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AUTHORITY OF BANKRUPTCY JUDGE TO ENTER MONEY JUDGMENTS
ON NON-DISCHARGEABLE DEBT

by
Bankruptcy Judge Jennie D. Latta
Western District of Tennessee

ISSUE: When a creditor sues to determine the dischargeability of a debt not reduced to judgment prior to the filing of a bankruptcy petition, does the bankruptcy judge have authority to enter a money judgment in addition to determining the amount of the debt for purposes of distribution from the bankruptcy estate?

***Hart v. Southern Heritage Bank (In re Hart)*, __ Fed. Appx. __, 2014 WL 1663029 (6th Cir., April 28, 2014).**

Judge Bernice B. Donald, Circuit Court Judge and former Bankruptcy Judge for the Western District of Tennessee, drafted the opinion of the three-judge panel.

The Debtor, Hart, filed Chapter 11 petition in Eastern District of Tennessee. The case was converted to Chapter 7. The creditor, Southern Heritage Bank, filed a complaint to determine the dischargeability of four loans pursuant to 11 U.S.C. § 523(a)(2)(B). The bankruptcy judge determined that the loans were not dischargeable, but did not enter a money judgment. The Bank moved for amendment pursuant to Rule 9024 by reason of mistake, asking the bankruptcy judge to enter a money judgment. The Debtor objected. The bankruptcy judge overruled the objection and entered judgment for the Bank. The Debtor appealed to the district court, which affirmed. The Sixth Circuit affirmed as well.

Hart argued that the bankruptcy judge lacked constitutional authority to enter a final money judgment in connection with the action under § 523(a)(2)(B). The court of appeals distinguished the case from that of *Stern v. Marshall*, 564 U.S. __, 131 S. Ct. 2594, 2611, 180 L. Ed. 2d 475 (2011), *reh'g denied*, __ U.S. __, 132 S. Ct. 56, 180 L. Ed. 2d 924 (2011), saying that the only claim before the bankruptcy judge was the claim of the Bank. The Debtor had raised no counterclaim in connection with the adversary proceeding. Thus, the court of appeals said that, (1) the Bank's claim against the Debtor "arises specifically in bankruptcy" because it was an action to determine the dischargeability of a debt; and (2) the Bank's non-dischargeability claim was "resolvable by a ruling on the creditor's proof of claim in bankruptcy," citing *Stern v. Marshall*; *Waldman v. Stone*, 698 F.3d 910, 919-20 (6th Cir. 2013); and *Longo v. McLaren (In re McLaren)*, 2 F.3d 958, 965-66 (6th Cir. 1993). In the cited cases, the court of appeals held that a bankruptcy judge has authority to "adjudge the validity and amount of a claim together with its dischargeability," and that "the bankruptcy court had authority to enter final judgment on dischargeability claims that arose under federal law and 'were part and parcel of the claims-allowance process in bankruptcy.'"

In explaining its decision, the court of appeals said that the bankruptcy court did not exceed its authority even though its decision precluded the Debtor from pursuing counterclaims in state court because the bankruptcy judge found that the Debtor never filed any counter-claims, federal or state, against the Bank in the adversary proceeding or in a related state court proceeding. Thus, the bankruptcy judge did not address the Debtor's counterclaims directly. The court merely entered

a money judgment on a federal issue—dischargeability—which indirectly precluded the Debtor from filing counterclaims in state court. The bankruptcy judge preserved an opportunity for the Debtor to benefit from state court litigation between the Bank and a third party (Optimum Staffing) by reserving the possibility of an offset for Debtor should Optimum Staffing succeed on its defense.

***Southern Heritage Bank v. Hart (In re Hart)*, 2012 WL 326912 (Bankr. E.D. Tenn., Aug. 9, 2012) (Rucker, B.J.)**. The bankruptcy judge’s memorandum opinion provides additional details which shed light on Judge Donald’s opinion.

The Bank filed an adversary proceeding objecting to discharge. Following trial, the bankruptcy judge signed an order finding that four debts owed to the Bank were not dischargeable:

1. Debtor’s debt owed to Bank as the result of guaranty of Optimum Loan. To the extent that any portion of the debt owed to the Bank is the result of the Debtor’s guaranty of the debt of Optimum Staffing, the order was without prejudice to any counterclaims or offsets claimed by Optimum Staffing.
2. Debtor’s debt on Personal Loan.
3. Debtor’s debt on the Daisy Loan.
4. Debtor’s debt on the Residence Loan.

The Bank then filed suit against the Debtor in Bradley County seeking judgments against the Debtor on the Personal Loan and the Daisy Loan. The Debtor attempted to raise counterclaims and defenses not raised in the adversary proceeding. The Bank responded by returning to the bankruptcy court to file a motion to amend the bankruptcy judge’s prior order to include a money judgment. The effect of entry of a money judgment would be to cut off the Debtor’s right to assert counterclaims and/or other defenses in the Bradley County litigation. The Bank acknowledged, however, that the Debtor’s liability on the judgment would be reduced if Optimum Staffing were successful in its defense against the Bank.

The Debtor opposed the motion to amend on four grounds:

1. No evidence to support finding of mistake.
2. Court should abstain to allow chancery court to adjudicate Bank’s claim and Debtor’s and Optimum Staffing’s counterclaims.
3. Bank should be estopped from seeking judgment because Bank had filed two new lawsuits in county court seeking judgment against the Debtor. Debtor argued that she should be permitted to raise any counterclaims and defenses specific to her in those suits.
4. Court lacks jurisdiction to cut off claims that Debtor is entitled to raise with respect to the Bank on the basis of *Stern v. Marshall*.

At the time of the bankruptcy trial, there was a suit pending in the Chancery Court of Bradley County: *Southern Heritage Bank v. Optimum Staffing, Inc., Loretta J. Hart, and Jerry Scheib*.

The Debtor was the principal of Optimum Staffing and had guaranteed its note to the Bank. The chancery litigation was stayed by a bankruptcy filing by Optimum Staffing and by the bankruptcy filing of the Debtor. Both cases were closed at the time the memorandum opinion in the adversary proceeding was entered. During the pendency of the bankruptcy cases, the chancery litigation lay dormant. Neither trustee pursued claims against the Bank. Any claims held by the bankruptcy trustee revested in each debtor upon the closing of their respective cases. Optimum Staffing did not obtain a discharge in its case because it is not an individual. The Debtor did not receive a discharge of the four debts listed. The chancery litigation was resumed, and the issue arose whether the bankruptcy judge intended to enter a judgment in favor of the Bank that would preclude the Debtor from raising any counterclaims against the Bank in the prior pending litigation or in the two new suits filed by the Bank in Bradley County.

The bankruptcy judge found that the Debtor did not raise any affirmative defense to the Bank's loans in her answer to the dischargeability complaint. Rather, the Debtor stated in her answer that there were "some very questionable documents that have been filed with this court on various claims of this creditor," but never amended her answer to assert either a counterclaim or to raise an affirmative defense. The Debtor failed to list claims against the Bank as property of the bankruptcy estate and first mentioned the issue of counterclaim shortly before trial. As a result, the bankruptcy judge granted the Bank's motion in limine to prohibit the Debtor from raising counterclaims against the Bank based upon the written waiver of defenses contained in her guaranty. The bankruptcy judge also prohibited evidence of the counterclaims of Optimum Staffing, finding these irrelevant to the determination of the dischargeability of the Debtor's obligations to the Bank.

Bankruptcy Judge Rucker indicated that she had heard nothing that indicated the existence of a set-off or cause of action that would reduce the debt that belonged to Debtor. Instead, she said the Debtor would be a beneficiary if Optimum Staffing were successful in asserting its defense against the Bank. The bankruptcy judge allowed the Debtor to proceed only on a count of forgery, which apparently was not actually argued or proved at trial.

After the trial and the entry of the bankruptcy judge's order determining that the debts were not dischargeable, the Debtor attempted to raise claims against the Bank on her own behalf which were never pled in the chancery court or in the bankruptcy court. For this reason, as the result of the Bank's motion to amend, the bankruptcy judge agreed to enter a money judgment against the Debtor subject to any credit that would result in the event that Optimum Staffing was successful in its defense of the Bank's claim.

The bankruptcy judge found no reason to abstain from entering the money judgments. Since the Debtor provided no evidence that she had claims pending in the state court prior to the filing of her bankruptcy petition, there was no basis for mandatory abstention under 28 U.S.C. § 1334(c) (2). Further, the bankruptcy judge found no basis for permissive abstention because an objection to discharge [sic] is a core matter. The Debtor did not demonstrate that her defenses (other than those of Optimum Staffing) arose from transactions other than the loans which were the subject of the complaint to determine dischargeability.

The bankruptcy judge found that the Bank was not estopped from seeking an amendment to the prior order because of the filing of the additional chancery court complaints. These two com-

plaints, one seeking judgment on the Personal Loan and the other on the Daisy Loan, both relied upon the findings of the bankruptcy court in the dischargeability action. If the bankruptcy court refused to amend its prior order, the effect would be to allow the Debtor to raise claims that she failed to raise or raised too late in the adversary proceeding.

The bankruptcy judge further found that she had jurisdiction to grant the requested relief, saying that a court has authority to interpret and amend its own orders. The Debtor opposed the motion on the basis that the bankruptcy court does have jurisdiction to hear a counterclaim (relying on *Stern v. Marshall*), but her argument was based upon a counterclaim she failed to raise. Therefore, *Stern* did not apply. The Debtor sought to pursue a claim against the Bank that was not raised in the chancery litigation or as an affirmative defense in the adversary proceeding. There was apparently a question about whether the proposed counterclaim even belonged to the Debtor.

Comment: The unusual facts in the *Hart* case make it an unfortunate one for the court of appeals to have addressed (and explain why the case was not recommended for full-text publication). As a result of the unusual facts, neither the bankruptcy court nor the court of appeals focused on the distinction between the determination of non-dischargeability and the liquidation of the claim, or upon the distinction between the claims-allowance process and the reduction of a claim to judgment. The following post-*Stern* cases address these issues in the context of the Supreme Court's decision. These decisions must of course be understood as preliminary in light of the impending decision of the Court in *Executive Benefits Ins. Agency v. Arkison*.

***Dragisic v. Boricich (In re Borichich)*.** The impact of *Stern v. Marshall* upon the constitutional authority of a bankruptcy judge to enter a final money judgment upon a state law claim in a non-dischargeability action was raised by Bankruptcy Judge Jack B. Schmetterer in *Dragisic v. Boricich (In re Borichich)*, 2011 WL 2600692 (Bankr. N.D. Ill. 2011) (*Boricich I*). In his initial opinion, Bankruptcy Judge Schmetterer determined a debt in an amount certain to be non-dischargeable, but stopped short of entering a money judgment. Instead, he reserved the issue for a period of twenty-eight days to permit the parties to file a motion to amend the judgment supported by appropriate briefs. *Boricich I*, at *9. In so doing, he noted that under prior Seventh Circuit precedent, bankruptcy judges had been permitted to determine the amount of a debt and enter a money judgment on that finding. *Id.*, citing *In re Hallahan*, 936 F.2d 1496, 1508 (7th Cir. 1991).

Motions to amend the judgment were filed by the plaintiff and the defendant. The motion of the defendant was denied for unrelated reasons. The motion of the plaintiff, however, was granted. Bankruptcy Judge Schmetterer distinguished the action in *Boricich* from that in *Stern* on two bases: (1) the action in *Stern* was one in which there was a right to jury trial, while the action in *Boricich* was one in which there was no right to jury trial; and (2) the action in *Stern* was one arising under state law while the one in *Boricich* was one arising under and defined by the Bankruptcy Code to determine non-dischargeability. According to Bankruptcy Judge Schmetterer, “[t]hat characteristic of the action is not changed because the theory of recovery arose under nonfederal law.” *Dragisic v. Boricich (In re Borichich)*, 464 B.R. 335, 337 (Bankr. N.D. Ill. 2011) (*Boricich II*). Bankruptcy Judge Schmetterer noted that most claims in the bankruptcy system require the bankruptcy judge to look to nonbankruptcy law for the rule of decision, and further that *Stern* itself was limited to the debtor's counterclaim and similar actions that are not resolved in the process of ruling on a creditor's proof of claim. *Boricich II*, 464 B.R. at 337, citing *In re Olde Prairie Block Owner, LLC*, 457 B.R. 692, 698-99 (Bankr. N.D. Ill. 2011). Bankruptcy Judge Schmetterer

reasoned that it is necessary to determine the amount of debt in order to determine that a debt is non-dischargeable, and therefore that a final judgment is authorized under *Stern* because that resolution is necessary to the determination of the creditor's claim. *Boricich II*, 464 B.R. at 337.

***Condon Oil Co. v. Wood (In re Wood)*, 503 B.R. 705 (Bankr. W.D. Wis. 2013).** Taking the position opposite that of Bankruptcy Judge Schmetterer is Bankruptcy Judge Robert D. Martin in *Condon Oil Co. v. Wood*. In light of *Stern*, Bankruptcy Judge Martin recognized the bankruptcy court's "lack of constitutional jurisdiction to enter a money judgment for a debt that is determined to be nondischargeable." *Id.* at 709. Bankruptcy Judge Martin made note of the same Seventh Circuit precedent relied upon by Bankruptcy Judge Schmetterer, but concluded that under the reasoning of *Stern*, the practice of bankruptcy judges entering money judgments must be discontinued based upon the conclusion in *Stern* that "a claim that is founded on a 'state law action independent of federal bankruptcy law,' based on private rather than public rights, and 'not necessarily resolvable by a ruling on the creditor's proof of claim in bankruptcy' cannot be finally determined by an Article I bankruptcy judge." *Wood*, 503 B.R. at 709.

Disagreeing with Bankruptcy Judge Schmetterer, Bankruptcy Judge Martin said that "the amount of the debt is patently unnecessary to a determination that it is nondischargeable." *Id.* Judge Martin commented:

As Douglas Baird explains in *Blue Collar Constitutional Law*, the Supreme Court in *Stern* "distinguishes between administering the bankruptcy estate on the one hand and engaging in actions that are the province of a common law judge on the other." Douglas G. Baird, *Blue Collar Constitutional Law*, 86 Am. Bankr. L.J. 3, 4-5 (2012). **A debt need not be reduced to judgment in order for the court to determine whether that debt is nondischargeable.** *Johnson v. Weihert (In re Weihert)*, 489 B.R. 558, 564 (Bankr. W.D. Wis. 2013). Once a debt is rendered non-dischargeable, it becomes an ordinary debt, and entering judgment on such a debt is an exercise of federal judicial power.... Therefore, since liquidating a nondischargeable debt is not necessary to administer the bankruptcy estate, and entering judgment is an exercise of judicial power, a bankruptcy judge lacks the constitutional authority to reduce a nondischargeable debt to judgment.

Id. at 9-10 (emphasis mine).

***Chen v. Huang (In re Huang)*, __ B.R. __, 2014 W.L. 56053 (Bankr. D. Mass., Jan. 7. 2014).** In this case, Bankruptcy Judge Henry J. Boroff gives an extensive and scholarly presentation of the history of the question of the authority of bankruptcy judges to enter money judgments, ultimately concluding that bankruptcy judges may enter such judgments because determination of the scope of a debtor's liability on a claim and right to payment are necessary to the determination of non-dischargeability.

Bankruptcy Judge Boroff described two approaches that have been taken by the courts: a "limited approach" and an "expansive approach." The judge noted that most published decisions (prior to *Stern*) adopted the expansive approach.

Courts that adopted the limited approach, i.e., finding that bankruptcy judges do not have the power to enter money judgments on non-dischargeable debts, arise from the seminal decision *In*

re Thrall, 196 B.R. 959 (Bankr. D. Colo. 1996). In her opinion, Bankruptcy Judge (now District Judge) Marcia Kreiger noted that the prior Bankruptcy Act § 17(c)(3) specifically required the bankruptcy court not only to determine the dischargeability of a debt, but also to enter judgment and make necessary orders for its enforcement. The Bankruptcy Code, on the other hand, mentions dischargeability, but not money judgments against the debtor. Bankruptcy Judge Kreiger concluded, therefore, that Congress did not intend to confer this power upon the bankruptcy judges. A more recent decision to take the limited approach was *Cambio v. Mattera (In re Cambio)*, 353 B.R. 30 (B.A.P. 1st Cir. 2004), which also concluded that Congress intended to limit the bankruptcy courts to deciding dischargeability issues.

Bankruptcy Judge Boroff noted that if the term “money judgment” was limited to executable judgments, he would join the minority and adopt the limited approach. *Huang*, at *7. He found, however, that in both *Thrall* and *Cambio*, the term “money judgment” was used as shorthand for a judgment that liquidates the amount of the underlying debt. *Id.* In the context of a no-asset Chapter 7 case, such as *Cambio*, the only effect of the liquidation of the debt in a dischargeability action “would be to enhance [the creditor’s] future ability to collect from [the debtor’s] post-bankruptcy income and assets, with no effect at all on property of the estate or creditors’ claims against the estate. *Cambio*, 353 B.R. at 33-34. It was for this reason, he thought, that the *Cambio* panel rendered its decision adopting the limited approach.

Ultimately, Bankruptcy Judge Boroff disagreed with two assumptions he found to underlie *Thrall* and *Cambio*: (1) the assumption that a matter having no effect on the bankruptcy estate cannot constitute a “core” or “related to” matter within the bankruptcy court’s jurisdiction; and (2) the assumption that the dischargeability of a particular debt and validity or amount of that debt are severable and can, or at least should be, separately determined. In response to the second assumption, Judge Boroff states:

[E]ven if the facts necessary to determine the amount or validity of the underlying debt are separable from those related to the requisites for nondischargeability, both the Bankruptcy Code and the jurisdictional statute treat the determination of the amount of any nondischargeable debt (as well as the extent of the debtor’s liability on that debt) as an essential element of the matter to be determined by, and within the jurisdiction of, the bankruptcy court.

Id. Taking the same position as Judge Schmetterer, Judge Boroff concluded that the determination of the liability and right to payment are necessary to the dischargeability proceeding. *Id.* Moreover, Judge Boroff disagrees with Judge Kreiger on the intent of Congress in eliminating reference to the authority of a bankruptcy judge to enter a money judgment from the Bankruptcy Code. In light of the greatly expanded jurisdiction granted under the Bankruptcy Code, he concluded that “Congress clearly did not intend to shrink the jurisdiction of the bankruptcy courts with the passage of the Bankruptcy Code,” citing for support legislative history indicating the Bankruptcy Code was designed to subsume all matters that bankruptcy courts were then able to hear under the Bankruptcy Act including “determination of the dischargeability of debts [and] liquidation of non-dischargeable debts.” *Id.* at *9 quoting H.R. Rep. No. 95-595, at 446, 49 (1977), reprinted in 1978 U.S.C.C.A.N. 5963, 6401, 6010.

Comment. Bankruptcy *jurisdiction*, which is granted to the district courts at 28 U.S.C § 1334(a), must be distinguished from the authority of bankruptcy judges at 28 U.S.C. § 157(a). Moreover,

the Supreme Court has made clear that statutory authority and Constitutional authority are two different things and the mere fact that Congress has labeled a proceeding “core” does not mean that a bankruptcy judge has Constitutional authority to hear and finally determine it. My thoughts on *Stern* are set out at *In re Davis*, 2011 WL 5429095 (Bankr. W.D. Tenn. 2011).

I note with interest that the opening remarks of Douglas Hallward-Driemeier, for the petitioner in *Executive Benefits Ins. Agency v. Arkison*, a case that raises the question of whether a bankruptcy judge may exercise the judicial power of the United States based upon the consent of the litigants, included the following statements:

The entry of a judgment of the United States is not nearly [sic] a matter of private interest to litigants. Rather, it carries the force of law that is binding on other courts, binding on the executive branch which must enforce the judgment, and even binding on the legislature which cannot reopen the judgment. The entry of final judgment of the United States is the ultimate exercise of the judicial power under Article 3, just as the enactment of legislation is the ultimate exercise of the legislative power under Article I.

2014 WL 125548.

With respect to the question of the authority of bankruptcy judges to enter money judgments with respect to non-dischargeable debts, it seems a distinction can (and perhaps should) be drawn between determining “creditor’s hierarchically ordered claims to a pro rata share of the bankruptcy res,” *Granfinanciera, S.A. v. Nordberg*, 492 U.S. 33, 56, 109 S. Ct. 2782, 106 L. Ed. 2d 26 (1989), and entering an executable money judgment, enforceable by the executive power of the United States.

Those who would like further background on the question of the bankruptcy judges’ authority to enter money judgments on a non-dischargeable debt should consult Ralph Brubaker, *Bankruptcy Court Jurisdiction to Enter a Money Judgment on a Nondischargeable Debt: Exposing Pacor’s Deficiencies and the True Supplemental Nature of Third-Party “Related To” Bankruptcy Jurisdiction*, 29 No. 4 BLL 1 (2009). At the time that article was written, all circuit courts of appeal to address the issue had concluded that the bankruptcy courts do have jurisdiction to enter a money judgment against a debtor on an underlying non-dischargeable debt. Professor Brubaker’s article, of course, precedes *Stern v. Marshall*, so it must be read in light of the Court’s comments about the authority of the bankruptcy judges.

It was written in response to the Fifth Circuit’s decision *Morrison v. Western Builders of Amarillo, Inc. (In re Morrison)*, 555 F.3d 473 (5th Cir. 2009), a decision written by a former bankruptcy law practitioner. In *Morrison*, Judge Edith Hollan Jones explained that the basis for the bankruptcy court’s jurisdiction to enter a money judgment on a non-dischargeable claim can only be “related to” jurisdiction not encompassed by the *Pacor* test: “whether *the outcome of ... [the] proceeding could conceivably have any effect on the estate being administered in bankruptcy*” (*Pacor, Inc. v. Higgins*, 743 F.2d 984, 994 (3d Cir. 1984)), but rather *supplemental jurisdiction* which permits a federal court to entertain and dispose of related state law claims on the basis of judicial economy and procedural convenience. Brubaker, 29 No. 4 BLL 1, at 5-6. Professor Brubaker concludes:

[T]he only reconciliation consistent with the terms of the jurisdictional statute and the legislative history regarding its purposes is to simply recognize that *Pacor* was

wrong; third-party “related to” bankruptcy jurisdiction is supplemental jurisdiction, and there is “related to” bankruptcy jurisdiction over any third-party dispute sharing a conventional supplemental relationship with a claim before the court (1) “arising under” the Bankruptcy Code or (2) to which the federal bankruptcy estate is a party.

Brubaker, 29 No. 4 BLL, at 7. Professor Brubaker can hardly be faulted for failing to anticipate the line drawn by the Supreme Court in *Stern* between bankruptcy jurisdiction and bankruptcy judge authority. His conclusion concerning the jurisdiction supplemental to federal bankruptcy jurisdiction is no doubt the correct analysis with respect to the jurisdiction of the Article III district court to enter a money judgment supplemental to a declaration that a particular debt is non-dischargeable, but gives no basis for the exercise of this jurisdiction by the Article I bankruptcy judges.

The question of the convenience of the litigants may be one of those to be addressed by the Court in *Executive Benefits Ins. Agency v. Arkison*. Stay tuned.