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BANKRUPTCY COURT JURISDICTION AND THE *MARATHON-STERN* DEBACLE

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The unusual jurisdictional aspects of the original Bankruptcy Code from 1978 were addressed with devastating effects in the 1982 U.S. Supreme Court decision in *Northern Pipeline Construction Co. v. Marathon Pipe Line Co.*[1] To understand the broad implications of the *Marathon* decision, and the legislative actions that followed in response, an examination of what came before is critical.

Jurisdiction Before 1982

After enactment of the Bankruptcy Code in 1978 and before June 28, 1982, there was little serious question about the bankruptcy court's incredibly expansive and unfettered subject matter jurisdiction. That jurisdiction was being exercised in accordance with 28 U.S.C. §1471 and, more specifically, subsection (c) of that section. 28 U.S.C. §1471 provided:

> (a) Except as provided in subsection (b) of this section, the district courts shall have original and exclusive jurisdiction of all cases under Title 11.
>
> (b) Notwithstanding any Act of Congress that confers exclusive jurisdiction on a court or courts other than the district courts, the district courts shall have original but not exclusive jurisdiction of all civil proceedings arising under Title 11 or arising in or related to cases under Title 11.
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> (c) The bankruptcy court for the district in which a case under Title 11 is commenced shall exercise all of the jurisdiction conferred by this section on the district courts.
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> (d) Subsection (b) or (c) of this section does not prevent a district court or a bankruptcy court, in the interest of justice, from abstaining from hearing a particular proceeding arising under Title 11 or arising in or related to a case under Title 11. Such abstention, or a decision not to abstain, is not reviewable by appeal or otherwise.
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> (e) The bankruptcy court in which a case under Title 11 is commenced shall have exclusive jurisdiction of all of the property, wherever located, of the debtor, as of the commencement of such case.

The *Marathon* Decision

On June 28, 1982, the U.S. Supreme Court rendered an opinion devastating in its breadth in *Northern Pipeline Construction Co. v. Marathon Pipe Line Co.*, holding that the jurisdictional grant to the bankruptcy court under 28 U.S.C. §1471(c) was unconstitutional.[2] The Supreme Court's principal concern

[1] 458 U.S. 50 (1982).

[2] The *Marathon* case arose when a debtor sued another corporation for breach of contract, breach of warranty, and misrepresentation based on facts occurring before the bankruptcy. The defendant moved to dismiss based on lack of subject matter jurisdiction. The Bankruptcy Court for the District of Minnesota denied that motion. The defendant appealed to the District Court, which reversed the Bankruptcy Court and held for the defendant. *See* 12 B.R. 946 (D. Minn. 1982). The parties took a direct appeal to the U.S. Supreme Court in accordance with 28 U.S.C. §1252. Interestingly, two years after it rendered its decision in *Marathon*, the Supreme Court summarized their holding in that case as meaning "only that Congress may not vest in a non-Article III court the power to adjudicate, render final judgment, and issue binding orders in a traditional contract action arising under state law, without consent of the litigants, and subject only to ordinary appellate review." Thomas v. Union Carbide Agric. Prods. Co.,

was that bankruptcy judges, who were appointed for fixed terms and had salaries subject to reduction by Congress, had jurisdiction under the law to hear and decide all matters, even those based solely on state law and having only a tangential nexus to the bankruptcy estate. The Supreme Court's deeply divided, plurality decision in *Marathon* overturned as unconstitutional the omnibus jurisdiction given to the bankruptcy court under 28 U.S.C. §1471(c) because the bankruptcy court lacks essential elements of federal courts authorized under Article III of the U.S. Constitution: lack of life tenure for judges; judges' salary subject to reduction, and so on.[3] The Supreme Court stayed its decision until October 1982, and then again until December 24, 1982, to prevent procedural chaos and to allow Congress time to fix the problem. Notwithstanding the reprieve, the 97th Congress adjourned without passing any corrective legislation.

The Emergency Rule

In the conspicuous absence of legislation, it fell on the courts of appeal to develop a system to keep the bankruptcy courts afloat pending congressional action. The circuit courts of appeal promulgated the infamous "Interim Emergency Rule" under 28 U.S.C. §§331, 332, and 2071, which the district courts around the country adopted. The Emergency Rule provided a rather creative legalistic ploy to circumvent the constitutional problems identified in *Marathon*. Despite the holding in *Marathon*, the district courts arguably still had jurisdiction over all bankruptcy matters. Since the district courts were Article III courts and district court judges were full-fledged Article III judges, they could exercise jurisdiction over all matters properly brought before them. The Emergency Rule provided the legal fiction that the district courts were really the courts in which all bankruptcy cases were pending, but they could (and did, as a matter of course) exercise an automatic, blanket referral of all bankruptcy cases to the bankruptcy court. The bankruptcy court would hear and decide everything as before, but the district court actually signed the orders.

The Emergency Rule severely limited the bankruptcy courts' jurisdiction and prohibited those courts from conducting jury trials, enjoining another court, exercising criminal contempt powers, or exercising any appellate jurisdiction. The Emergency Rule further delineated and distinguished between "related proceedings" and "nonrelated proceedings." Specifically, *nonrelated proceedings* were those with no connection to the Bankruptcy Code and were commonly referred to as "non-core" matters. *Related proceedings* were those matters arising directly under the Bankruptcy Code—preference actions, turnover actions, dischargeability matters, and so on. These were commonly referred to as "core" matters. A bankruptcy judge could enter final orders in core matters, but could only submit proposed findings of fact and conclusions of law to the district court on non-core matters absent consent of all parties.

Certain procedural safeguards were incorporated into the Emergency Rule, such as providing for the district court's *de novo* review of bankruptcy court orders in related proceedings. This had the unseemly effect of giving the district court the power to ignore completely, for example, a four-day trial that a creditor endured in the bankruptcy court at an expense of $50,000, and start over from scratch. Luckily, owing to their own crowded calendars and lack of interest in bankruptcy matters, very few district judges ever exercised their *de novo* prerogative.

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473 U.S. 568 (1985). *See also* Commodity Futures Trading Comm'n v. Schor, 478 U.S. 833 (1986) (*Marathon* based "solely on the separation of powers principles inherent in Article III, despite the fact that the claim sought to be adjudicated in the bankruptcy court was created by state law").

[3] Article III of the U.S. Constitution mandates that the judicial power of the United States be vested in one Supreme Court and in other, inferior courts that Congress establishes. The *Marathon* ruling was based principally on the fact that bankruptcy courts were exercising Article III powers without being Article III courts.

Congressional Action

In the meantime, Congress—ever vigilant if not timely—began churning out a number of bills to remedy the problem. The House of Representatives proposed no fewer than four bills, and the Senate, not to be outdone, came up with four of its own. Political challenges and partisan rivalries (the Democrats did not want to give President Reagan the opportunity to appoint more than 220 judges with life tenure), as well as pressures from assorted special interest groups, stymied a workable legislative solution until June 29, 1984, when Congress finally passed BAFJA.

The House bills ranged from the simple, commonsense solution of appointing the 227 bankruptcy judges as Article III judges[4] to the possibility of keeping the bankruptcy judges as non-Article III judges with district court review of certain orders. The Senate bills ranged from proposing the appointment of Article III bankruptcy judges, to creating some Article III and some non-Article III judges, to creating jurisdiction based on the type of matters being heard. Some of these bills were dizzyingly complex.[5]

SUBJECT MATTER JURISDICTION UNDER BAFJA

Despite all the chaos and debate over BAFJA, it contained little in the way of substantive jurisdictional and procedural changes to the practical operation of the Emergency Rule. In fact, except for certain minor procedural modifications and changes in terminology, BAFJA essentially codified the Emergency Rule. These changes, except where noted, took effect on July 10, 1984. The primary jurisdictional provisions of BAFJA are found in 28 U.S.C. §§1334 and 157. The jurisdictional scheme under BAFJA appears deceptively simple at first blush. District courts have original and exclusive subject matter jurisdiction of all Bankruptcy Code cases.[6] District courts have original, but not exclusive, subject matter jurisdiction over civil proceedings "arising under" the Bankruptcy Code ("core" matters) or those arising in, or "related to," the Bankruptcy Code ("non-core" matters).[7] The bankruptcy court is a "unit" of the district court.[8] The district court may provide that all cases or proceedings, or both, be referred to the bankruptcy court.[9] Bankruptcy courts may hear and enter final orders in all core matters and may hear all non-core matters referred to them by the district courts.[10] The bankruptcy court may not, however, enter final orders in non-core matters unless all parties consent.[11] Absent consent, the bankruptcy court submits proposed findings of fact and conclusions of law to the district court, which may review those findings and conclusions *de novo* on any party's timely request.[12] Two Circuit Courts of Appeal have held that a bankruptcy court, like an Article III court, has the inherent power to sanction parties for improper conduct.[13] Although this jurisdictional scheme seems fairly simple, case law would soon add the uncertainty on which lawyers thrive.[14]

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[4] Many commentators still regard this as the most efficient and ultimately effective solution. *See* Rodino & Parker, The Simplest Solution, 7 Bankr. Dev. J. 329, 338 (1990).

[5] *See* Bankruptcy Judges: Article III Beckons, 16 Pac. L.J. 957 (1985).

[6] 28 U.S.C. §1334(a).

[7] 28 U.S.C. §1334(b).

[8] 28 U.S.C. §151.

[9] 28 U.S.C. §157(a).

[10] 28 U.S.C. §157(b)(1), (c)(1).

[11] 28 U.S.C. §157(c)(2).

[12] 28 U.S.C. §157(c)(1).

[13] *See In re* Downs, 103 F.3d 472 (6th Cir. 1996); *In re* Rainbow Magazine, 77 F.3d 278 (9th Cir. 1996).

[14] 28 U.S.C. §157(b)(3) requires bankruptcy judges to determine whether a matter is core or non-core on the motion of any party or the court's own motion. The uncertainty in this area has prompted more *sua sponte* determinations. *See, e.g., In re* Elsinore Shore Assocs., 820 F.2d 62 (3d Cir. 1987); *In re* Nell, 71 B.R. 305 (D. Utah 1987). This is particularly important for judicial efficiency because lack of subject matter jurisdiction can be raised at any time (even on appeal). *See In re* Ryther, 799 F.2d 1412 (9th Cir. 1986). Moreover, the 1987 amendments to

JUDICIAL GLOSS ON CORE AND NON-CORE PROCEEDINGS

Core Proceedings

Section 157(b)(2) of Title 28 defines "core proceeding" by a nonexclusive list of examples. Core proceedings include, but are not limited to:

1. matters concerning the administration of the estate;
2. allowance or disallowance of claims (except the liquidation or estimation of contingent or unliquidated personal injury or wrongful death claims);[15]
3. exemptions from property of the estate;
4. estate counterclaims against creditors;
5. orders regarding obtaining credit;
6. orders to turn over estate property;
7. orders pertaining to preferences and fraudulent transfers;
8. proceedings concerning the automatic stay;
9. discharge and dischargeability actions;
10. actions regarding validity, priority, and extent of liens;
11. confirmation of plans;
12. orders approving the use, lease, or sale of property and cash collateral;
13. proceedings affecting liquidation of assets and the adjustment of the debtor-creditor relationship (except personal injury or wrongful death claims); and
14. recognition of foreign proceedings and other matters under Chapter 15.

Case law in this area provides some interesting examples of the types of proceedings that are deemed to fit under the "core" umbrella: an action brought by a Chapter 7 trustee against a corporate debtor's former officers and directors for breach of fiduciary duty;[16] an action commenced in bankruptcy court by an assignee of a Chapter 11 debtor's overdue prepetition accounts against the account debtors, even if those account debtors are nonresidents;[17] an action over a third-party defendant impleaded by a party to a suit initiated by a debtor, regardless of whether that impleaded party has even minimum contacts with the jurisdiction;[18] a counterclaim by a debtor seeking a setoff against a claim filed by a creditor;[19] an action

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the Bankruptcy Rules require that in formal adversary proceedings there must be an allegation that a matter is core or non-core (Rule 7008(a)), and the responsive pleadings must admit or deny the allegation (Rule 7012(b)). Although Rules 7008(a) and 7012(b) are not formally incorporated into contested matter practice under Bankruptcy Rule 9014, a prudent litigator will make the same allegations (and seek a response) to clarify the issue up front.

[15] Personal injury tort and wrongful death claims must be tried in the district court—either the district court where the bankruptcy case is pending or the district court in the district where the claim arose (as determined by the district court where the bankruptcy case is pending). 28 U.S.C. §157(b)(5).

[16] *In re* DeLorean Motor Co., 49 B.R. 900 (Bankr. E.D. Mich. 1985).

[17] *In re* WWG Industries, Inc., 44 B.R. 287 (N.D. Ga. 1984).

[18] *In re* McRae Fire Protection, 49 B.R. 773 (Bankr. E.D. Mich. 1985).

by a debtor against a creditor for tortious interference with contractual relations;[20] a counterclaim by a debtor against a creditor alleging RICO violations;[21] an action by a debtor to declare a lien unenforceable under state law;[22] an action by a DIP to collect a post-petition account receivable;[23] an action by a DIP to collect a prepetition account receivable;[24] an action by a DIP to recover unauthorized draws against a letter of credit;[25] collection action by DIP against former officers;[26] an action for rescission of assignment and security agreement;[27] an action to avoid a lien given to a debtor's law firm;[28] an action for breach of insurance contract;[29] an action to determine the scope of an insurance policy;[30] an action for assumption of an executory contract;[31] an action by a debtor alleging breach of usury laws and federal truth-in-lending laws;[32] a dispute between a debtor/lessee and lessor regarding the validity of a lease;[33] contempt proceedings;[34] a trustee's preference action;[35] an action to sell estate property free and clear of liens;[36] an action by a debtor to invalidate a deed of trust;[37] motion to change venue or to abstain;[38] trustee's action to avoid fraudulent transfers under both bankruptcy and state law;[39] enforcement of prepetition settlement of patent infringement lawsuit if renewed post-petition;[40] a motion to remand after removal;[41] actions to

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[19] Macon Prestressed Concrete Co. v. Duke, 46 B.R. 727 (M.D. Ga. 1985); *In re* Wood, 52 B.R. 513 (Bankr. N.D. Ala. 1985) (counterclaim against State Mining Commission); *In re* L.B. Trucking, Inc., 75 B.R. 88 (Bankr. D. Del. 1987) (counterclaim is core proceeding even if not filed as a direct response to a creditor's claim).

[20] *In re* Marketing Resources International, 43 B.R. 71 (Bankr. E.D. Pa. 1984).

[21] *In re* Lion Capital Group, 46 B.R. 850 (Bankr. S.D.N.Y. 1985).

[22] 34 *In re* Shell Materials, Inc., 50 B.R. 44 (Bankr. M.D. Fla. 1985); *see also In re* Rosol, 114 B.R. 560 (Bankr. N.D. Ill. 1989) (action to avoid lien on wages under Bankruptcy Code §522(f)).

[23] *In re* Franklin Computer Corp., 50 B.R. 620 (Bankr. E.D. Pa. 1985); *In re* L.A. Clark & Son, 51 B.R. 31 (Bankr. D.D.C. 1985); *In re* Epi-Scan, Inc., 71 B.R. 975 (Bankr. D.N.J. 1987); *In re* DAK Manufacturing Corp., 73 B.R. 917 (Bankr. D.N.J. 1987); *In re* J.B. Van Sciver Co., 73 B.R. 838 (Bankr. E.D. Pa. 1987) (action by debtor for breach of post-petition contract); *In re* Agri-Concrete Products, Inc., 153 B.R. 673 (Bankr. M.D. Pa. 1993); *In re* National Equipment & Mold Corp., 71 B.R. 24 (Bankr. N.D. Ohio 1986).

[24] *In re* Windsor Communications Group, Inc., 67 B.R. 692 (Bankr. E.D. Pa. 1986); *In re* Bucyrus Grain Co., 56 B.R. 204 (Bankr. D. Kan. 1985); *In re* Alloy Metal Wire Works, Inc., 52 B.R. 39 (Bankr. E.D. Pa. 1985); *In re* All-American of Ashburn, Inc., 49 B.R. 926 (Bankr. N.D. Ga. 1985). These would seem to be pure *Marathon*-type lawsuits, yet these courts concluded they were core proceedings.

[25] *In re* Lombard-Wall, Inc., 44 B.R. 928 (S.D.N.Y. 1985).

[26] *In re* Baldwin-United Corp., 48 B.R. 49 (Bankr. S.D. Ohio 1985).

[27] *In re* B.W. Development Co., Inc., 49 B.R. 129 (Bankr. W.D. Ky. 1985).

[28] *In re* Douthit, 47 B.R. 428 (D. Ga. 1985).

[29] *In re* Mike Burns Inn, Inc., 70 B.R. 863 (Bankr. D. Mass. 1987).

[30] *In re* Celotex Corp., 152 B.R. 667 (Bankr. M.D. Fla. 1993).

[31] Moody v. Amoco Oil Co., 734 F.2d 1200 (7th Cir. 1984).

[32] *In re* Blackman, 55 B.R. 437 (Bankr. D.D.C. 1985).

[33] *In re* Republic Oil Corp., 51 B.R. 355 (Bankr. W.D. Wis. 1985); *In re* Manville Forest Products Corp., 896 F.2d 1384 (2d Cir. 1990) (objection to claim arising under oil and gas lease).

[34] *In re* Better Homes of Virginia, Inc., 804 F.2d 289 (4th Cir. 1986); *In re* Crum, 55 B.R. 455 (Bankr. M.D. Fla. 1985); *In re* Emergency Beacon Corp., 52 B.R. 979 (S.D.N.Y. 1985).

[35] Delgado Oil Co. v. Torres, 785 F.2d 857 (10th Cir. 1986); *In re* Associated Grocers of Nebraska Corp., Inc., 62 B.R. 439 (D. Neb. 1986); *In re* Northwest Cinema Corp., 49 B.R. 479 (Bankr. D. Minn. 1985); *In re* Gaildeen Industries, Inc., 59 B.R. 402 (N.D. Cal. 1986).

[36] *In re* Harlow Properties, Inc., 56 B.R. 794 (Bankr. 9th Cir. 1985).

[37] *In re* Atlas Fire Apparatus, Inc., 56 B.R. 927 (Bankr. E.D.N.C. 1986).

[38] *In re* Oceanquest Feeder Services, Inc., 56 B.R. 715 (Bankr. D. Conn. 1986) (change venue); *In re* Consulting Actuarial Partners, Ltd., 72 B.R. 821 (Bankr. S.D.N.Y. 1987) (abstention).

[39] *In re* Harbour, 840 F.2d 1165 (4th Cir. 1988); *In re* Mankin, 823 F.2d 1296 (9th Cir. 1987); *In re* Branding Iron Motel, Inc., 798 F.2d 396 (10th Cir. 1986); *In re* Wencl, 71 B.R. 879 (Bankr. D. Minn. 1987).

[40] *In re* Franklin Computer Corp., 14 B.C.D. 516 (Bankr. E.D. Pa. 1986).

assume or reject executory contracts and for turnover of property seized post-petition;[42] action to enjoin debtor's use of trade name;[43] action to protect insurance policy obtained post-petition if necessary for effective reorganization;[44] action to determine who controlled corporate debtor;[45] action to enjoin equity holder committee from pursuing state court action to force a shareholder's meeting;[46] action to impose statutory or constructive trust against estate property;[47] action to enjoin creditors from pursuing guarantors/management of debtor;[48] action to collect balance of price for assets sold post-petition;[49] a DIP's counterclaim for breach of contract against a creditor after the creditor files a proof of claim;[50] action to obtain an injunction prohibiting a union from striking against the debtor;[51] action brought by debtor for an injunction;[52] claim against the debtor for malpractice committed prepetition;[53] counterclaim for personal injury asserted by debtor against creditor;[54] action by creditors against debtor's attorney for mishandling of estate assets;[55] breach of warranty suit against debtor;[56] turnover proceedings;[57] action between county agency and secured creditor over alleged wrongful payment on account receivable pledged by debtor to secured creditor;[58] action to determine the applicability of civil immunity afforded by the government contractor defense;[59] proceedings to determine the effect of a subordination agreement between two creditors as it relates to lien priority;[60] objections to proofs of claim based on federal and state unfair practices laws;[61] action to enjoin suits against a trustee in his personal capacity;[62] actions

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[41] *In re* Wayne, 55 B.R. 615 (Bank. N.D. Tex. 1985).

[42] *In re* Republic Oil Corp., 51 B.R. 355 (Bankr. W.D. Wis. 1985); *In re* Chipwich, 54 B.R. 427 (Bankr. S.D.N.Y. 1985); *In re* Turbowind, Inc., 42 B.R. 579 (Bankr. S.D. Cal. 1984); *In re* Harry C. Partridge, Jr. & Sons, Inc., 43 B.R. 669 (Bankr. S.D.N.Y. 1984).

[43] *In re* Nettie Lee Shops of Bristol, Inc., 49 B.R. 946 (Bankr. W.D. Va. 1985).

[44] *In re* Heaven Sent, Ltd., 50 B.R. 636 (Bankr. E.D. Pa. 1985).

[45] *In re* SCK Corp., 54 B.R. 165 (Bankr. D.N.J. 1984).

[46] *In re* Johns-Manville Corp., 801 F.2d 60 (2d Cir. 1986).

[47] *In re* Wayne, 55 B.R. 615 (Bankr. N.D. Tex. 1985); *In re* Richmond Children's Center, Inc., 49 B.R. 262 (S.D.N.Y. 1985); *In re* Fresh Approach, Inc., 51 B.R. 412 (Bankr. N.D. Tex. 1985).

[48] *In re* Rustic Manufacturing, Inc., 55 B.R. 25 (Bankr. W.D. Wis. 1985).

[49] *In re* Arnold Print Works, Inc., 815 F.2d 165 (1st Cir. 1987); *see also In re* White Motor Credit Corp., 75 B.R. 944 (Bankr. N.D. Ohio 1987) (declaratory judgment action by purchasers of estate property pertaining to successor liability is a core proceeding).

[50] *In re* Sun West Distributors, Inc., 69 B.R. 861 (Bankr. S.D. Cal. 1987).

[51] *In re* Elsinore Shore Associates, 820 F.2d 62 (3d Cir. 1987).

[52] MacArthur Co. v. Johns-Manville Corp., 837 F.2d 89 (2d Cir. 1988) (action to enjoin pursuit of debtor's insurers).

[53] *In re* Clark, 75 B.R. 337 (Bankr. N.D. Ala. 1987); *see also In re* Park Place Associates, 118 B.R. 613 (Bankr. N.D. Ill. 1990) (action to obtain sanctions against debtor and debtor's counsel under Bankruptcy Rule 9011 is core proceeding).

[54] *In re* Manning, 71 B.R. 981 (Bankr. N.D. Ala. 1987).

[55] *In re* Stockert Flying Service, Inc., 74 B.R. 704 (N.D. Ind. 1987).

[56] *In re* Meyertech Corp., 831 F.2d 410 (3d Cir. 1987) (Bankruptcy Court can adjudicate because it can be characterized as an action pertaining to allowance or disallowance of a claim against the estate).

[57] *In re* Cassidy Land & Cattle Co., 836 F.2d 1130 (8th Cir. 1988) (debtor's action, as lienholder, to foreclose upon mortgage); *In re* Kenston Management Co., 137 B.R. 100 (Bankr. E.D.N.Y. 1992) (action to enforce prepetition settlement agreement); *In re* Double TRL, Inc., 65 B.R. 993 (Bankr. E.D.N.Y. 1986); *In re* Baldwin United Corp., 48 B.R. 49 (Bankr. S.D. Ohio 1985); *In re* Total Transportation, Inc., 87 B.R. 568 (D. Minn. 1988).

[58] *In re* Contractors Equipment Supply Co., 861 F.2d 241 (9th Cir. 1988).

[59] *In re* Chateaugay Corp., 22 C.B.C.2d 592 (Bankr. S.D.N.Y. 1990).

[60] *In re* Pittsburgh Cut Flower Co., 118 B.R. 31 (Bankr. W.D. Pa. 1990).

[61] *In re* Milbourne, 108 B.R. 522 (Bankr. E.D. Pa. 1989).

[62] *In re* Jacksen, 105 B.R. 542 (Bankr. 9th Cir. 1989).

brought to enjoin proceedings in nonbankruptcy forums that conflict with debtor's reorganization;[63] foreclosure actions brought by debtor;[64] trustee's action to recover ERISA pension plan assets;[65] objection to motion for entry of a final decree;[66] action by debtor subtenant to enjoin landlord from prosecuting state court unlawful detainer action in violation of the stay;[67] actions by a creditor to determine the validity of a claim;[68] with respect to a debt determined to be nondischargeable (also a core proceeding), an action to determine the underlying merits and amount of damages and to enter judgment in favor of the creditor;[69] a proceeding by the purchaser of assets of the estate to recover, as an administrative expense, damages for the trustee's breach of the sale contract and a return of the earnest money deposit;[70] issues involving abstention and removal and remand are core matters even if the underlying action is a non-core proceeding;[71] and motions to change venue are core proceedings.[72]

Other actions that will likely be deemed core proceedings (based on court rulings under the Emergency Rule) include: application for an order under 11 U.S.C. §105 to restrict discretionary actions by the Federal Communications Commission;[73] application for an order directing the Commodity Credit Corporation to release a lien on property of the estate;[74] resolution of a dispute involving a claim of equitable subordination;[75] determination of the validity and priority of liens in property to be sold by a trustee;[76] and a punitive damages claim arising out of an alleged nondischargeable debt.[77]

Non-Core Proceedings

Presumably, all proceedings that are not core are non-core. A *non-core proceeding* has been defined as a civil proceeding that, in the absence of a petition in bankruptcy, could have been brought in a district court or a state court.[78]

Non-core proceedings have been further characterized by courts as non-core "related" (that is, there is a sufficient nexus and impact on the estate that federal jurisdiction over the dispute is warranted and justified),[79] and non-core "not related" (that is, not only is the dispute not a core proceeding, but the resolution of the dispute has no conceivable effect on the estate being administered in bankruptcy).[80] If a

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[63] *In re* Deltacorp, Inc., 111 B.R. 419 (Bankr. S.D.N.Y. 1990) (FIRREA receivership actions); *In re* MCorp Financial, 900 F.2d 852 (5th Cir. 1990) (Federal Reserve action).

[64] *In re* Cassidy Land & Cattle Co., 836 F.2d 1130 (8th Cir. 1988) (held to be a type of turnover action).

[65] *In re* Kincaid, 917 F.2d 1162 (9th Cir. 1990).

[66] *In re* Marcus Hook Development, Inc., 943 F.2d 261 (3d Cir. 1991).

[67] *In re* Goodman, 991 F.2d 613 (9th Cir. 1993).

[68] *In re* McLaren, 900 F.2d 850 (6th Cir. 1993).

[69] *In re* Kennedy, 108 F.2d 1015 (9th Cir. 1997); *In re* Russell, 203 B.R. 303 (Bankr. S.D. Cal. 1996). *See also In re* McLaren, 3 F.3d 958 (6th Cir. 1993); *In re* Hallahan, 936 F.2d 1496 (7th Cir. 1991).

[70] *In re* Hildebrand, 205 B.R. 278 (Bankr. D. Colo. 1997).

[71] Twyman v. Wedlo, Inc., 204 B.R. 1006 (Bankr. N.D. Ala. 1996).

[72] *In re* 1111 Prospect Partners, L.P., 204 B.R. 222 (Bankr. D. Kan. 1996).

[73] *In re* D.H. Overmyer Telecasting Co., 35 B.R. 200 (Bankr. D. Ohio 1984).

[74] *In re* Berg, 42 B.R. 335 (D.N.D. 1984).

[75] *In re* Osborne, 42 B.R. 988 (W.D. Wis. 1984).

[76] *In re* Pat Freeman, Inc., 42 B.R. 224 (S.D. Ohio 1984).

[77] *In re* Criswell, 44 B.R. 95 (Bankr. E.D. Va. 1984).

[78] *In re* Colorado Energy Supply, Inc., 728 F.2d 1283 (10th Cir. 1984).

[79] The Third Circuit has held that a district court action pending outside the district where the case was commenced automatically is deemed "related to." *In re* Maritime Elec. Co. v. United Jersey Bank, 22 B.C.D. 1309 (3d Cir. 1992).

[80] Celotex Corp. v. Edwards, 514 U.S. 300 (1995), *on remand sub nom*. Edwards v. Armstrong World Industries, 56 F.3d 24 (5th Cir. 1995) (the bankruptcy court has the power to enjoin an action by a judgment creditor

matter is deemed non-core, non-related, there is no subject matter jurisdiction in the federal court at all as a result of a pending bankruptcy petition (either the district court or, derivatively, the bankruptcy court), and the dispute must be dismissed to be litigated in another forum.[81]

Stern v. Marshall

In what could prove to be the most significant U.S. Supreme Court decision in the bankruptcy area since *Marathon,* the June 2011 ruling in *Stern v. Marshall* [82] could have wide-ranging implications for a bankruptcy court's ability to preside over litigation of claims within bankruptcy cases and could signal a huge change in the statutory and constitutional underpinnings of bankruptcy court jurisdiction. The decision's legal and practical effects began to play out in the bankruptcy courts almost immediately, with courts taking wildly different approaches to responding to the *Stern* decision.

The Court's decision arises from the seemingly endless and endlessly lurid tale of the late Vickie Lynn Marshall (known to the popular culture as Anna Nicole Smith) and her extremely wealthy, deceased

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against the surety on the debtor's supersedeas bond where the surety holds collateral of the debtor as security under the "related to" jurisdiction of 28 U.S.C.§§1334(b) and 157(a)); *In re* Munford, 97 F.3d 449 (11th Cir. 1996) (the bankruptcy court has the power to issue a protective order enjoining non-settling defendants from pursuing indemnity and contribution claims against a valuation firm under its "related to" jurisdiction). *See also* Donaldson v. Bernstein, 104 F.3d 547 (3d Cir. 1997) (despite confirmation of plan and closing of case, bankruptcy court had jurisdiction with respect to adversary brought by trustee in reopened and converted Chapter 7 case against principals of debtor who guaranteed plan payments). *But see In re* Murray Industries, Inc., 204 B.R. 74 (M.D. Fla. 1995) (after confirmation of Chapter 11 debtor's liquidating plan and completion of case administration, bankruptcy court had no "related to" jurisdiction under 28 U.S.C. §1334(b)). *See also In re* Boco Enterprises, Inc., 204 B.R. 407 (Bankr. S.D.N.Y. 1997) (bankruptcy court has "related to" jurisdiction over a creditor-adversary defendant's counterclaim to enforce a personal guaranty, despite the dismissal of the Chapter 11 debtor's adversary proceeding); *In re* Green, 210 B.R. 556 (Bankr. N.D. Ill. 1997) (in the Seventh Circuit, a bankruptcy court lacks "related to" jurisdiction over litigation between non-debtor parties unless the outcome will have a "material" effect on the estate); *In re* M.A. Baheth Construction Co., Inc., 118 F.3d 1082 (5th Cir. 1997) (action against the trustee and the surety on his bond that was based on the alleged wrongful obtaining of a temporary restraining order was at least "related to" the bankruptcy case). *See also In re* Gardner, 913 F.2d 1515 (10th Cir. 1990); *In re* Diamond Mortgage Corp. v. Sugar, 913 F.2d 1233 (7th Cir. 1990); *In re* Smith, 866 F.2d 576 (3d Cir. 1989); *In re* Quattrone Accountants, Inc., 895 F.2d 921 (3d Cir. 1990) (notwithstanding §505, bankruptcy court had no jurisdiction to adjudicate tax dispute between IRS and non-debtor); Pacor, Inc. v. Higgins, 743 F.2d 984 (3d Cir. 1984); *In re* Fietz, 852 F.2d 455 (9th Cir. 1988); *In re* Salem Mortgage Co., 783 F.2d 626 (6th Cir. 1986); *In re* The Julien Co., 136 B.R. 760 (Bankr. W.D. Tenn. 1991) (action involving primarily the government and third parties had no conceivable impact on estate and was therefore non-core, non-related); *In re* Bowling Green Trust, Inc., 53 B.R. 391 (Bankr. W.D. Ky. 1985).

[81] *See* United States v. Huckabee Auto Co., 783 F.2d 1546 (11th Cir. 1986) (dispute over tax liability of non-debtor is non-core, but related); *In re* Brandt-Airflex Corp., 843 F.2d 90 (2d Cir. 1988) (same); *In re* La Salle Rolling Mills, Inc., 832 F.2d 390 (7th Cir. 1987) (contra); *In re* Kubly, 818 F.2d 643 (7th Cir. 1987) (dispute between creditors of non-debtor corporation in which debtor is sole shareholder over distribution of corporate assets is non-core, non-related); *In re* Malone, 74 B.R. 315 (Bankr. E.D. Pa. 1987) (suit by creditor against general partner of a debtor partnership deemed non-core, non- related because indemnity claim the general partner would have against the partnership could not be paid); *In re* Maislen Industries, U.S., Inc., 75 B.R. 170 (Bankr. E.D. Mich. 1987) (creditor's third-party complaint for indemnity raised in adversary proceeding commenced by the debtor is non-core, non-related even though it involves common questions of law and fact); Central Maine Restaurant Supply v. Omni Hotels Management Corp., 73 B.R. 1018 (Bankr. D. Me. 1987) (suit by supplier against debtor's agent); *but see In re* Wedtech Corp., 72 B.R. 313 (Bankr. S.D.N.Y. 1987). *See also* Szilagyi, Guide to Core vs. Noncore Jurisdiction under the Bankruptcy Code (1989) (for a thorough analysis of applicable cases and relevant distinctions); *In re* Dogpatch USA, Inc., 810 F.2d 786 (8th Cir. 1987); *In re* Arnold Print Works, Inc., 815 F.2d 165 (1st Cir. 1987); Hendel & Reinhardt, Attempting to Define the Scope of Bankruptcy Court Jurisdiction, No Miracle Drugs for the Patient, 92 Com. L.J. 350 (Winter 1987); Galligan, Article III and the "Related to" Bankruptcy Jurisdiction: A Case Study in Protective Jurisdiction, 11 U. Puget Sound L. Rev. 1 (1987).

[82] Stern v. Marshall, 131 S. Ct. 2594 (2011).

husband, J. Howard Marshall. Howard's son, Pierce, filed a claim against Vickie in her bankruptcy case, and Vickie responded with an (ostensibly) compulsory counterclaim against Pierce for tortious interference with the gift Vickie expected to get from Howard (half Howard's estate). In September 2000, following a bench trial, the bankruptcy court (which had previously entered summary judgment in Vickie's favor on Pierce's defamation claim) awarded Vickie more than $400 million on the counterclaim. Pierce argued that the bankruptcy court lacked jurisdiction to enter a final judgment on the counterclaim, but the bankruptcy court cited 28 U.S.C. §157(b)(2)(C) in holding that Congress had expressly given bankruptcy courts jurisdiction over core proceedings, which expressly include "counterclaims by the estate against persons filing claims against the estate"—counterclaims like Vickie's. The U.S. District Court, hearing the matter on Pierce's appeal from the bankruptcy court, disagreed, holding that, although Vickie's counterclaim fell within the "literal language" of 28 U.S.C. §157(b)(2)(C), there were nonetheless constitutional limits to what is a core proceeding on which a bankruptcy judge—not a lifetime-appointed judge under Article III of the U.S. Constitution—can enter a final judgment. Following this reasoning, the district court held the counterclaim to be non-core because it was not sufficiently closely related to the claim against Vickie's bankruptcy estate. The district court treated the bankruptcy court's findings of fact and conclusions of law as "recommended," and based its own judgment in Vickie's favor on an "independent review" of those findings and conclusions.

But by the time the district court entered a judgment in Vickie's favor, a Texas state court had conducted a jury trial on essentially the same issues and entered a judgment in Pierce's favor. When Pierce appealed the district court's judgment to the Ninth Circuit Court of Appeals, that court agreed that the counterclaim could not constitutionally be considered a core proceeding, but went a step further than the district court, holding that the Texas state court judgment in Pierce's favor preceded and, therefore, precluded the district court's judgment in Vickie's favor. Vickie's estate sought further review in the Supreme Court, and for the second time in the litigation, the Supreme Court granted certiorari to consider the Ninth Circuit's ruling. In affirming the Ninth Circuit, the Supreme Court called into serious question the constitutionality of Congress's 27-year-old statutory grant of jurisdiction to bankruptcy courts.

The Supreme Court agreed with the district court and the Ninth Circuit Court of Appeals in holding that, despite the unambiguous language of 28 U.S.C. §157(b)(2)(C) (which regards as core all counterclaims to claims against the estate), not all counterclaims are core proceedings with respect to which bankruptcy judges can constitutionally enter judgment. Put most succinctly by Chief Justice Roberts for the Court: "Although we conclude that §157(b)(2)(C) permits the Bankruptcy Court to enter final judgment on Vickie's counterclaim, Article III of the Constitution does not."[83]

As described above, Congress enacted the current version of 28 U.S.C. §157 in 1984, creating the very concept of the "core proceeding" as a direct response to the Supreme Court's 1982 decision in *Marathon*, which declared unconstitutional previous Congressional grants of jurisdiction to bankruptcy courts under the then-relatively new Bankruptcy Code of 1978. That the Supreme Court has held in *Stern v. Marshall* as unconstitutional (or, at least, unconstitutionally broad) one of the enumerated "core proceedings" in 28 U.S.C. §157(b)(2)—that is, Congress's attempt to address *Marathon*—could make *Stern v. Marshall* at least as important as *Marathon*.

If what the Supreme Court found unconstitutional is a bankruptcy court entering a judgment on a legal claim that does not pertain directly to federal bankruptcy law, then it is not much of a conceptual leap to the notion that many types of state law or common law claims against a bankruptcy estate cannot constitutionally be heard to judgment in a bankruptcy court. Is there really any difference between a bankruptcy estate's counterclaim based on state tort law and a claim against the bankruptcy estate based on state tort law? How much of what has been, for more than a quarter century, regarded as core to a bankruptcy case could now fall outside the Supreme Court's constitutional boundaries for non-Article III bankruptcy judges?

[83] 131 S. Ct. at 2608.

If even compulsory counterclaims brought in the bankruptcy court in response to a claim filed against the bankruptcy estate must be ruled on by a district court judge rather than the bankruptcy judge hearing the same facts—and this appears to be exactly what the Supreme Court now requires—then at least two different federal courts will be called on to make rulings arising from the same facts and affecting the same bankruptcy estate. A district court judge will be, in a very real sense, determining the ultimate course of the bankruptcy case—something surely most district court judges would regard as both surprising and probably a little bit scary. They are, in the main, hardly the specialists that bankruptcy judges are when it comes to bankruptcy administration, and they could never be expected to have the same perspective as a presiding bankruptcy judge on how one claim's resolution affects an entire bankruptcy estate. As Justice Breyer's dissent in *Stern v. Marshall* noted, the Supreme Court's approach engenders a "game of jurisdictional ping-pong between courts [that] would lead to inefficiency, increased cost, delay, and needless additional suffering among those faced with bankruptcy."[84]

The Court's ruling in *Stern* was so potentially broad and the Court's actual guidance so modest, bankruptcy courts and litigants flailed about to make sense of the ruling, a process that resulted in widely disparate approaches emerging even between judges in the same court.[85] By the end of 2012, circuit courts of appeals began to issue rulings applying *Stern* principles. The first was the Sixth Circuit, which addressed whether a bankruptcy court could enter a final order in an adversary proceeding in which the Chapter 11 debtor had brought fraud claims against a creditor who had not filed a proof of claim. There, the creditor conceded that the debtor's action was a "core" proceeding, filed a counterclaim, and did not contest the bankruptcy court's jurisdiction to enter a final order until the matter reached the appellate court. The Sixth Circuit ruled, however, citing *Stern*, that the bankruptcy court lacked jurisdiction under Article III to adjudicate the fraud claim, vacating a $3 million judgment against the creditor arising from what the bankruptcy court called "one of the most egregious frauds the court had ever encountered."[86]

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[84] .131 S. Ct. at 2630.

[85] *Cf.* Meoli v. Huntington Nat'l Bank (*In re* Teleservices Grp., Inc.) 456 B.R. 318 (Bankr. W.D. Mich. 2011) (court held it had jurisdiction to hear the claims and to enter findings and recommendations but that it did not have jurisdiction to enter final judgment), and Tibble v. Wells Fargo Bank (*In re* Hudson), 455 B.R. 648 (Bankr. W.D. Mich. 2011) (holding that bankruptcy courts continue to have jurisdiction to enter final judgments in all matters except the specific types of counterclaims at issue in *Stern*, essentially limiting *Stern* to its facts); Weisfelner v. Blavatnik (*In re* Lyondell Chem. Co.), 467 B.R. 712 (S.D.N.Y. 2012) (bankruptcy courts lack constitutional authority to enter final orders in fraudulent transfer actions, broadly applying *Stern*), and Marshall v. Picard (*In re* Madoff), 848 F. Supp. 2d 469 (S.D.N.Y. 2012) (*Stern* must be applied only narrowly; bankruptcy courts may enter judgment in fraudulent transfer actions without violating Article III). A comprehensive survey of the myriad bankruptcy court decisions interpreting, applying, or declining to expand *Stern* would make this footnote needlessly long, but even small sampling of bankruptcy cases decided in the immediate aftermath of the *Stern* ruling offers a picture of the havoc wrought by that decision in the nation's bankruptcy courts. *See, e.g., In re* Am. Bus. Fin. Servs., Inc., 457 B.R. 314 (Bankr. D. Del. 2011) (under *Stern*'s "narrow" decision, court had "jurisdiction to hear [the] adversary proceeding [because] it directly stems from the bankruptcy case"); *In re* Safety Harbor Resort & Spa, 456 B.R. 703 (Bankr. M.D. Fla. 2011) ("Bankruptcy courts should not invalidate a Congressional statute, such as section 157(b)(2)(F) —or otherwise limit its authority to finally resolve other core proceedings—simply because dicta in *Stern* suggests the Supreme Court may do the same down the road"); *In re* The Mortgage Store, Inc., 464 B.R. 421 (Bankr. D. Hawaii 2011) (court held it could enter findings and recommendations regarding fraudulent transfer actions even if it lacked the jurisdiction to enter a final judgment); *In re* Canopy Financial, Inc., 464 B.R. 770 (Bankr. N.D. Ill. 2011) (holding that the bankruptcy court could hear claims on which it could not enter final judgment); *In re* Olde Prairie Block Owner, LLC, 457 B.R. 692 (Bankr. N.D. Ill. 2011) (where "non-bankruptcy issues must be decided and [they] stem from the bankruptcy itself or would necessarily be resolved in the claims allowance process . . . [t]hose issues are likely within the public rights exception as defined in *Stern*") (internal quotation marks and citation omitted); *In re* Salander O'Reilly Galleries, 453 B.R. 106, 117 (Bankr. S.D.N.Y. 2011) *aff'd sub nom. In re* Salander-O'Reilly Galleries, LLC, 475 B.R. 9 (S.D.N.Y. 2012) (holding that a bankruptcy court may "rule with respect to state law when determining a proof of claim in the bankruptcy, or when deciding a matter directly and conclusively related to the bankruptcy").

[86] Machine & Fabrication, LLC v. Stone (*In re* Waldman), 698 F.3d 910 (6th Cir. 2012).

Only a month earlier, The Sixth Circuit had ruled that the bankruptcy court *did* have jurisdiction to enter a final judgment in a fraudulent transfer claim against a creditor who *had* filed a proof of claim in the case, ostensibly because, among other things, the creditor had consented to that jurisdiction by filing a proof of claim.[87]

Elsewhere, other circuit courts of appeals constructed a confusing landscape. The Eighth Circuit ruled that creditors who file proofs of claim have waived a right to jury trial and have consented to bankruptcy court jurisdiction sufficiently to allow the bankruptcy court to enter a final judgment on a non-dischargeability action.[88] While lower courts grappled with whether *Stern* prohibited bankruptcy courts from entering judgments on ostensibly "core" proceedings such as fraudulent transfers, preferences, non-dischargeability, lien avoidance, lien priority, and a debtor's state-law counterclaims to a creditor's filed proof of claim, the Ninth Circuit created a split with the Sixth Circuit's ruling in *Machine & Fabrication* when it ruled that a creditor's conduct in bankruptcy court litigation amounted to consent to bankruptcy court jurisdiction—despite that the creditor had not filed a proof of claim—enabling the bankruptcy court to enter a final judgment on a fraudulent transfer claim.[89] In *Bellingham,* immediately before filing for bankruptcy, the debtor transferred assets to Executive Benefits Insurance Agency ("EBIA"). The chapter 7 trustee sued EBIAto recover what it alleged was a fraudulent transfer. EBIA did not contest bankruptcy court jurisdiction in the bankruptcy court and lost on the merits in the bankruptcy court. EBIA appealed the bankruptcy court's judgment to the U.S. District Court, which affirmed the bankruptcy court's ruling. After EBIA appealed to the Ninth Circuit Court of Appeals but before the appellate court had ruled, the Supreme Court issued its ruling in *Stern*, and EBIA for the first time argued that the bankruptcy court had been constitutionally incapable of entering final judgment on the fraudulent transfer claims. The Ninth Circuit agreed that the trustee's claims were *Stern* claims—that is, a "core" matter on which a bankruptcy court cannot constitutionally enter a final judgment—but concluded that EBIA had consented to final adjudication by the bankruptcy court through its conduct.

The Supreme Court granted *certiorari* in *Bellingham*, ostensibly to resolve the split between the Sixth and Ninth Circuits on the issue of consent. When the Supreme Court ruled,[90] however, it scrupulously avoided the issue of consent in its unanimous decision. The Supreme Court affirmed the Ninth Circuit, but on different grounds. The Court acknowledge that *Stern* claims create a statutory gap: "By definition, a *Stern* claim may not be adjudicated to final judgment by the bankruptcy court, as in a typical core proceeding. But the alternative procedure, whereby the bankruptcy court submits proposed findings of fact and conclusions of law, applies only to non-core claims." Whereas the Ninth Circuit upheld the bankruptcy court's judgment based on consent, the Supreme Court expressly declined to decide whether parties can consent to bankruptcy court adjudication of *Stern* claims. Instead, the Supreme Court noted that the 1984 law that created the core/non-core distinction contained a severability clause, stating that if any provision was held invalid "the remainder of this Act … is not affected thereby." Applying the severability clause, the court determined that EBIA's *Stern* claim was entitled to the same treatment as non-core claims that are related to a bankruptcy case: *i.e.,* the claim can be heard by a bankruptcy judge, who must submit proposed findings of fact and conclusions of law to an Article III judge who then conducts a *de novo* review before entering a final judgment. In EBIA's case, the Supreme Court concluded that the district court had already conducted a *de novo* review when it heard EBIA's appeal. Despite that the precise procedure was different from what the Supreme Court requires for Stern claims—the District Court had technically heard an appeal rather than the bankruptcy court's proposed findings

[87] Onkyo Europe Electronics GMBH v. Global Technovations Inc., (*In re* Global Technovations Inc.), 694 F.3d 705 (6th Cir. 2012).

[88] Pearson Educ. Inc. v. Almgren, 685 F.3d 691 (8th Cir. 2012).

[89] Executive Benefits Insurance Agency v. Arkison (*In re* Bellingham Insurance Agency, Inc.), 702 F.3d 553 (9th Cir. 2012).

[90] Executive Benefits Insurance Agency v. Arkison (*In re* Bellingham Insurance Agency, Inc.), 573 U.S. ____ (2014).

and conclusions—the practical result was the same.

The Supreme Court's decision in *Bellingham* did not address one of the central questions raised by *Stern* and by scores of lower-court decisions, including the Sixth Circuit in *Machine & Fabrication* and the Ninth Circuit in *Bellingham*: whether and how parties can consent to the final adjudication of a *Stern* claim by a bankruptcy judge. Stated differently, can parties cure constitutional deficiencies in bankruptcy court jurisdiction for *Stern* claim by consent (either express or even implied)? The Fifth, Sixth, Seventh, and Ninth Circuit Courts of Appeals have already split on this issue.[91] That the Supreme Court declined to use its *Bellingham* decision to resolve this issue—an issue, it should be noted, of its own making in *Stern*—is why the bankruptcy professional community read the *Bellingham* decision with no small measure of frustration. One imagines that the Supreme Court will allay that frustration when it rules in the *Wellness* case, for which it granted *certiorari* on July 1, 2014.

[91] Frazin v. Haynes and Boone, L.L.P., (*In re* Frazin), 732 F.3d 313 (5th Cir. 2013) (bankruptcy courts lack jurisdiction to decide "core" *Stern* claims even when parties consent to bankruptcy court jurisdiction); Waldman v. Stone, 698 F.3d 910 (6th Cir. 2012) (same); Wellness Int'l Network, Ltd. v. Sharif, 727 F.3d 751 (7th Cir. 2013) (same); *contra* Executive Benefits Ins. Agency v. Arkinson (*In re* Bellingham Ins. Agency), 702 F.3d 553 (9th Cir. 2012) (consent can be implied by conduct and can cure a bankruptcy court's jurisdictional deficiency). So controversial is the issue of consent that a separate decision in the Seventh Circuit seems to contradict the *Wellness* decision in holding that parties *can* consent to a bankruptcy court's adjudication of a *Stern* claim. Peterson v. Somers Dublin Ltd., 729 F.3d 741 (7th Cir. 2013).

Syllabus

NOTE: Where it is feasible, a syllabus (headnote) will be released, as is being done in connection with this case, at the time the opinion is issued. The syllabus constitutes no part of the opinion of the Court but has been prepared by the Reporter of Decisions for the convenience of the reader. See *United States* v. *Detroit Timber & Lumber Co.,* 200 U. S. 321, 337.

SUPREME COURT OF THE UNITED STATES

Syllabus

LAW *v.* SIEGEL, CHAPTER 7 TRUSTEE

CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

No. 12–5196. Argued January 13, 2014—Decided March 4, 2014

Petitioner Law filed for Chapter 7 bankruptcy. He valued his California home at $363,348, claiming that $75,000 of that value was covered by California's homestead exemption and thus was exempt from the bankruptcy estate. See 11 U. S. C. §522(b)(3)(A). He also claimed that the sum of two voluntary liens—one of which was in favor of "Lin's Mortgage & Associates"—exceeded the home's nonexempt value, leaving no equity recoverable for his other creditors. Respondent Siegel, the bankruptcy estate trustee, challenged the "Lin" lien in an adversary proceeding, but protracted and expensive litigation ensued when a supposed "Lili Lin" in China claimed to be the beneficiary of Law's deed of trust. Ultimately, the Bankruptcy Court concluded that the loan was a fiction created by Law to preserve his equity in the house. It thus granted Siegel's motion to "surcharge" Law's $75,000 homestead exemption, making those funds available to defray attorney's fees incurred by Siegel in overcoming Law's fraudulent misrepresentations. The Ninth Circuit Bankruptcy Appellate Panel and the Ninth Circuit affirmed.

Held: The Bankruptcy Court exceeded the limits of its authority when it ordered that the $75,000 protected by Law's homestead exemption be made available to pay Siegel's attorney's fees. Pp. 5–12.

(a) A bankruptcy court may not exercise its authority to "carry out" the provisions of the Code, 11 U. S. C. §105(a), or its "inherent power . . . to sanction 'abusive litigation practices,' " *Marrama* v. *Citizens Bank of Mass.*, 549 U. S. 365, 375–376, by taking action prohibited elsewhere in the Code. Here, the Bankruptcy Court's "surcharge" contravened §522, which (by reference to California law) entitled Law to exempt $75,000 of equity in his home from the bankruptcy estate, §522(b)(3)(A), and which made that $75,000 "not liable for payment of

Syllabus

any administrative expense," §522(k), including attorney's fees, see §503(b)(2). The surcharge thus exceeded the limits of both the court's authority under §105(a) and its inherent powers. Pp. 5–7.

(b) Siegel argues that an equitable power to deny an exemption by "surcharging" exempt property in response to a debtor's misconduct can coexist with §522. But insofar as that argument equates the surcharge with an outright denial of Law's homestead exemption, it founders on this case's procedural history. The Bankruptcy Appellate Panel recognized that because no one timely objected to the homestead exemption, it became final before the surcharge was imposed. And a trustee who fails to make a timely objection cannot challenge an exemption. *Taylor* v. *Freeland & Kronz*, 503 U. S. 638, 643–644. Assuming the Bankruptcy Court could have revisited Law's entitlement to the exemption, §522 specifies the criteria that render property exempt, and a court may not refuse to honor a debtor's invocation of an exemption without a valid statutory basis. Federal courts may apply state law to disallow state-created exemptions, but federal law itself provides no authority for bankruptcy courts to deny an exemption on a ground not specified in the Code. Pp. 7–10.

(c) Neither the holding of *Marrama* v. *Citizens Bank* nor its dictum points toward a different result. There, the debtor's bad faith kept him from converting his bankruptcy from a Chapter 7 liquidation to a Chapter 13 reorganization as permitted by §706(a). But that was because his conduct prevented him from qualifying under Chapter 13, and thus he could not satisfy §706(d), which expressly conditions conversion on the debtor's ability to qualify under Chapter 13. Pp. 10–11.

(d) This ruling forces Siegel to shoulder a heavy financial burden due to Law's egregious misconduct and may produce inequitable results for other trustees and creditors, but it is not for courts to alter the balance that Congress struck in crafting §522. Cf. *Guidry* v. *Sheet Metal Workers National Pension Fund*, 493 U. S. 365, 376–377. P. 11.

(e) Ample authority remains to address debtor misconduct, including denial of discharge, see §727(a)(2)–(6); sanctions for bad-faith litigation conduct under the Bankruptcy Rules, §105(a), or a bankruptcy court's inherent powers; enforcement of monetary sanctions through the normal procedures for collecting money judgments, see §727(b); or possible prosecution under 18 U. S. C. §152. Pp. 11–12.

435 Fed. Appx. 697, reversed and remanded.

SCALIA, J., delivered the opinion for a unanimous Court.

SUPREME COURT OF THE UNITED STATES

No. 12–5196

STEPHEN LAW, PETITIONER *v.* ALFRED H. SIEGEL, CHAPTER 7 TRUSTEE

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

[March 4, 2014]

JUSTICE SCALIA delivered the opinion of the Court.

The Bankruptcy Code provides that a debtor may exempt certain assets from the bankruptcy estate. It further provides that exempt assets generally are not liable for any expenses associated with administering the estate. In this case, we consider whether a bankruptcy court nonetheless may order that a debtor's exempt assets be used to pay administrative expenses incurred as a result of the debtor's misconduct.

I. Background

A

Chapter 7 of the Bankruptcy Code gives an insolvent debtor the opportunity to discharge his debts by liquidating his assets to pay his creditors. 11 U. S. C. §§704(a)(1), 726, 727. The filing of a bankruptcy petition under Chapter 7 creates a bankruptcy "estate" generally comprising all of the debtor's property. §541(a)(1). The estate is placed under the control of a trustee, who is responsible for managing liquidation of the estate's assets and distribution of the proceeds. §704(a)(1). The Code authorizes

the debtor to "exempt," however, certain kinds of property from the estate, enabling him to retain those assets post-bankruptcy. §522(b)(1). Except in particular situations specified in the Code, exempt property "is not liable" for the payment of "any [prepetition] debt" or "any administrative expense." §522(c), (k).

Section 522(d) of the Code provides a number of exemptions unless they are specifically prohibited by state law. §522(b)(2), (d). One, commonly known as the "homestead exemption," protects up to $22,975 in equity in the debtor's residence. §522(d)(1) and note following §522; see *Owen* v. *Owen*, 500 U. S. 305, 310 (1991). The debtor may elect, however, to forgo the §522(d) exemptions and instead claim whatever exemptions are available under applicable state or local law. §522(b)(3)(A). Some States provide homestead exemptions that are more generous than the federal exemption; some provide less generous versions; but nearly every State provides some type of homestead exemption. See López, State Homestead Exemptions and Bankruptcy Law: Is It Time for Congress To Close the Loophole? 7 Rutgers Bus. L. J. 143, 149–165 (2010) (listing state exemptions).

B

Petitioner, Stephen Law, filed for Chapter 7 bankruptcy in 2004, and respondent, Alfred H. Siegel, was appointed to serve as trustee. The estate's only significant asset was Law's house in Hacienda Heights, California. On a schedule filed with the Bankruptcy Court, Law valued the house at $363,348 and claimed that $75,000 of its value was covered by California's homestead exemption. See Cal. Civ. Proc. Code Ann. §704.730(a)(1) (West Supp. 2014). He also reported that the house was subject to two voluntary liens: a note and deed of trust for $147,156.52 in favor of Washington Mutual Bank, and a second note and deed of trust for $156,929.04 in favor of "Lin's Mortgage &

Associates." Law thus represented that there was no equity in the house that could be recovered for his other creditors, because the sum of the two liens exceeded the house's nonexempt value.

If Law's representations had been accurate, he presumably would have been able to retain the house, since Siegel would have had no reason to pursue its sale. Instead, a few months after Law's petition was filed, Siegel initiated an adversary proceeding alleging that the lien in favor of "Lin's Mortgage & Associates" was fraudulent. The deed of trust supporting that lien had been recorded by Law in 1999 and reflected a debt to someone named "Lili Lin." Not one but two individuals claiming to be Lili Lin ultimately responded to Siegel's complaint. One, Lili Lin of Artesia, California, was a former acquaintance of Law's who denied ever having loaned him money and described his repeated efforts to involve her in various sham transactions relating to the disputed deed of trust. *That* Lili Lin promptly entered into a stipulated judgment disclaiming any interest in the house. But that was not the end of the matter, because the second "Lili Lin" claimed to be the true beneficiary of the disputed deed of trust. Over the next five years, *this* "Lili Lin" managed—despite supposedly living in China and speaking no English—to engage in extensive and costly litigation, including several appeals, contesting the avoidance of the deed of trust and Siegel's subsequent sale of the house.

Finally, in 2009, the Bankruptcy Court entered an order concluding that "no person named Lili Lin ever made a loan to [Law] in exchange for the disputed deed of trust." *In re Law*, 401 B. R. 447, 453 (Bkrtcy. Ct. CD Cal.). The court found that "the loan was a fiction, meant to preserve [Law's] equity in his residence beyond what he was entitled to exempt" by perpetrating "a fraud on his creditors and the court." *Ibid.* With regard to the second "Lili Lin," the court declared itself "unpersuaded that Lili Lin of

China signed or approved any declaration or pleading purporting to come from her." *Ibid.* Rather, it said, the "most plausible conclusion" was that Law himself had "authored, signed, and filed some or all of these papers." *Ibid.* It also found that Law had submitted false evidence "in an effort to persuade the court that Lili Lin of China—rather than Lili Lin of Artesia—was the true holder of the lien on his residence." *Id.,* at 452. The court determined that Siegel had incurred more than $500,000 in attorney's fees overcoming Law's fraudulent misrepresentations. It therefore granted Siegel's motion to "surcharge" the entirety of Law's $75,000 homestead exemption, making those funds available to defray Siegel's attorney's fees.

The Ninth Circuit Bankruptcy Appellate Panel affirmed. BAP No. CC–09–1077–PaMkH, 2009 WL 7751415 (Oct. 22, 2009) (*per curiam*). It held that the Bankruptcy Court's factual findings regarding Law's fraud were not clearly erroneous and that the court had not abused its discretion by surcharging Law's exempt assets. It explained that in *Latman* v. *Burdette*, 366 F. 3d 774 (2004), the Ninth Circuit had recognized a bankruptcy court's power to "equitably surcharge a debtor's statutory exemptions" in exceptional circumstances, such as "when a debtor engages in inequitable or fraudulent conduct." 2009 WL 7751415, *5, *7. The Bankruptcy Appellate Panel acknowledged that the Tenth Circuit had disagreed with *Latman*, see *In re Scrivner*, 535 F. 3d 1258, 1263–1265 (2008), but the panel affirmed that *Latman* was correct. 2009 WL 7751415, *7, n. 10. Judge Markell filed a concurring opinion agreeing with the panel's application of *Latman* but questioning "whether *Latman* remains good policy." 2009 WL 7751415, *10.

The Ninth Circuit affirmed. *In re Law*, 435 Fed. Appx. 697 (2011) (*per curiam*). It held that the surcharge was proper because it was "calculated to compensate the estate for the actual monetary costs imposed by the debtor's

misconduct, and was warranted to protect the integrity of the bankruptcy process." *Id.,* at 698. We granted certiorari. 570 U. S. ___ (2013).

II. Analysis

A

A bankruptcy court has statutory authority to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of" the Bankruptcy Code. 11 U. S. C. §105(a). And it may also possess "inherent power . . . to sanction 'abusive litigation practices.'" *Marrama* v. *Citizens Bank of Mass.*, 549 U. S. 365, 375–376 (2007). But in exercising those statutory and inherent powers, a bankruptcy court may not contravene specific statutory provisions.

It is hornbook law that §105(a) "does not allow the bankruptcy court to override explicit mandates of other sections of the Bankruptcy Code." 2 Collier on Bankruptcy ¶105.01[2], p. 105–6 (16th ed. 2013). Section 105(a) confers authority to "carry out" the provisions of the Code, but it is quite impossible to do that by taking action that the Code prohibits. That is simply an application of the axiom that a statute's general permission to take actions of a certain type must yield to a specific prohibition found elsewhere. See *Morton* v. *Mancari*, 417 U. S. 535, 550–551 (1974); *D. Ginsberg & Sons, Inc.* v. *Popkin*, 285 U. S. 204, 206–208 (1932).[1] Courts' inherent sanctioning powers are

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[1] The second sentence of §105(a) adds little to the analysis. It states: "No provision of this title providing for the raising of an issue by a party in interest shall be construed to preclude the court from, sua sponte, taking any action or making any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process." Even if the "abuse of process" language were deemed to confer additional authority beyond that conferred by the first sentence (which is doubtful), that general authority would also be limited by more specific provisions of the Code.

likewise subordinate to valid statutory directives and prohibitions. *Degen* v. *United States*, 517 U. S. 820, 823 (1996); *Chambers* v. *NASCO, Inc.*, 501 U. S. 32, 47 (1991). We have long held that "whatever equitable powers remain in the bankruptcy courts must and can only be exercised within the confines of" the Bankruptcy Code. *Norwest Bank Worthington* v. *Ahlers*, 485 U. S. 197, 206 (1988); see, *e.g., Raleigh* v. *Illinois Dept. of Revenue*, 530 U. S. 15, 24–25 (2000); *United States* v. *Noland*, 517 U. S. 535, 543 (1996); *SEC* v. *United States Realty & Improvement Co.*, 310 U. S. 434, 455 (1940).

Thus, the Bankruptcy Court's "surcharge" was unauthorized if it contravened a specific provision of the Code. We conclude that it did. Section 522 (by reference to California law) entitled Law to exempt $75,000 of equity in his home from the bankruptcy estate. §522(b)(3)(A). And it made that $75,000 "not liable for payment of any administrative expense." §522(k).[2] The reasonable attorney's fees Siegel incurred defeating the "Lili Lin" lien were indubitably an administrative expense, as a short march through a few statutory cross-references makes plain: Section 503(b)(2) provides that administrative expenses include "compensation . . . awarded under" §330(a); §330(a)(1) authorizes "reasonable compensation for actual, necessary services rendered" by a "professional person employed under" §327; and §327(a) authorizes the trustee to "employ one or more attorneys . . . to represent or assist the trustee in carrying out the trustee's duties under this title." Siegel argues that even though attorney's fees incurred responding to a debtor's fraud qualify as "administrative expenses" for purposes of determining the trus-

[2]The statute's general rule that exempt assets are not liable for administrative expenses is subject to two narrow exceptions, both pertaining to the use of exempt assets to pay expenses associated with the avoidance of certain voidable transfers of exempt property. §522(k)(1)–(2). Neither of those exceptions is relevant here.

tee's right to reimbursement under §503(b), they do not so qualify for purposes of §522(k); but he gives us no reason to depart from the "'normal rule of statutory construction'" that words repeated in different parts of the same statute generally have the same meaning. See *Department of Revenue of Ore.* v. *ACF Industries, Inc.*, 510 U. S. 332, 342 (1994) (quoting *Sorenson* v. *Secretary of Treasury*, 475 U. S. 851, 860 (1986)).

The Bankruptcy Court thus violated §522's express terms when it ordered that the $75,000 protected by Law's homestead exemption be made available to pay Siegel's attorney's fees, an administrative expense. In doing so, the court exceeded the limits of its authority under §105(a) and its inherent powers.

B

Siegel does not dispute the premise that a bankruptcy court's §105(a) and inherent powers may not be exercised in contravention of the Code. Instead, his main argument is that the Bankruptcy Court's surcharge did not contravene §522. That statute, Siegel contends, "establish[es] the procedure by which a debtor may seek to claim exemptions" but "contains no directive requiring [courts] to allow [an exemption] regardless of the circumstances." Brief for Respondent 35. Thus, he says, recognition of an equitable power in the Bankruptcy Court to deny an exemption by "surcharging" the exempt property in response to the debtor's misconduct can coexist comfortably with §522. The United States, appearing in support of Siegel, agrees, arguing that §522 "neither gives debtors an absolute right to retain exempt property nor limits a court's authority to impose an equitable surcharge on such property." Brief for United States as *Amicus Curiae* 23.

Insofar as Siegel and the United States equate the Bankruptcy Court's surcharge with an outright denial of Law's homestead exemption, their arguments founder

upon this case's procedural history. The Bankruptcy Appellate Panel stated that because no one "timely oppose[d] [Law]'s homestead exemption claim," the exemption "became final" *before* the Bankruptcy Court imposed the surcharge. 2009 WL 7751415, at *2. We have held that a trustee's failure to make a timely objection prevents him from challenging an exemption. *Taylor* v. *Freeland & Kronz*, 503 U. S. 638, 643–644 (1992).

But even assuming the Bankruptcy Court could have revisited Law's entitlement to the exemption, §522 does not give courts discretion to grant or withhold exemptions based on whatever considerations they deem appropriate. Rather, the statute exhaustively specifies the criteria that will render property exempt. See §522(b), (d). Siegel insists that because §522(b) says that the debtor "may exempt" certain property, rather than that he "*shall* be entitled" to do so, the court retains discretion to grant or deny exemptions even when the statutory criteria are met. But the subject of "may exempt" in §522(b) is the debtor, not the court, so it is the debtor in whom the statute vests discretion. A debtor need not invoke an exemption to which the statute entitles him; but if he does, the court may not refuse to honor the exemption absent a valid statutory basis for doing so.

Moreover, §522 sets forth a number of carefully calibrated exceptions and limitations, some of which relate to the debtor's misconduct. For example, §522(c) makes exempt property liable for certain kinds of prepetition debts, including debts arising from tax fraud, fraud in connection with student loans, and other specified types of wrongdoing. Section 522(*o*) prevents a debtor from claiming a homestead exemption to the extent he acquired the homestead with nonexempt property in the previous 10 years "with the intent to hinder, delay, or defraud a creditor." And §522(q) caps a debtor's homestead exemption at approximately $150,000 (but does not eliminate it en-

tirely) where the debtor has been convicted of a felony that shows "that the filing of the case was an abuse of the provisions of" the Code, or where the debtor owes a debt arising from specified wrongful acts—such as securities fraud, civil violations of the Racketeer Influenced and Corrupt Organizations Act, or "any criminal act, intentional tort, or willful or reckless misconduct that caused serious physical injury or death to another individual in the preceding 5 years." §522(q) and note following §522. The Code's meticulous—not to say mind-numbingly detailed—enumeration of exemptions and exceptions to those exemptions confirms that courts are not authorized to create additional exceptions. See *Hillman* v. *Maretta*, 569 U. S. ___, ___ (2013) (slip op., at 12); *TRW Inc.* v. *Andrews*, 534 U. S. 19, 28–29 (2001).

Siegel points out that a handful of courts have claimed authority to disallow an exemption (or to bar a debtor from amending his schedules to claim an exemption, which is much the same thing) based on the debtor's fraudulent concealment of the asset alleged to be exempt. See, *e.g., In re Yonikus*, 996 F. 2d 866, 872–873 (CA7 1993); *In re Doan*, 672 F. 2d 831, 833 (CA11 1982) (*per curiam*); *Stewart* v. *Ganey*, 116 F. 2d 1010, 1011 (CA5 1940). He suggests that those decisions reflect a general, equitable power in bankruptcy courts to deny exemptions based on a debtor's bad-faith conduct. For the reasons we have given, the Bankruptcy Code admits no such power. It is of course true that when a debtor claims a *state-created* exemption, the exemption's scope is determined by state law, which may provide that certain types of debtor misconduct warrant denial of the exemption. *E.g., In re Sholdan*, 217 F. 3d 1006, 1008 (CA8 2000); see 4 Collier on Bankruptcy ¶522.08[1]–[2], at 522–45 to 522–47. Some of the early decisions on which Siegel relies, and which the Fifth Circuit cited in *Stewart*, are instances in which federal courts applied state law to disallow state-created exemptions.

See *In re Denson*, 195 F. 857, 858 (ND Ala. 1912); *Cowan* v. *Burchfield*, 180 F. 614, 619 (ND Ala. 1910); *In re Ansley Bros.*, 153 F. 983, 984 (EDNC 1907). But *federal law* provides no authority for bankruptcy courts to deny an exemption on a ground not specified in the Code.

C

Our decision in *Marrama* v. *Citizens Bank*, on which Siegel and the United States heavily rely, does not point toward a different result. The question there was whether a debtor's bad-faith conduct was a valid basis for a bankruptcy court to refuse to convert the debtor's bankruptcy from a liquidation under Chapter 7 to a reorganization under Chapter 13. Although §706(a) of the Code gave the debtor a right to convert the case, §706(d) "expressly conditioned" that right on the debtor's "ability to qualify as a 'debtor' under Chapter 13." 549 U. S., at 372. And §1307(c) provided that a proceeding under Chapter 13 could be dismissed or converted to a Chapter 7 proceeding "for cause," which the Court interpreted to authorize dismissal or conversion for bad-faith conduct. In light of §1307(c), the Court held that the debtor's bad faith could stop him from qualifying as a debtor under Chapter 13, thus preventing him from satisfying §706(d)'s *express condition* on conversion. *Id.,* at 372–373. That holding has no relevance here, since no one suggests that Law failed to satisfy any express statutory condition on his claiming of the homestead exemption.

True, the Court in *Marrama* also opined that the Bankruptcy Court's refusal to convert the case was authorized under §105(a) and might have been authorized under the court's inherent powers. *Id.,* at 375–376. But even that dictum does not support Siegel's position. In *Marrama*, the Court reasoned that if the case had been converted to Chapter 13, §1307(c) would have required it to be either dismissed or reconverted to Chapter 7 in light of the debt-

or's bad faith. Therefore, the Court suggested, even if the Bankruptcy Court's refusal to convert the case had not been expressly authorized by §706(d), that action could have been justified as a way of providing a "prompt, rather than a delayed, ruling on [the debtor's] unmeritorious attempt to qualify" under §1307(c). *Id.,* at 376. At most, *Marrama*'s dictum suggests that in some circumstances a bankruptcy court may be authorized to dispense with futile procedural niceties in order to reach more expeditiously an end result required by the Code. *Marrama* most certainly did not endorse, even in dictum, the view that equitable considerations permit a bankruptcy court to contravene express provisions of the Code.

D

We acknowledge that our ruling forces Siegel to shoulder a heavy financial burden resulting from Law's egregious misconduct, and that it may produce inequitable results for trustees and creditors in other cases. We have recognized, however, that in crafting the provisions of §522, "Congress balanced the difficult choices that exemption limits impose on debtors with the economic harm that exemptions visit on creditors." *Schwab* v. *Reilly*, 560 U. S. 770, 791 (2010). The same can be said of the limits imposed on recovery of administrative expenses by trustees. For the reasons we have explained, it is not for courts to alter the balance struck by the statute. Cf. *Guidry* v. *Sheet Metal Workers Nat. Pension Fund*, 493 U. S. 365, 376–377 (1990).

* * *

Our decision today does not denude bankruptcy courts of the essential "authority to respond to debtor misconduct with meaningful sanctions." Brief for United States as *Amicus Curiae* 17. There is ample authority to deny the dishonest debtor a discharge. See §727(a)(2)–(6). (That

sanction lacks bite here, since by reason of a postpetition settlement between Siegel and Law's major creditor, Law has no debts left to discharge; but that will not often be the case.) In addition, Federal Rule of Bankruptcy Procedure 9011—bankruptcy's analogue to Civil Rule 11—authorizes the court to impose sanctions for bad-faith litigation conduct, which may include "an order directing payment. . . of some or all of the reasonable attorneys' fees and other expenses incurred as a direct result of the violation." Fed. Rule Bkrtcy. Proc. 9011(c)(2). The court may also possess further sanctioning authority under either §105(a) or its inherent powers. Cf. *Chambers*, 501 U. S., at 45–49. And because it arises postpetition, a bankruptcy court's monetary sanction survives the bankruptcy case and is thereafter enforceable through the normal procedures for collecting money judgments. See §727(b). Fraudulent conduct in a bankruptcy case may also subject a debtor to criminal prosecution under 18 U. S. C. §152, which carries a maximum penalty of five years' imprisonment.

But whatever other sanctions a bankruptcy court may impose on a dishonest debtor, it may not contravene express provisions of the Bankruptcy Code by ordering that the debtor's exempt property be used to pay debts and expenses for which that property is not liable under the Code.

The judgment of the Court of Appeals is reversed, and the case is remanded for further proceedings consistent with this opinion.

It is so ordered.

Wellness Int'l Network, Ltd. v. Sharif, 727 F.3d 751 (7th Cir. 2013), *cert. granted*, 134 S. Ct. 2901 (2014): Will the Supreme Court Address Waiver and Consent this Time?

Stacey G. C. Jernigan
United States Bankruptcy Judge
Northern District of Texas, Dallas Division
August 6, 2014

On July 1, 2014, barely after the dust settled on the Supreme Court's mid-June 2014 decision in *Exec. Benefits Ins. Agency v. Arkinson (In re Bellingham Ins. Agency)*, 134 S. Ct. 2165 (2014)–and just as the bankruptcy professional community was starting to air frustration that *Exec. Benefits* had not addressed the nagging "consent/waiver" question–the Supreme Court granted a petition for writ of certiorari in the case of *Wellness Int'l Network, Ltd. v. Sharif*, 727 F.3d 751 (7th Cir. 2013), *cert. granted*, 134 S. Ct. 2901 (2014). *Wellness Int'l* once again presents the opportunity for the Supreme Court to tell us whether litigants can consent to (or can waive the right to contest) a bankruptcy court finally adjudicating a matter that should otherwise be adjudicated by an Article III court. The exact two questions on which the Supreme Court granted certiorari were phrased as follows:

(1) Whether the presence of a subsidiary state property law issue in a 11 U.S.C. § 541 action brought against a debtor to determine whether property in the debtor's possession is property of the bankruptcy estate means that such action does not "stem[] from the bankruptcy itself" and therefore, that a bankruptcy court does not have the constitutional authority to enter a final order deciding the action; and

(2) Whether Article III permits the exercise of the judicial power of the United States by the bankruptcy courts on the basis of litigant consent, and if so, whether implied consent based on a litigant's conduct is sufficient to satisfy Article III.

Factual Context of *Wellness Int'l*

It should first be noted that the Seventh Circuit's *Wellness Int'l* decision was issued August 21, 2013–well before the Supreme Court's ruling in *Exec. Benefits*.

The facts of *Wellness Int'l* were as follows. A judgment creditor ("WIN") in a Chapter 7 case of an individual named Richard Sharif filed an adversary proceeding involving five counts, four of which were objections to discharge pursuant to section 727 of the Bankruptcy Code (*e.g.,* concealing property; failing to keep or produce records, making false oaths, failing to explain disappearance of assets), and one of which was a claim for a declaratory judgment that a certain trust was the debtor's alter ego and its assets should be treated as property of the estate. During the course of the adversary proceeding various discovery was propounded on the debtor and, again and again, the debtor was evasive and dilatory in responding to the discovery requests. Motions to compel and for sanctions were filed against the debtor and he was given more time to comply with the discovery requests at various points. Finally, the bankruptcy court ended up entering a final default judgment in favor of the creditor, WIN, on all five counts of the adversary proceeding, as a sanction for the debtor's violation of the discovery order that was in place in the adversary proceeding, and also awarded attorney's fees to WIN. Among other things, the debtor, Sharif, had failed to produce any documents regarding the trust that had been alleged to be his alter ego, failed to turnover numerous other documents requested including tax

returns and bank records, failed to sign interrogatories, and failed to answer various important questions.

The debtor appealed, initially only arguing that the bankruptcy court abused its discretion in entering a default judgment (making various arguments relating thereto), and also arguing that due process had been denied to him with regard to the level of notice that he was given regarding the sanctions he was facing because of the discovery problems. During the pendency of the appeal before the district court (and before briefing was due at such court), the Supreme Court's *Stern v. Marshall* decision was issued. *See Stern v. Marshall,* 131 S. Ct. 2594 (2011). The debtor, Sharif, did not challenge the bankruptcy court's authority in his initial briefing, but later briefing on his behalf did. The district affirmed the bankruptcy court and ultimately held that the debtor had waited too long and waived the right to make a *Stern* constitutional challenge.

Thereafter, the debtor, Sharif, appealed to the Seventh Circuit. He raised numerous points of error but, most notably, argued that "the bankruptcy court lacked constitutional authority to enter final judgment, default or otherwise, on WIN's adversary complaint" under *Stern*. The creditor, WIN, responded that the debtor waived this argument by failing to present it sooner and also, through his litigation conduct, consented to final adjudication by the bankruptcy court. *See Wellness Int'l*, 727 F.3d at 760-61. The Seventh Circuit stated that the "purple elephant in this case is whether the bankruptcy court had authority to enter a final judgment and, if not, whether that is an issue that may be waived." *Id.* at 760.

Seventh Circuit's Analytical Approach

The Seventh Circuit started out by addressing whether the bankruptcy court had ***statutory*** authority to enter a final judgment on WIN's claims. The court first easily decided that it had statutory authority to enter final judgment on the four section 727 claims. As to the alter ego "claim," the Seventh Circuit, noting conflicting jurisprudence, stated that it need not determine whether it was core or non-core because the debtor had waived the issue: "[u]nlike the murky issue of waiver surrounding the bankruptcy court's constitutional authority, it is clear that a party can waive an argument concerning the core/noncore status of a claim under § 157." *Id.* at 762. So it assumed without deciding that an alter ego claim is a core proceeding.

Then turning to the more murky question of constitutional authority and whether waiver is possible in the event that the bankruptcy court did not have constitutional authority over the alter ego claim, the court started with the concept of waiver and whether waiver was possible, when a party would ordinarily have the right to have an Article III court adjudicate its matter. The court noted that Section 1 of Article III protects two separate interests: (1) the rights of litigants to have their cases decided by independent and impartial judges (which primarily protects ***personal*** interests–so would be waivable); and (2) the protection of the separation of powers doctrine, by protecting the judicial branch from encroachment by the political branches (which is a larger, ***structural*** check and balance in our constitutionally created system of government). With regard to this latter interest, "notions of consent and waiver cannot be dispositive because the limitations serve institutional interests." *Id.* at 769. The court, after

exhaustively analyzing various authority including *CFTC v. Schor*, 478 U.S. 833, 848-57 (1986), the Ninth Circuit's *Exec. Benefits* decision, 702 F.3d 553, 566-570 (9th Cir. 2012), and the Sixth Circuit's *Waldman v. Stone* decision, 698 F.3d 910 (6th Cir. 2012), *cert. denied*, 133 S. Ct. 1604 (2013), held that a litigant may not waive an Article III objection to a bankruptcy court's entry of a final judgment in a core proceeding because of the structural protections inherently involved and the court's view that *Stern* had "unequivocally" held that 28 U.S.C. § 157(b) violated the structural protections of Article III, Section 1 of the Constitution.

Then, turning to what actually seemed like the primary question of whether the bankruptcy court lacked constitutional authority to enter a final judgment on the alter ego claim, the Seventh Circuit held that the bankruptcy court indeed lacked authority. The court noted that an alter ego claim is similar to the tortious interference claim in *Stern* in that it is

> a state-law claim that does not involve 'public rights.' The dispute is between private parties and involves no governmental parties. It stems from state law rather than a federal regulatory scheme. And it does not involve a particularized area of law. Instead it is a commonlaw [stet] claim for which state law provides the rule of decision, and it is intended only to augment the bankruptcy estate. . . . Furthermore, it is beyond dispute that the bankruptcy court was not acting as an adjunct to the district court.

Id. at 774 (citations omitted). The court added that, while the alter ego had some overlap with the objection to discharge claims, nothing indicated that it had any relation to the claims allowance process and "it simply cannot be said that by resolving WIN's objection to discharge the bankruptcy court necessarily would have needed to resolve the alter-ego claim." *Id.* at 775. In sum, the bankruptcy court, while having constitutional authority to adjudicate the four discharge claims on a final basis, lacked constitutional authority to enter a final judgment on the alter ego claim.

Seventh Circuit's Remedy

Finally, the Seventh Circuit asked "now what" in the end–what was the "remedy" for the situation? The Seventh Circuit remanded to the district court to first determine whether the alter-ego claim was a ***statutory*** core or noncore proceeding (recall that no one raised that issue and the Seventh Circuit merely assumed it was a statutory core matter–and went straight to the next question finding there was nevertheless no constitutional authority for a bankruptcy court to adjudicate such a claim). If the district court were to determine that the claim was noncore, then the district court could treat the bankruptcy court's ruling as a proposed ruling and rule on it *de novo*. If the district court determined it was a core matter, the Seventh Circuit stated that "it is difficult to find a statutory basis on which the district court could rely to treat the bankruptcy court's order as proposed findings and conclusions." *Id.* at 776. Recall that *Wellness Int'l* was issued ***before*** *Exec. Benefits*–in which the Supreme Court instructed that, in the situation of statutory core matters–where there is no constitutional authority for a non-Article III court to finally adjudicate–there is no gap into which the matter falls. The bankruptcy court can treat the

matter as though it were a noncore matter and at least do proposed findings of fact and conclusions of law to the district court. Thus, without this guidance yet from the Supreme Court, the Seventh Circuit instructed the district court (in the event it found the matter to be statutory core) to withdraw the reference and conduct fresh discovery proceedings in the district court and hear the alter ego claim anew.

In sum, *Wellness Int'l* held that a constitutional objection based on *Stern* is not waivable because it implicates structural separation of powers principles. The court also held that the bankruptcy court lacked constitutional authority to enter a final judgment on the alter-ego claim but, in contrast, the bankruptcy court did have authority to enter a final judgment on the first four counts of the adversary proceeding (each of which were objections to Sharif's discharge). Finally, the court held that the entry of a default judgment and awarding of fees were proper sanctions under the circumstances, although the court remanded for a recalculation of fees.

Seventh Circuit Internal Split?

It is noteworthy that just seventeen days after the *Wellness Int'l* opinion was issued, a different panel of the Seventh Circuit issued an opinion in *Peterson v. Somers Dublin Ltd.*, 729 F.3d 741 (7th Cir. 2013) (issued September 6, 2013) that arguably seems to contradict the *Wellness Int'l* decision. In this decision involving a Chapter 7 trustee's avoidance actions against defendants that had filed proofs of claim, Judge Easterbrook found that there was no *Stern* problem with the bankruptcy court having finally adjudicated the suits, since "there is no constitutional problem when a bankruptcy judge adjudicates a trustee's avoidance actions against creditors who have submitted claims." *Id.* at 747. But in so ruling, Judge Easterbrook–noting the recent *Wellness Int'l* decision that had just been decided in his circuit– stated that "we think the effect of an express and mutual waiver [is] open in this circuit" and that the issue in *Wellness Int'l* was really one of "forfeiture rather than waiver." *Id.* After discussing two cases in the Seventh Circuit that allow parties to "consent on the record" to a magistrate judge adjudicating their case, but do not allow a "failure to object" to be treated as consent in the magistrate context,[1] Judge Easterbrook seemed to suggest that maybe express consent or express waiver on the record might work in the world of bankruptcy, but not a silent, implied consent (*i.e.,* forfeiture or failure to object should not ever work).

Will the Supreme Court Avoid the Question Again?

Query: Can the Supreme Court avoid addressing the issue of consent all over again? Will they? I would posit "maybe." Why? Because similar to *Exec. Benefits,* there were no disputed facts that the bankruptcy court finally adjudicated in *Wellness Int'l*. Recall that in *Exec. Benefits*, the Supreme Court sidestepped ruling on consent, because it determined that the district court conducted the same type of *de novo* review on appeal that it would have conducted if the

[1] *Geras v. Lafayette Display Fixtures, Inc.,* 742 F.2d 1037 (7th Cir. 1984); *Gibson v. Gary Hous. Authority*, 754 F.2d 205 (7th Cir. 1985).

bankruptcy court had merely issued a proposed ruling, because there were no disputed facts to review *de novo*–in other words, the bankruptcy court had issued a summary judgment based on undisputed facts, and so the district court had looked at whether the bankruptcy court correctly entered summary judgment as a matter of law–looking at the law and judgment on a *de novo* basis. In *Wellness Int'l*, the bankruptcy court entered a default judgment–it did not do any fact finding on the merits of the claims. Then, the district court looked at whether the bankruptcy court abused its discretion–presumably the same way it might have if the bankruptcy court had entered a mere proposed default judgment as a sanction based on the debtor's discovery abuses.

Stay tuned. The Supreme Court will hear arguments in the *Wellness Int'l* matter this coming 2014-2015 term and, if history is any indication, we will all be reading their opinion sometime in mid June 2015! Get your adult-beverage-of-choice ready!