would point out is when you start analyzing the core, the items that are in the part of 28 U.S.C. § 157 that lists core proceedings, think about issues like who else is affected—who besides debtors and creditors are affected, and does the matter that's to be adjudicated have the distinct odor of a matter that could've been tried in front of a jury in 1791.

I'll just throw out a couple of ideas. Section 363(h) of the Bankruptcy Code<sup>26</sup> permits the sale of non-debtor property. As far as the debtor is concerned, the property is property of the estate. It's right there. There's no dispute about it. Does the bankruptcy judge have the authority to order the sale of other people who just happen to have the bad luck of owning a piece of property with the debtor? Think about the effect that might have on them. Or on the turnover of property of the estate—that seems pretty straightforward. Well, what if the property of the estate is not in the possession of the debtor at the time of the filing and there's a dispute about whether it's property of the estate? Or suppose the property of the estate is a tax refund and the debtor in the chapter 7 case wasn't advised properly or ignored the advice of the attorney or just didn't know and spends the tax refund postpetition? It's received postpetition, spent postpetition, property of the estate. Now the trustee wants a turnover of the property of the estate. It doesn't exist anymore. I personally have questioned whether you can do that by motion, but maybe you could since the debtor is involved. But it sounds like conversion, doesn't it? It sounds like conversion.

Or what about avoiding liens against real property under § 544, or any kind of property under § 544?<sup>27</sup> Some of those kinds of claims that get made there could easily have been made in state court. It's not easy to figure out what the answer to all of this is. One way that some judges have tried to finesse this is to put in an opinion saying, I think I've got jurisdiction. That's kind of the bankruptcy practitioner/judge point of view that the Chief Justice says is not going to make a big ripple. This is just about this one case. There's one in particular out of the Southern District that I read where the bankruptcy judge said, I'm going to render a judgment on this fraudulent transfer claim, but if I didn't really have the authority to do so, please accept these findings of fact and conclusions of law as proposals. But a lot of the district courts now are saying flat-out that fraudulent transfer claims are matters that have to come before an Article III judge unless there's consent.

**MR. BOLLINGER:** Well, you have now witnessed the difficulty of squeezing a five-hour topic into about an hour. Jeremy, should we take a few minutes for questions or would you rather stay on schedule? We're happy to do either. One question. Anybody have a real urgent question?

**MR. BUSSEL:** Is it your question?

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<sup>26</sup> See 11 U.S.C. § 363(h) (2006).

<sup>27</sup> See *id.* § 544.

**MR. BOLLINGER:** If you have a question, go ahead and go to the microphone.

**JUDGE MASSEY:** No judges please.

**MR. BUSSEL:** That's what we need is judges.

**AUDIENCE MEMBER:** . . . statutory authority to estimate claims, presumably over the opposition of the creditor who doesn't want his claim estimated. There's a huge body of law about the bankruptcy court needing to be efficient and orderly and get the administration done, and not holding it up for a long period of time, which *Stern v. Marshall* is doing. So, is a possible statutory solution to give all the other chapter folks the same estimation power as in chapter 11, to benefit the economy in getting the estate resolved? And it just works in bankruptcy court, and if you want to go litigate it in state court, feel free, but for purposes of this estate, we're going to estimate the claim. What do you think?

**MR. BOLLINGER:** Dan or Judge Massey?

**MR. BUSSEL:** I think that you can do better than that. With respect to claims against the estate, I just can't believe that that's not still within the core jurisdiction. I think you can allow or disallow the claim, and it's a final judgment. If you're suggesting that you can estimate the counterclaim, I don't think that's going to be a binding judgment. I think that you're going to run headlong into *Stern v. Marshall* if you're talking about a claim out, a counterclaim against the creditor. If you're talking about a claim in, a claim against the estate, I think the bankruptcy judge can continue to do what they've always done, which is by final order allow or disallow the claim.

**MR. BOLLINGER:** Judge Massey wanted to bring up a particular case on whether or not claims were a slam dunk.

**JUDGE MASSEY:** I'll let the case speak for itself as the counterargument.

**MR. BUSSEL:** That case is wrong, by the way.

**JUDGE MASSEY:** It's the case of *In re Colony Beach & Tennis Club Association, Inc.* decided last July.<sup>28</sup> In that case, there was a dispute between a limited partnership and an association of homeowners. The association

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<sup>28</sup> *Colony Beach & Tennis Club, Ltd. v. Colony Beach & Tennis Club Ass'n (In re Colony Beach & Tennis Club Ass'n)*, 456 B.R. 545 (M.D. Fla. 2011).

members—the homeowners—were members of the association by virtue of buying the homes and they became limited partners, so they were part of both entities. The dispute was over who had the responsibility of maintaining certain common areas. Was it the partnership which had a hotel, which was generating some revenue? Or was it homeowners, which would have to be done by assessment? And so the dispute ended up in state court. The partnership sued the association. The association filed bankruptcy. The bankruptcy judge ruled for the debtor. Steve Merryday was the district judge. You've got to read it. He was not particularly happy with how the bankruptcy judge handled the factual analysis. He determined that the allowance of that claim was strictly a matter of how you interpret the contract involving the association under state law. Congress may have said it was a core matter, but it required an Article III judge to determine the amount of that claim. The problem with that, of course, is every claim just about arises under state law. And that is the ultimate nightmare.

**MR. BOLLINGER:** I have one more person sitting at—

**AUDIENCE MEMBER:** I just have two follow-up comments to keep in mind in all this discussion. One, Article III does not require presidential appointment. It does not require confirmation by the Senate to be an Article III judge. You look confused. Look at Article II that gives Congress the right to vest the appointment of inferior officers in, among other things, courts of law, just like the current system.

The second comment, just to keep in mind theoretically, *Stern v. Marshall* is not about jurisdiction of the bankruptcy court because bankruptcy courts do not have any jurisdiction. All of the jurisdiction is in the district court. *Stern v. Marshall* is about how much authority the bankruptcy judge has to determine these matters.

**MR. BUSSEL:** I think the second point is an important point. That's really the answer to the you-can't-consent argument, is to make a distinction between the subject matter jurisdiction which is vested in the federal district court, but the right of the allocation of authority between bankruptcy court and federal district court—that's not subject matter jurisdiction. That's a kind of lesser jurisdiction and consent can cure a defect there.

**JUDGE MASSEY:** And that's why you want to be sure if you get consent that it doesn't just say, "We agree, the bankruptcy judge has jurisdiction."

**MR. BUSSEL:** That's critical. On the Article III point, I think that the problem is that you can't assign the judicial power of the United States to an inferior officer. You have to assign it to a judge that's appointed consistent with the restrictions of Article III.

**MR. BOLLINGER:** Okay. Thank you very much. I apologize for going over, but thank you very much for your time.