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STERN CLAIMS AND ARTICLE III ADJUDICATION—
THE BANKRUPTCY JUDGE KNOWS BEST?
Laura B. Bartell*

In Stern v. Marshall, the Supreme Court concluded that, because bankruptcy judges are not appointed under Article III of the U.S. Constitution, they lack "constitutional authority to enter a final judgment on a state law counterclaim [constituting a core proceeding under 28 U.S.C. § 157(b)(2)(C)] that is not resolved in the process of ruling on a creditor’s proof of claim.”1 The Court stated that, in deciding whether the bankruptcy court had constitutional authority to hear and decide a core proceeding, “the question is whether the action at issue stems from the bankruptcy itself or would necessarily be resolved in the claims allowance process.”2 The decision created two immediate questions. First, how should a bankruptcy judge deal with a proceeding that is a core proceeding but which the bankruptcy judge has no power to hear and determine? Second, can the litigants consent to final adjudication of such a core proceeding (a “Stern claim”) by the bankruptcy court?

The Judicial Code authorizes bankruptcy judges to “hear and determine” core proceedings under 28 U.S.C. § 157(b)(1). The bankruptcy judge is statutorily authorized to “hear” non-core proceedings and “submit proposed findings of fact and conclusions of law to the district court” for entry of a final order or judgment under 28 U.S.C. § 157(c)(1). After the Supreme Court decision in Stern, most courts took the position that Stern claims could be treated as if they were non-core proceedings, and that bankruptcy courts could submit proposed findings of fact and conclusions of law to the district court for those claims despite the lack of statutory authority.3 The Supreme Court ultimately

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2 28 U.S.C. § 157(b)(2)(C) identifies as a “core proceeding” “counterclaims by the estate against persons filing claims against the estate.”
3 Stern, 564 U.S. at 503.
4 Id. at 499
validated this approach in *Executive Benefits Insurance Agency v. Arkison*, concluding that "when, under *Stern*'s reasoning, the Constitution does not permit a bankruptcy court to enter final judgment on a bankruptcy-related claim, the relevant statute nevertheless permits a bankruptcy court to issue proposed findings of fact and conclusions of law to be reviewed de novo by the district court."\(^7\)

Whether litigants in a proceeding involving a *Stern* claim could constitutionally consent to the final adjudication of the claim by a bankruptcy judge, just as litigants could do with respect to non-core proceedings under 28 U.S.C. § 157(c)(2), divided the courts.\(^8\) Again, the Supreme Court resolved the dispute in *Wellness International Network Ltd. v. Sharif*,\(^9\) holding that "litigants may validly consent to adjudication by bankruptcy courts"\(^10\) so long as that consent is "knowing and voluntary."\(^11\)

In this Article, I attempt to ascertain how *Stern* claims have been treated since the Supreme Court decisions in *Arkison* and *Wellness*. My first conclusion is that bankruptcy courts find very few core proceedings that they determine are governed by *Stern* and therefore are beyond their constitutional power to decide. With respect to those few proceedings that they find are *Stern* claims, most are heard and determined by the bankruptcy judge by litigant consent. Even if the bankruptcy judge concludes it is unable to determine the matter without consent and submits proposed findings of fact and conclusions of law to the district court, the district court almost always adopts those findings of fact and conclusions of law, making the non-Article III bankruptcy court the final decision-maker in substance, while allowing the district court the formal task of entering judgment.

\(^8\) Id. at 2168.
\(^11\) Id. at 1942.
\(^12\) Id. at 1948.
Therefore, for almost all proceedings for which Stern held that the litigants are constitutionally entitled to a final decision by an Article III judge, the substantive decision is made by the bankruptcy judge, although formally entered by the district court.

A. Scope of the Study

For purposes of my investigation, I first searched in Westlaw for all cases in bankruptcy court which mentioned “Stern v. Marshall” from May 26, 2015, the date the Supreme Court decided Wellness, through the end of calendar year 2017. There were 495 such cases. Although many courts were dealing with so-called Stern claims during the four years before Wellness was decided (and the three years before Arkison), they were still grappling with the issues of whether bankruptcy courts had the statutory authority to enter proposed findings of fact and conclusions of law, and whether consent permitted them to hear and determine claims they were otherwise constitutionally precluded from deciding. Therefore, to obtain a manageable sample, I confined my inquiry to cases decided after those issues were put to rest. I then searched for all bankruptcy court cases citing Arkison but not Stern (an additional sixteen cases), or Wellness but not Arkison or Stern (another seventy-five cases), in each case during the same period.

Because many adversary proceedings that may present a claim beyond the bankruptcy court’s constitutional power to decide are unreported, I also searched Westlaw for reported decisions of district courts during the same period in which the court was considering a bankruptcy matter, and was reviewing “proposed findings of fact” or a “report and recommendation.” I then searched the docket of the bankruptcy court proceeding giving rise to the district court decision and looked at any proposed findings of fact and conclusions of law issued during the period of the study.

I looked for those cases in which the court discussed whether it had the constitutional authority to decide a core matter. There have been conflicting views of the scope of the Stern decision. Many courts adopt the “narrow” view, interpreting Stern as invalidating only 28 U.S.C. § 157(b)(2)(C), leaving all

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13 I excluded cases decided by the bankruptcy appellate panels, which are included in the bankruptcy court library on Westlaw.
14 See, e.g., cases in note 6 supra.
15 See, e.g., cases in note 9 supra.
16 There may be cases in which the bankruptcy court considered whether it could constitutionally decide disputes after Wellness in which the court did not cite Stern, Arkison, or Wellness, but those cases would be difficult to find.
other “core” proceedings listed in § 157(b) unaffected.17 Other courts conclude that Stern cast doubt on the constitutionality of other provisions of § 157(b), and absent consent, the bankruptcy court may not constitutionally decide any matter that is based on state law and that is not necessarily resolved in connection with the allowance of an asserted claim.18 For example, some courts take the position that proceedings seeking to recover preferential transfers, also core proceedings under 28 U.S.C. § 157(b)(2)(F), constitute Stern claims,19 while other courts disagree.20 Whichever view a court adopts, I have examined those cases in which that court treats the particular dispute as if it is, or might be, governed by Stern, even if other courts would disagree and would hear and determine the same dispute.

17 See e.g., Deitz v. Ford ((In re Deitz), 760 F.3d 1038, 1045–46 (9th Cir. 2014); Badami v. Sears (In re AFY, Inc.), 461 B.R. 541, 547–48 (8th Cir. B.A.P. 2012); Tanguy v. West (In re Davis), 558 Fed. Appx. 440, 443 (5th Cir. 2013), cert. denied sub nom., Tanguy v. West., 134 S. Ct. 1002 (2014); in re 9 Hous. LLC, 578 B.R. 600 (Bankr. S.D. Tex. 2017); in re Trust Sand, LLC, 569 B.R. 435 (Bankr. S.D. Tex. 2017); Tyler v. Banks (In re Tyler), 493 B.R. 905 (N.D. Ga. 2013); Burch v. Scaport Cap., LLC (In re Direct Response Media, Inc.), 466 B.R. 626 (Bankr. D. Del. 2013). To support this view, courts cite Chief Justice Roberts’s statements in Stern that the question presented there was a “narrow” one; that Congress had violated Article III of the Constitution “in one isolated respect”; and that removal of state law counterclaims that are not resolved in the process of ruling on a creditor’s proof of claim from the definition of core does not “meaningfully” change “the division of labor in the current statute.” Stern, 564 U.S. at 502.


In most cases, the bankruptcy court transmitted the case to the district court because it determined that the matter before it was non-core. In other cases the


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plaintiff sought relief other than a final adjudication of the Stern claim (such as a dismissal under Federal Rule of Civil Procedure Rule 12(b)(6), or ordering remand, or denying summary judgment, or enforcing arbitration, or other interlocutory relief), and therefore the bankruptcy court concluded that it was not subject to the constitutional prohibition of Stern. Some cases citing Stern, Arkison, or Wellness did so for reasons other than final determination of a claim.
(such as considerations of motions for withdrawal, arbitration, abstention, dismissal for lack of jurisdiction, request for jury trial, and other relief), and I did not include those cases.

B. The Problem of Finding Stern Claims

After eliminating non-core matters, interlocutory matters, and cases in which an analysis of Stern was not at issue, I then looked at all the remaining cases to see if any of them involved Stern claims. I found that in almost all the remaining cases, hundreds of them, the bankruptcy court concluded that the matter before it was constitutionally core, i.e., statutorily core under 28 U.S.C. § 157(b)(2), and the bankruptcy court had the constitutional power to hear and decide it without litigant consent. The vast majority of those cases involved dischargeability of a debt under 28 U.S.C. § 157(b)(2)(I), or allowance or

claims or exemptions under 28 U.S.C. § 157(b)(2)(B), matters on which there cannot be any controversy about the ability of a bankruptcy court to hear and

determine the dispute. Other issues that were frequently analyzed under the Stern doctrine included core matters listed in almost all the other provisions of 28 U.S.C. § 157(b)(2), including motions for turnover of property of the estate under 28 U.S.C. § 157(b)(2)(E),25 motions to avoid preferential transfer under 28


Among the other matters found to be constitutionally core were the following:

- motion to disqualify counsel for claimant See In re MCK Millennium Ctr. Retail, LLC, 571 B.R. 783, 784 (Bankr. N.D. Ill. 2017).
counterclaims by the estate against persons filing claims against the estate, defined as core under 28 U.S.C. § 157(b)(2)(C), which was the section found constitutionally infirm in *Stern* to the extent that the counterclaim would not “necessarily be resolved in the claims allowance process,”35 the bankruptcy courts found, in most cases, that they could constitutionally decide the

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35 Stern, 564 U.S. at 499.
counterclaim because it was in fact necessary to the resolution of the claim filed by the defendant. 36

Although one might expect a bankruptcy court to discuss Stern when presented with a counterclaim described in 28 U.S.C. § 157(b)(2)(C), it is more surprising that bankruptcy courts found it necessary to discuss Stern in connection with other core matters. In fact, most bankruptcy courts rarely do so. Of the 495 cases citing Stern during the period of the survey, only ten districts had ten or more bankruptcy cases citing the case. 37

But certain districts seem to fixate on Stern far more than others. For example, of those 495 cases, 102 of them were in the Southern District of Texas, a remarkable number for a district with a relatively small caseload. The Southern District of Texas shows a similar focus on Wellness, citing that decision eighty-one times through the end of 2017. The district with the second most cases citing Stern and Wellness was the Northern District of Illinois, with sixty-nine citations of Stern and thirty-one citations to Wellness during the same period. The others had thirty-two or fewer cases citing Stern and fifteen or fewer cases citing Wellness during the period of the survey. (Citations to Arkison were relatively rare in all districts.)

Many of the bankruptcy courts that concluded that the core matter before them was within their constitutional powers to decide also relied on consent of the litigants to confer adjudicative power 38 (an approach that appears to be


37 These districts were the Central District of California, the Northern and Central District of Illinois, the District of Maryland, the Southern and Eastern District of New York, the Northern and Southern District of Ohio, and the Northern and Southern District of Texas.

adopted most often by bankruptcy judges in the Southern District of Texas\(^3\). As discussed in Part C(1) infra, if the parties have consented to a determination

\[^{3}\text{An example of a typical discussion of } \textit{Stern v. Marshall} \text{ in a case before Judge Bohm of the bankruptcy court for the Southern District of Texas follows:}\]

C. Constitutional Authority to Enter a Final Order

In the wake of the Supreme Court’s issuance of \textit{Stern v. Marshall}, — U.S. —, 131 S.Ct. 2594, 180 L.Ed.2d 473 (2011), this Court is required to determine whether it has the constitutional authority to enter a final order in any dispute brought before it. In \textit{Stern}, which involved a core proceeding brought by the debtor under 28 U.S.C. § 157(b)(2)(C), the Supreme Court held that a bankruptcy court “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.” \textit{Id}. at 2620. The pending dispute before this Court is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(A) and (O) because whether or not to dismiss this case concerns the administration of this estate and also affects the adjustment of the relationship between the Debtor and his creditors. Because \textit{Stern} is replete with language emphasizing that the ruling is limited to the one specific type of core proceeding involved in that dispute, this Court concludes that the limitation imposed by \textit{Stern} does not prohibit this Court from entering a final order here. A core proceeding under § 157(b)(2)(A)
by the bankruptcy court, the court does not have to decide whether the matter before it is constitutionally core, a *Stern* claim, or a non-core matter.

Out of the hundreds of cases I looked at during the period of the survey, I found only forty-two cases in which the bankruptcy court indicated that it might be dealing with a core claim the court could not constitutionally decide.  

and (O) is entirely different than a core proceeding under § 157(b)(2)(C). See, e.g., *Badami v. Sears (In re Afy, Inc.)*, 461 B.R. 541, 547–48 [sic] (8th Cir. B.A.P. 2012) ("Unless and until the Supreme Court visits other provisions of §157(b)(2), we take the Supreme Court at its word and hold that the balance of the authority granted to bankruptcy judges by Congress in 28 U.S.C. § 157(b)(2) is constitutional."); see also *In re Davis*, 538 Fed.Appx. 440, 443 (5th Cir.2013) cert. denied sub nom. Tanguy v. W., — U.S. —, 134 S.Ct. 1002, 187 L.Ed.2d 851 (2014) ("While it is true that Stern invalidated 28 U.S.C. § 157(b)(2)(C) with respect to 'counterclaims by the estate against persons filing claims against the estate,' Stern expressly provides that its limited holding applies only in that 'one isolated respect.' . . . We decline to extend Stern's limited holding herein.").

Alternatively, even if *Stern* applies to all of the categories of core proceedings brought under § 157(b)(2), see *In re Renaissance Hosp. Grand Prairie Inc.*, 713 F.3d 285, 294 n. 12 (5th Cir.2013) ("Stern's 'in one isolated respect' language may underestimate the totality of the encroachment upon the Judicial Branch posed by § 157(b)(2) . . ."). this Court still concludes that the limitation imposed by *Stern* does not prohibit this Court from entering a final order in the dispute at bar. In *Stern*, the debtor filed a counterclaim based solely on state law; whereas, here, the Motion brought by the UST is based solely on express Code provisions (§§ 706(b) and 707(a)) and judicially-created bankruptcy law interpreting these provisions; there is no state law involved whatsoever. This Court is therefore constitutionally authorized to enter a final order on the Motion. See *In re Airhart*, 473 B.R. 178, 181 (Bankr.S.D.Tex.2012) (noting that the court has constitutional authority to enter a final order when the dispute is based upon an express provision of the Code and no state law is involved).

Finally, in the alternative, this Court has the constitutional authority to enter a final order on the Motion because all the parties in this contested matter have consented, impliedly if not explicitly, to adjudication of this dispute by this Court. *Wellness Int'l Network, Ltd. v. Sharif*, — U.S. —, 135 S.Ct. 1932, 1947, 135 S.Ct. 1932 (2015) ("Sharif contends that to the extent litigants may validly consent to adjudication by a bankruptcy court, such consent must be expressed. We disagree. Nothing in the Constitution requires that consent to adjudication by a bankruptcy court be expressed. Nor does the relevant statute, 28 U.S.C. § 157, mandate express consent. . ."). Indeed, the UST filed the Motion in this Court, [Finding of Fact No. 4]; the Debtor filed the Response opposing the Motion, [Finding of Fact No. 5], and the parties proceeded to make a record in a multi-day hearing without ever objecting to this Court’s constitutional authority to enter a final order on the Motion, [Finding of Fact No. 6]. If these circumstances do not constitute consent, nothing does.

In *In re Wilcox*, 539 B.R. at 145–46. Almost identical language appears in all of the cases from the bankruptcy court for the Southern District of Texas listed in note 38 supra decided by Judge Bohm, modified only to reflect the core proceeding in the particular case, and the evidence of consent.

Despite the apocalyptic predictions after the Supreme Court’s decision in 
Stern,41 it seems that the bankruptcy courts have in fact concluded that, as Chief Justice Roberts suggested in the opinion, Stern “does not change all that much.”42
What claims have the courts found to be governed by *Stern*? They generally fall into one of two categories. First, courts have concluded that counterclaims by the trustee against a claimant that are statutorily core under 28 U.S.C. § 157(b)(2)(C) but seek an affirmative recovery beyond the amount of a filed claim (if any) are *Stern* claims. These are the claims that were at issue in *Stern*, and the Supreme Court there decided that they are beyond the power of a bankruptcy court to hear and determine.

For example, in *Global Computer Enterprises*, the debtor filed an adversary proceeding objecting to a proof of claim filed by the defendant law firm, but also seeking recovery of attorneys’ fees paid to the law firm before the bankruptcy filing and alleging legal malpractice. *Patwari* involved the bankruptcy of a franchisee who made prepetition claims against the franchisor (and others) in response to an arbitration award against the franchisee. (The case was referred to the bankruptcy court after the franchisee filed for bankruptcy protection). In both these cases, the parties consented to adjudication by the bankruptcy court.

However, the litigants did not consent in the other case in which counterclaims were asserted by the debtor against a claimant. In *Alexander*, the plaintiff filed a proceeding alleging wrongful foreclosure against a mortgagee who had obtained a judgment awarding possession of the debtor’s house prior to the bankruptcy filing and did not file a proof of claim for its deficiency. The bankruptcy court issued proposed findings of fact and conclusions of law to the district court recommending dismissal of the plaintiff’s proceeding.

The second (and much larger) category of cases in the study in which courts found themselves potentially constrained by *Stern* from entering final decisions involves avoidance actions under 28 U.S.C. § 157(b)(2)(F) (preferences) and (H) (fraudulent conveyances).

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45 *In re Patwari*, 2016 WL 1577842.
The decision to treat fraudulent transfer actions as *Stern* claims stems from the Supreme Court’s prior treatment of such claims in earlier decisions. In *Granfinanciera, S.A. v. Nordberg*, the Court held that a defendant in a fraudulent conveyance action had a right to a jury trial because such an action is “more accurately characterized as a private rather than a public right” and fraudulent transfer suits “are quintessentially suits at common law that more nearly resemble state-law contract claims brought by a bankrupt corporation to augment the bankruptcy estate than they do creditors’ hierarchically ordered claims to a pro rata share of the bankruptcy res.” In *Stern*, the Court equated the state-law counterclaim at issue with a fraudulent conveyance action, suggesting that, “like the fraudulent conveyance claim at issue in *Granfinanciera*, [the counterclaim did] not fall within any of the varied formulations of the public rights exception in this Court’s cases.” The counterclaim was created by common law, not by Congress, and therefore the Court held that it should be decided by an Article III court. The Supreme Court has never held that a fraudulent transfer is a *Stern* claim, but in *Arkison* the Court

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noted that “[t]he Ninth Circuit held that the fraudulent conveyance claims at issue here are Stern claims—that is, proceedings that are defined as ‘core’ under §157(b) but may not, as a constitutional matter, be adjudicated as such (at least in the absence of consent, . . . . See 702 F. 3d, at 562) ]. Neither party contests that conclusion.”

Preferences are arguably different matters, in that they do not exist outside of a bankruptcy case and, by definition, constitute transfers that occur within a specified period “before the date of the filing of the [bankruptcy] petition.” Nevertheless, in Granfinanciera (in which no preference actions were at issue), the Supreme Court said that “actions to recover preferential or fraudulent transfers were often brought at law in late 18th-century England,” before concluding that fraudulent transfer actions were suits at law rather than equity. However, the Supreme Court recognized in Langencamp v. Culp that the bankruptcy court has the constitutional authority to determine preference actions against a creditor who has filed a claim in the bankruptcy case because “the ensuing preference action by the trustee become[s] integral to the restructuring of the debtor-creditor relationship.” Similarly, in Katchen v. Landy, the Supreme Court allowed a bankruptcy referee to exercise summary jurisdiction over a voidable preference claim brought against a creditor who had filed a proof of claim because resolution of the preference action was a necessary prerequisite to a ruling on the proof of claim.

After Langencamp and Katchen—holdings that were endorsed by the Court in Stern—if a fraudulent transfer or preference action is brought by the trustee against an entity that has filed a proof of claim in the bankruptcy case, the bankruptcy court has the constitutional power to hear and determine the action to the extent necessary to resolve the filed claim. By contrast, the Supreme Court in Stern suggested that Langencamp and Katchen would not allow a bankruptcy court to determine an avoidance action against a creditor that had not filed a proof of claim because resolution of the preference action would not

53 Arkison, 134 S. Ct. at 2172.
55 Granfinanciera, 492 U.S. at 43.
57 Id. at 45.
59 Id. at 329-30.
60 Stern, 564 U.S. at 495–97.
61 This is why many courts find that these matters are constitutionally core, see cases in notes 26 and 28 supra.
be part of the claims allowance process. Presumably, the same analysis would apply if the trustee seeks to recover an amount that exceeds the claim filed by the transferee.

Because, as discussed below, the defendants in almost all of the preference and fraudulent transfer proceedings in cases in this survey consented to adjudication by the bankruptcy court, the court had no reason to discuss whether it would have had jurisdiction to decide the matter under Langencamp and Katchen. Indeed, most of the courts never mention whether the defendant had filed a proof of claim.

The other cases in which courts found Stern to be implicated are more difficult to classify (or to understand why the court felt constrained by Stern). For example, in Fisher, the bankruptcy court had “doubts” about whether it could dismiss counterclaims against the bankruptcy trustee (who had sued the counterclaimants seeking declaratory relief about ownership of a deposit made by the debtor in connection with a prepetition real estate transaction) alleging malfeasance by the trustee. Such a counterclaim cannot exist outside a bankruptcy case, and cannot be subject to Stern.

Similarly, in Jordan, the action was aimed at deciding whether a mortgage originated by an unlicensed lender and then sold to JPMorgan Chase Bank was valid. Although the court recognized that this was a core proceeding under 28 U.S.C. § 157(b)(2)(K) (one to determine the validity, extent, or priority of liens), because JPMorgan Chase did not file a proof of claim, the court believed it might be a Stern claim. Because all parties consented to final determination by the bankruptcy court, no further consideration of the issue was necessary, but the

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62 Stern, 564 U.S. at 497.
63 See Part (C)(1) infra.
64 See Part (C)(1) infra.
66 Id. at *1.
claim should not have been governed by Stern. In another adversary proceeding against JPMorgan Chase with respect to foreclosure of a mortgage on the debtor’s property, the court in Gillies68 labelled the complaint by the debtor a core proceeding under 28 U.S.C. § 157(b)(2)(A), (B), (K) and (O), but still issued proposed findings because the parties did not consent to bankruptcy court adjudication. The debtor in Carswell69 sought to prevent foreclosure on the property securing its debt and to declare the notes and deed of trust invalid. The court characterized the proceeding as core under 28 U.S.C. § 157(b)(2)(A), (B), (K) and (O), but again issued proposed findings of fact and conclusions of law because the plaintiff did not consent. All these proceedings were in fact constitutionally core and should not have been taken to the district court.

Other proceedings treated as presenting potential Stern claims were most likely non-core. In Willett,70 the dispute was one between neighbors (including the debtor) regarding water usage pursuant to a well agreement. Similar litigation began even before the bankruptcy case, and certainly did not “arise in” the case within the meaning of 28 U.S.C. § 1334(b). Nevertheless, the court suggested it was a core proceeding under 28 U.S.C. § 157(b)(2)(A) and (O), but had non-core claims as well and relied on the consent of the parties to adjudicate it. Similarly, in Plaza Healthcare Center,71 the litigation involved the ability of the debtor to exercise an option to extend a lease agreement. The court stated that it had “elected to treat this adversary proceeding as a non-core matter” and was submitting proposed findings of fact and conclusions of law to the district court “[p]ursuant to Stern v. Marshall.”

Two cases, Silva72 and Brack,73 purported to be turnover proceedings, designated by the court as core under 28 U.S.C. § 157(b)(2)(E). The debtor in Silva claimed that she had acquired ownership of the defendant’s property by adverse possession and therefore it should belong to the estate. In Brack, the trustee sought spousal support arrearages from the debtor’s former spouse. These cases in fact present non-bankruptcy contract and statutory claims and were non-core rather than Stern claims. When the debtor is seeking property in

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which the debtor did not previously have an ownership interest as a matter of
state property law, that claim is likely non-core rather than a Stern claim.74
Neither of the courts actually held the claims to be Stern claims: in Silva
the parties consented to adjudication by the bankruptcy judge, and in Brack the
court issued proposed findings of fact and conclusions of law. That resolution
was appropriate for non-core matters, as it would have been for Stern
claims.

In Ralph Roberts Realty,75 the debtor claimed that certain profits made by
the defendants upon the sale of properties that belonged to the debtor. Again,
there is little doubt that the claim was non-core, but because the litigants had
consented, the court declined to label it.

C. How Does the Bankruptcy Court Deal with Stern Claims

1. Consent

By far the most prevalent treatment of a Stern claim in the bankruptcy courts
since the decision in Wellness76 is for the litigants to consent to final adjudication
by the bankruptcy judge. The creditor in Wellness filed an adversary proceeding
seeking to deny the debtor, Mr. Sharif, a discharge, and seeking a declaratory
judgment that the assets of a trust, purportedly administered by Mr. Sharif for
his mother, was his alter ego and its assets were assets of the estate.77 Mr. Sharif
conceded in his answer to the complaint that the adversary proceeding was a

74 As the court explained in Charter Crude Oil Co. v. Exxon Co. U.S.A. (in re Charter Co.), 913 F.2d
1575, 1579 (11th Cir. 1990):

Turnover proceedings are not to be used to liquidate disputed contract claims.... Congress
envisioned the turnover provision of [11 U.S.C. § 542] to apply to tangible property and money
due to the debtor without dispute which are fully matured and payable on demand.... To apply
turnover principles to [a] dispute between [a creditor] and [debtor] would allow [the debtor] to
recover monies under the Bankruptcy Code from disputed claims based strictly on state law.
Certainly such procedure could not be sanctioned outside bankruptcy and there is no just reason
why it should be sanctioned just because the entity seeking to collect disputed funds happens to be
a debtor under the Bankruptcy Code.

Id.

75 Ralph Roberts Realty, LLC v. Savoy (In re Ralph Roberts Realty, LLC), 562 B.R. 144 (Bankr. E.D.


77 Wellness, 135 S. Ct. at 1940.
"core" matter under 28 U.S.C. § 157(b)(2) and he responded to the allegations against him, seeking a favorable judgment from the bankruptcy judge.\[78\]

After judgment was entered against Mr. Sharif and he appealed the judgment to the district court, *Stern* was decided. Mr. Sharif did not cite *Stern* in his initial brief to the district court filed six weeks after *Stern* was issued, but sought permission to file a supplemental brief claiming that the bankruptcy court lacked the power to decide his case. The district court declined to permit supplemental briefing, finding that Mr. Sharif had waived his right to assert the issue by his delay in raising it, and affirmed the bankruptcy court on all counts.\[79\] The Seventh Circuit reversed, holding that, because *Stern* implicated structural concerns between Article III courts and bankruptcy judges, Mr. Sharif’s *Stern* objection to the power of the bankruptcy court was not waived and that the bankruptcy court lacked the constitutional power to enter a judgment on one of the claims asserted against him.\[80\]

The Supreme Court reversed the Seventh Circuit, holding that "litigants may validly consent to adjudication by bankruptcy courts."\[81\] Rejecting the contention of Mr. Sharif that such consent must be express to be effective, the Supreme Court referred to its prior decision in *Roell v. Withrow*,\[82\] which held that consent to adjudication by magistrate judges could be based on “actions rather than words.”\[83\] That “implicit consent” standard was, the Court held, the appropriate one for bankruptcy cases as well.\[84\] The Court emphasized that a litigant’s consent—whether express or implied—must still be knowing and voluntary. *Roell* makes clear that the key inquiry is whether “the litigant or counsel was made aware of the need for consent and the right to refuse it, and still voluntarily appeared to try the case” before the non-Article III adjudicator.\[85\]

The Supreme Court remanded the case to the Seventh Circuit for a determination of whether Sharif’s actions evinced the requisite knowing and voluntary

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\[78\] *Id.* at 1941. 
\[80\] Wellness Intern. Network, Ltd. v. Sharif, 727 F.3d 751, 773 (7th Cir. 2013). The Seventh Circuit affirmed the district court with respect to all causes of action relating to the debtor’s discharge, but concluded that the claim seeking a declaratory judgment that a trust the debtor claimed he administered for his mother and sister was his “alter ego” and should be treated as part of the bankruptcy estate was beyond the constitutional power of the bankruptcy court to decide. *Id.* at 775–76. 
\[81\] Wellness, 135 S. Ct. at 1939. 
\[83\] *Id.* at 589, 590. 
\[84\] Wellness, 135 S. Ct. at 1948. 
\[85\] *Id.* (citing *Roell*, 538 U.S. at 590).
consent, and also whether, as Wellness contends, Sharif forfeited his *Stern* argument below. On remand, the Seventh Circuit concluded that Mr. Sharif forfeited his *Stern* claim by waiting too long to raise it, and reinstated the judgment against him. Wellness, therefore, tells us that knowing and voluntary consent is required, but does not tell us what actions meet that standard.

Until December 1, 2016, the Federal Rules of Bankruptcy Procedure provided no mechanism for parties to consent to adjudication of a core claim by a bankruptcy judge. Rule 7008(a), applicable to all adversary proceedings in a bankruptcy case, required that “the complaint, counterclaim, cross-claim, or third-party complaint shall contain a statement that the proceeding is core or non-core and, if non-core, that the pleader does or does not consent to the entry of final orders or judgment by the bankruptcy judge.” Similarly, Rule 7012(b) required that a responsive pleading “admit or deny an allegation that the proceeding is core or non-core” and only “[i]f 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.” The Rules have been amended, effective December 1, 2016, to facilitate consent to final determinations of *Stern* claims by the bankruptcy courts.

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86 Id. at 1949.
89 Fed. R. Bankr. P. 7012(b) (emphasis added) (as in effect prior to Dec. 31, 2017).
90 In the revised Federal Rule of Bankruptcy Procedure 7008, the pleader no longer has to specify whether the proceeding is core or non-core, and must always “include a statement that the pleader does or does not consent to entry of final orders or judgment by the bankruptcy court.” Similarly, Rule 7012(b) required that a responsive pleading “admit or deny an allegation that the proceeding is core or non-core” and only “[i]f 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 court.” The final sentence of former Rule 7012(b), which stated that “[i]n 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,” was eliminated.

The bankruptcy court is directed, in new Rule 7016(b), to decide whether to hear and determine the proceeding, hear the proceeding and issue proposed findings of fact and conclusions of law, or take some other action. Rule 9027(a)(1) now requires the party filing the notice to remove a claim or cause of action include in that notice “a statement that upon removal of the claim or cause of action, the party filing the notice does or does not consent to entry of final orders or judgment by the bankruptcy court.” Rule 9027(c)(3) requires any party filing a pleading in connection with the removed claim or cause of action (other than the party filing the notice of removal), must file “a statement that the party does or does not consent to entry of final orders or judgment by the bankruptcy court.” Both provisions formerly required statements regarding the core or non-core nature of the claim or cause of action, and limited the statement regarding consent to non-core matters.

Rule 9033 was formerly entitled, “Review of Proposed Findings of Fact and Conclusions of Law in Non-Core Proceedings,” and, in clause (a), directed the bankruptcy judge to file proposed findings of fact and conclusions of law “[i]n non-core proceedings heard pursuant to 28 U.S.C. § 157(c)(1).” It then directed the clerk to serve copies on all parties. The revised Rule 9033 deletes the words “in Non-Core Proceedings” from its title, and in clause (a) simply directs the clerk to serve copies of proposed findings of fact and conclusions of law “[i]n a proceeding in which the bankruptcy court has issued” them.
In twenty-four of the forty-two Stern cases in this study, the court concluded that the parties had consented to final determination by the bankruptcy judge of what the court thought might be considered a Stern claim or forfeited their right to object. In eighteen of those cases, the court indicated that the consent was explicit.

In the others, the court found implicit consent in various ways. In some cases, consent was implied by the litigants' failure to raise objection to the bankruptcy court's determination of the proceeding, coupled with active participation in court. But in other cases, the court concluded that failure to respond in court after being notified of the consequences of non-appearance constitutes implied consent to the entry of a default judgment by the bankruptcy court or forfeiture of the right to object.


93 See In re Allegro L., 545 B.R. at 700 (assertion of counterclaims and filing administrative claim constituted implied consent); In re Fatoorechi, 564 B.R. at 789 (failure to object at any stage, admission that the case was a core proceeding, no demand for jury trial, seeking final judgment through sophisticated counsel constituted implied consent).

94 See In re Fannon, 2015 WL 9594302, at *4 n.1 (failure to respond to summary judgment motion); In re Frye, 2015 WL 9595306, at *4 n.2 (failure to respond to summary judgment motion); In re Hoku, 2015 WL 8488949, at *3 (failure to respond to summons and complaint).
Other cases also demonstrate a broad view of implied consent, equating failure to object (silence) with implied consent, especially when coupled with any participation in the proceeding. Although the result may seem harsh (and difficult to square with the requirement of Wellness for consent to be “knowing and voluntary”), they can be understood as a form of forfeiture rather than consent—failure to exercise one’s rights in a timely manner which leads to loss of those rights. This is the analysis adopted by the Seventh Circuit on remand in Wellness. The judicial system cannot countenance gamesmanship, where litigants keep silent about their desire for an Article III judge until they lose before a bankruptcy judge.

Because consent is always effective to confer constitutional authority to determine a claim or cause of action, in many cases the bankruptcy court never decides whether it would have authority in the absence of consent to decide the pending proceeding. Instead, the court will often proceed to decide a dispute without determining whether it is a Stern claim because the parties have consented to determination by the bankruptcy court. Indeed, in many recent cases involving fraudulent transfers or preferences that may be beyond the

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97 See discussion at note 87 supra.


In many of the non-core proceedings included in this survey litigants also consented to adjudication by the bankruptcy court.\footnote{When the bankruptcy court concludes that it does not have the constitutional authority to hear and determine a matter only if the parties (1) claim that the proceeding is governed by Stern, and (2) do not consent to adjudication by a non-Article III judge, either expressly or impliedly. Such cases are very rare.} The bankruptcy court needs to decide whether it has constitutional authority to enter a final determination on a claim without consent, and no consent has been forthcoming, it issues proposed findings of fact and conclusions of law (PPFCL) to the district court under 28 U.S.C. § 157(c)(1).\footnote{28 U.S.C. § 157(c)(1) allows a bankruptcy judge to “hear a proceeding that is not a core proceeding but hat is otherwise related to a case under title 11” and directs the judge “[i]n such [non-core] proceeding” to “submit proposed findings of fact and conclusions of law to the district court, and any final order or judgment entered by the court shall be reviewable as a matter of right.”}

The bankruptcy court’s proposed findings and conclusions of law are the subject of this article and are discussed in the next section.

2. Proposed Findings of Fact and Conclusions of Law

When the bankruptcy court concludes that it does not have the constitutional authority to enter a final determination on a claim without consent, and no consent has been forthcoming, it issues proposed findings of fact and conclusions of law (PPFCL) to the district court under 28 U.S.C. § 157(c)(1).
By its terms, § 157(c)(1) applies only to proceedings that are not core proceedings, but the Supreme Court concluded unanimously in *Arkison* that whenever a bankruptcy court could not constitutionally hear and determine a claim, the court had the statutory authority to issue proposed findings of fact and conclusions of law pursuant to § 157(c)(1).

In *Arkison*, the bankruptcy trustee asserted fraudulent conveyance claims, both under § 548 of the Bankruptcy Code and state law, against Executive Benefits Insurance Agency, Inc., a company created with assets transferred from the debtor, Bellingham Insurance Agency, Inc. at the direction of their common owners after the debtor became insolvent and ceased operations. The bankruptcy court granted summary judgment to the trustee, and Executive Benefits appealed. The district court conducted a de novo review of the bankruptcy court determination, and affirmed. After Executive Benefits appealed to the Ninth Circuit, the Supreme Court decided *Stern*, and Executive Benefits moved to dismiss the appeal for lack of jurisdiction, claiming that the bankruptcy court had no authority to decide the fraudulent transfer claims.

The Ninth Circuit affirmed the decision of the district court. The court held that the fraudulent transfer claims at issue were, in fact, *Stern* claims that were not within the constitutional power of the bankruptcy court to decide. Nevertheless, the court concluded that Executive Benefits had impliedly consented to adjudication by the bankruptcy court and in any event, the district court provided de novo review of the bankruptcy court decision, the same level of review that would be provided had the bankruptcy court issued proposed findings of fact and conclusions of law with respect to the claims.

Because both parties agreed that the fraudulent transfer claims were governed by *Stern*, the Supreme Court “assume[d] without deciding, that the fraudulent conveyance claims in this case are *Stern* claims.” Relying on the severability clause in the Judicial Code provisions applicable to bankruptcy

shall be entered by the district judge after considering the bankruptcy judge’s proposed findings and conclusions and after reviewing de novo those matters to which any party has timely and specifically objected.” *Id.*

*Id.* at 2169.

*Id.* at 2169.

*Id.* at 565.

*Id.* at 566, 568.

*Id.* at 566.

*Arkison*, 134 S. Ct. at 2174.
courts, which provides that other provisions are not affected if any provision is held invalid, the Supreme Court concluded that Stern had implicitly held invalid the application of 28 U.S.C. § 157(b) to Stern claims, which left unaffected the provisions of 28 U.S.C. § 157(c). Because Stern claims can no longer be "core" matters, and because the Court concluded that fraudulent transfer claims are "self-evidently 'related to a case under title 11," § 157(c)(1) (which applies to "a proceeding that is not a core proceeding but that is otherwise related to a case under title 11") must be applicable.

Although the bankruptcy court did not follow the procedures set forth in § 157(c)(1) by issuing proposed findings of fact and conclusions of law, the Court noted that the district court actually provided the same de novo review it would have provided had the bankruptcy court done so. Therefore, the Court concluded that the district court cured any jurisdictional error and affirmed the judgment of the Court of Appeals.

To find cases in which the bankruptcy court issued proposed findings of fact and conclusions of law because of Stern, I searched for all bankruptcy cases during the period of the survey that mentioned Stern or Wellness or Arkison or § 157(c)(1) and the term "proposed findings of fact" or "report and recommendation" or similar language. In most of those cases, the court simply discussed its obligations with respect to non-core claims or Stern claims, or the bankruptcy court was making a recommendation with respect to withdrawal of the reference or dismissal of an appeal or other procedural matters. But in seventy-one cases, the bankruptcy court issued what it characterized as proposed findings of fact and conclusions of law or a report and recommendation dealing with the substance of an adversary proceeding. In most of those cases, the

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Arkison, 134 S. Ct. at 2173.
Id. at 2174.
Arkison, 134 S. Ct. at 2175.


bankruptcy court followed this procedure because the court concluded that one or more of the claims under consideration were non-core. However, in twenty-

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one cases in the study, the court issued proposed findings of fact and conclusions of law because it concluded that the dispute was (or may be) a Stern claim and the parties did not consent to a final determination by the bankruptcy court.119
These cases included fourteen in which the dispute involved alleged fraudulent transfers,\textsuperscript{120} one which involved an alleged preference,\textsuperscript{121} and the remaining six involved claims that were either probably core claims that the bankruptcy court could have constitutionally decided,\textsuperscript{122} or claims that appeared to be non-core.\textsuperscript{123}

3. District Court De Novo Review

Once a bankruptcy court has produced proposed findings of fact and conclusions of law under 28 U.S.C. § 157(c)(1) (whether because the proceeding is non-core or alternatively is core but beyond the constitutional competence of the bankruptcy court to decide), the bankruptcy court is required to serve copies on all parties,\textsuperscript{124} and transmit the PFFCL to the district court.\textsuperscript{125} Those so served have fourteen days to serve and file written objections to the PFFCL, identifying the specific proposed findings or conclusions to which they object and stating the grounds for the objection.\textsuperscript{126} The other parties then have another fourteen days after service to respond to those objections.\textsuperscript{127} The district court provides a de novo review of any portion of the bankruptcy court’s PFFCL to which an objection has been made in accordance with the requirements of the rules.\textsuperscript{128}

The district court has broad discretion as to its disposition of a proceeding transmitted in this fashion. It may “accept, reject, or modify the proposed findings of fact or conclusions of law, receive further evidence, or recommit the


\textsuperscript{121} In re Big Apple Volkswagen, LLC, 2016 WL 1069303.


\textsuperscript{124} Fed. R. Bankr. P. 9033(a).

\textsuperscript{125} 28 U.S.C. § 157(c)(1).

\textsuperscript{126} Fed. R. Bankr. P. 9033(b). The court may extend the period for filing objections for cause for a period not to exceed twenty-one additional days. Fed. R. Bankr. P. 9033(c).

\textsuperscript{127} Id.

\textsuperscript{128} Fed. R. Bankr. P. 9033(d).
matter to the bankruptcy judge with instructions.\textsuperscript{129} I found, however, that in most cases involving Stern claims the district court does only one thing—accept the recommendation of the bankruptcy court. Cases in which the district court, after de novo review, disagrees in whole or in part with the PFFCL submitted by the bankruptcy court based on a Stern claim are rare.

I looked at how the district court dealt with the seventy-one cases in the study in which I found bankruptcy courts issuing proposed findings of fact and conclusion of law. Beginning with the twenty-one cases in which the bankruptcy court believed it might be dealing with Stern claims, the district court approved and adopted the PFFCL in whole in all fifteen cases in which a decision has been rendered.\textsuperscript{130} Indeed, it is rare that there are any objections filed to the PFFCL for these Stern claims.\textsuperscript{131}

\textsuperscript{129} Id.


In Plaza Healthcare Center, the bankruptcy court issued a second report and recommendation on an award of fees with respect to the prior litigation, but the parties settled their dispute before a second decision by the district court, and dismissed the proceeding. See W. Pico Terrace-Lt, LLC v. Flora Terrace E. LLC (In re Plaza Healthcare Ctr. LLC), No. 17-00191 (C.D. Cal. filed Feb. 21, 2017), No. 14-11335, Adv. No. 14-01297 (Order on Stipulated Dismissal, Bankr. C.D. Cal. Filed May 3, 2017).

In Lyondell Chem. Co. v. CIBC World Mchts., No. 16-06734 (S.D.N.Y. Aug. 15, 2017), on motion of the defendants and without objection by the plaintiff, the court ordered the case remanded to the bankruptcy court prior to any decision on the PFFCL.

In Himelfarb v. First Int’l Diamond, Inc., No. 14-00258 (D. Haw. Sept. 8, 2015), the district court administratively closed the proceeding after submission of the PFFCL but before a decision because the parties settled their dispute.


\textsuperscript{131} Objections were filed in only eight of the twenty-one cases. See Bash, 575 B.R. 814 (objections filed by trustee with respect to Stern claim); In re Tomahawk Oil & Gas Mktg., LLC, 2017 WL 1050128 (objection filed by defendant); Field v. Mirikitani, 2016 WL 736760 (objections filed by both plaintiff/trustee and defendants), Picard (Tr. for the Liquidation of Bernard L. Madoff Inv. Sec. LLC) v. Cohen, 2017 BL 480129
This is not to suggest that the district court never rejects proposed findings of fact and conclusions of law on Stern claims, but they are difficult to find. Looking at district court decisions issued during the period of the survey in which the court was reviewing a PFFCL, I found nine additional cases involving Stern claims in which the bankruptcy court filed its PFFCL earlier than May 26, 2015, the earliest date included in the survey.\textsuperscript{132} Five of those cases involved alleged fraudulent transfers,\textsuperscript{133} and in all of them the district court adopted the PFFCL of the bankruptcy court in full, overruling objections in three cases.\textsuperscript{134} Of the other four district court cases, only one, Jamsek Clinic, involved a counterclaim by the estate against someone filing a claim against the estate within the meaning of 28 U.S.C. § 157(b)(2)(C) and was therefore a Stern claim.\textsuperscript{135} Another case, Lindo, involved alleged malpractice by the debtor’s bankruptcy attorney, which is also a core matter that is subject to Stern.\textsuperscript{136} The district court adopted the PFFCL in full in both cases, although the appellate court in Jamsek Clinic vacated the decision, holding that the bankruptcy court imposed sanctions (dismissal with prejudice and damage award) that were disproportionate to the offense.\textsuperscript{137} The other two cases, although the court characterized the dispute as involving Stern claims, were arguably non-core matters that were related to the bankruptcy case but could have been pursued.


\textsuperscript{133} See Veluchamy, 551 B.R. 364; In re Khan, 2015 BL 319310; Meoli, 2015 WL 5609533; Myers, 534 B.R. 6; Burkart, 2015 WL 3887686.


\textsuperscript{135} See In re Jemsek Clinic, P.A., 2015 WL 8328823 (breach of contract and tortious interference with business claims against creditor).

\textsuperscript{136} See In re Lindo, 2015 WL 9255561.

\textsuperscript{137} See Blue Cross Blue Shield of N.C. v. Jemsek Clinic, P.A. (In re Jemsek Clinic, P.A.), 850 F.3d 150 (4th Cir. 2017).
outside of the bankruptcy court. In one of those the district court adopted the PFFCL in full; in the other, the district court rejected the PFFCL in part.

Even if we look at the cases in the study involving non-core proceedings, the number of cases in which the district court modified or rejected the PFFCL of the bankruptcy court are far outnumbered by those in which the district court adopted the recommendations in full. (In a few cases there is either no

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139 See Pyle, 2015 WL 3949576.

140 See Meyes, 2015 WL 7008213.


indication on the docket that the PFFCL were transmitted to the district court, or no decision from the district court after transmittal.

It is unsurprising that a district court would be more likely to reject or modify PFFCL of a bankruptcy court with respect to a non-core proceeding than a Stern claim. Most Stern claims involve fraudulent transfers or preferences, topics with which bankruptcy judges tend to be more familiar than district court judges. Bankruptcy judges have no special expertise with respect to non-core proceedings, which could exist outside of bankruptcy, and therefore they may be more likely to differ in their analysis from the district court judge.

CONCLUSION

Stern v. Marshall has had far less impact on the bankruptcy firmament than was originally feared. Most adversary proceedings brought before bankruptcy judges are either non-core, or are statutorily core matters that the bankruptcy court, sometimes after more analysis than is probably necessary, concludes it has the constitutional power to hear and decide. Even when the court questions its power to reach a final determination, in most cases (both core and non-core) the parties consent to bankruptcy court adjudication, thereby waiving the right to have the dispute determined by an Article III judge. In those rare cases when


(i) the matter is statutory core but not within the bankruptcy court’s constitutional power to decide, (ii) the parties decline to consent to a final adjudication by the bankruptcy judge, and (iii) the bankruptcy judge prepares proposed findings of fact and conclusions of law for the benefit of the district court, in almost all cases the district court (after de novo review) adopts the findings of fact and conclusions of law as its own.

With the recent amendments to the Federal Rules of Bankruptcy Procedure, I suspect that the distinction between core matters (Stern claims or not) and non-core matters will become even less important because most litigants will consent to adjudication by the bankruptcy court at the inception of an adversary proceeding. In light of the respect shown to the bankruptcy courts by the district courts with respect to Stern claims, those litigants who choose to assert their constitutional right to a final determination by an Article III judge are likely to find that the Article III judge will conclude that the bankruptcy judge knows best.

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145 See text, supra notes 88–90.