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Stern v. Marshall: One Year Later

Navigating the Impact of the Ruling on Fraudulent Transfer, Preference and Other Bankruptcy Claims Litigation

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WHAT WE HAVE LEARNED ABOUT THE PRACTICAL RAMIFICATIONS OF *STERN v. MARSHALL* ONE YEAR LATER

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Background Facts

- *Stern* arose from the bankruptcy of Vickie Lynn Marshall, more famously known as Anna Nicole Smith.
- Vickie married octogenarian oil magnate J. Howard Marshall roughly one year before his death.
- As J. Howard's health failed, Vickie discovered that neither his living trust nor his will made any provision for her.
- Vickie then sued J. Howard's son, Pierce, in Texas probate court, alleging tortious interference with her expected testamentary gift.
- With her suit still unresolved at the time of J Howard's death, Vickie filed for bankruptcy.

Background Facts (cont.)

- Pierce commenced an adversary proceeding against Vickie in bankruptcy court, alleging defamation and seeking a declaration of non-dischargability.
  - Critically, Pierce also filed a proof of claim in the bankruptcy, seeking damages on account of his defamation claim.
- Vickie responded by filing a counterclaim against Pierce, raising tortious interference claims identical to those raised before the Texas probate court.
- Pierce argued that the bankruptcy court lacked jurisdiction to enter a final order on Vickie's counterclaim, asserting that it was a "non-core matter" under 28 U.S.C. § 157.
- The bankruptcy court rejected this argument and ultimately enter a judgment for $475 million in favor of Vickie.

Background Facts (cont.)

- Following the bankruptcy court's order, the Texas probate court came to the opposite conclusion and held that no tortious interference occurred.
- On appeal of the bankruptcy court's order, the district court concluded that the bankruptcy court lacked jurisdiction to enter a final order on Vickie's claim, but nevertheless entered its own order in favor of Vickie, albeit for significantly reduced damages.
- These conflicting orders created a quandary:
  - If the district court was correct that the bankruptcy court lacked jurisdiction to enter a final order, then the Texas probate court's decision was the first final order on the matter and should have been given preclusive effect.
  - If, however, the bankruptcy court possessed the authority to enter a final order, then its judgment should have been given preclusive effect.
  - In either case, the district court's order would necessarily be reversed.
  - After a number of further appellate proceedings (including a separate hearing by the Supreme Court), the case that is the subject of today's presentation came before the Supreme Court.

Stern v. Marshall

- "We conclude that, although the Bankruptcy Court had the statutory authority to enter judgment on Vickie's counterclaim, it lacked the constitutional authority to do so…" *Stern v. Marshall, 131 S.Ct. 2594,* 2601 (S.Ct. 2011).

- Bankruptcy Courts have the statutory authority to enter final judgments as to each of the "core proceedings" defined in 28 U.S.C. § 157(b)(2), but do not have the Constitutional authority to do so as to certain proceedings defined as core (e.g., state law counterclaims).

- The District Courts must enter final judgment as to non-core proceedings (28 U.S.C. § 157(c)(1)).

There Was Initial Uncertainty as to the Impact of the Decision

"Everyday I am presented with numerous orders that Congress expects me to sign either as final or forward on with a report and recommendation. However, prior to *Stern*, I did have a standard—28 U.S.C. § 157(b)(2)—to serve as my guide. But now I am told that that standard is unreliable when tested against the Constitution itself. My frustration with *Stern* is that it offers virtually no insight as to how to recalibrate the core/non-core dichotomy so that I can again proceed with at least some assurance that I will not be making the same constitutional blunder with respect to some other aspect of Authority Section 157(b)(2)…

One Alternative would be to play it safe and simply refer without reflection every future determination I make to a district judge for his or her final review. However, I do not see how I can do so in good faith given Authority Section 157(b)(3)'s direction that I must decide even in instances when not requested whether I have the ability or not under that section to enter a final order. 28 U.S.C. § 157(b)(3). Moreover, I suspect that the Article III judges in my district would not be pleased with the extra workload such an approach would impose upon them…"

In re Teleservices Group, Inc. (Meoli v. Huntington National Bank), 2011 WL 3610050, 2-3 (Bankr. W.D. Mi. 2011).

Has There Been Any Greater Certainty as to the Impact of *Stern* Over the Past Year?

Some Practical Issues—What We've Learned in the Last Year

1. Whether Bankruptcy Courts will enter final orders on the core proceedings listed, or will simply prepare proposed findings of fact and conclusions of law for the District Courts to enter.

2. Whether District Courts will withdraw the reference.

3. What Does a de novo review by the District Court look like?

4. What Bankruptcy Courts will do regarding 9019 motions and motions for default judgment.

5. Express and implied consent as a means of avoiding *Stern* issues.

6. Practical approaches to the *Stern* problem.

Issue # 1

Whether Bankruptcy Courts will enter final orders on the core proceedings listed, or will simply prepare proposed findings of fact and conclusions of law for the District Courts to enter.

Core vs. Non-Core

- "As explained below, bankruptcy courts may hear and enter final judgments in "core proceedings" in a bankruptcy case. In non-core proceedings, the bankruptcy courts instead submit proposed findings of fact and conclusions of law to the district court, for that court's review and issuance of a final judgment." *Stern* at pp. 2601-2602.

Core Claims
(Final Judgments May Be Entered by Bankruptcy Courts)

"Bankruptcy judges may hear and enter final judgments in "all core proceedings arising under title 11, or arising in a case under title 11." § 157(b)(1). "Core proceedings include, but are not limited to" 16 different types of matters, including "counterclaims by [a debtor's] estate against persons filing claims against the estate." § 157(b)(2)(c). Parties may appeal final judgments of a bankruptcy court in core proceedings to the district court, which reviews them under traditional appellate standards. See § 158(a); Fed. Rule Bkrpcy. Proc. 8013."

Stern at pp. 2603-2604.

Non-Core (Proposed Findings of Fact and Conclusions of Law Submitted to the District Court)

"When a bankruptcy judge determines that a referred "proceeding… is not a core proceeding but… is otherwise related to a case under title 11," the judge may only "submit proposed findings of fact and conclusions of law to the district court." § 157(c)(1). It is the district court that enters final judgment in such cases after reviewing *de novo* any matter to which a party objects."

Stern at p. 2604.

Narrow vs. Broad Interpretation

"We conclude today that Congress, in one isolated respect, exceeded that limitation in the Bankruptcy Act of 1984. The Bankruptcy Court below lacked the constitutional authority to enter a final judgment on a state law counterclaim that is not resolved in the process of ruling on a creditor's proof of claim…"

"Pierce has not argued that the bankruptcy courts "are barred from 'hearing' all counterclaims" or proposing findings of fact and conclusions of law on those matters, but rather that it must be the district court that "finally decide[s]" them. [citation omitted.] We do not think the removal of counterclaims such as Vickie's from core bankruptcy jurisdiction meaningfully changes the division of labor in the current statute; we agree with the United States that the question presented here is a "narrow" one."

Stern at p. 2620.

OTHER RECENT CONSTITUTIONALLY CORE/NON-CORE CASES

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

- Defendant in copyright infringement suit files for bankruptcy.
- Bankruptcy court struck plaintiff's demand for a jury trial but entered judgment for plaintiff for the minimum in statutory damages, deeming the claim non-dischargeable in bankruptcy.
- The 8th Circuit held that the Bankruptcy court was permitted to determine the amount of the damages award, instead of a jury, as it was "part of the process of allowing or disallowing the [plaintiff's] claims for copyright infringement."

Ortiz v. Aurora Health Care, Inc., 665 F.3d 906 (7th Cir. 2011)

- Bankruptcy court granted summary judgment to Defendant , dismissing debtors' claims that defendant violated state law when it revealed their medical information.

- On direct appeal, the 7th Circuit held that the bankruptcy judge improperly entered final judgment.
- Like *Stern*, the debtors' claims involved private parties disputing ordinary state-law claims not historically determined by the executive or legislative branches.
- That the claims arose out of procedures in the debtor's bankruptcies was insufficient to bypass Article III requirements.

In re DPH Holdings Corp., 448 Fed. Appx. 134 (2nd Cir. 2011)

- Chapter 11 debtor's insurers sought declaratory judgment against debtor and others regarding policies issued to debtor.
- Bankruptcy court rejected argument that it lacked jurisdiction under *Stern* and the 2d Circuit affirmed.

- The 2d Circuit held as long as the "proceeding is one or the other [core or non-core], the Bankruptcy Court possessed subject matter jurisdiction."
- This was a "core proceeding" because:
  - At issue were several post-petition contracts;
  - Proceeding was likely to "directly affect a core bankruptcy function" because the validity of the contracts would determine the allowance or disallowance of claims against the estate; and
  - the resolution of the matter concerns and affects the liquidation of the assets of the estate.
  - The court also noted that it made no difference that the proceeding arose post-confirmation

In re Quigley Co. Inc., 676 F.3d 45 (2d Cir. 2012)

- Both parties challenged a bankruptcy court's authority to enjoin a class-action suit from proceeding against the debtor's parent company.
- The 2d Circuit found the holding in *Stern* inapposite and stressed that the Supreme Court indicated that its holding was a narrow one.
- "Enjoining litigation to protect bankruptcy estates during the pendency of bankruptcy proceedings, unlike the entry of a final tort judgment at issue in *Stern*, has historically been the province of the bankruptcy courts."

FRAUDULENT TRANSFER ACTION: Core or "Unconstitutionally Core"

"We reasoned that fraudulent conveyance suits were "quintessentially suits at common law that more nearly resemble state law contract claims brought by a bankrupt corporation to augment the bankruptcy estate than they do creditors' hierarchically ordered claims to a pro rata share of the bankruptcy res." *Id.* at 56, 109 S.Ct. 2782. As a consequence, we concluded hat fraudulent conveyance actions were "more accurately characterized as a private rather than a public right as we have used those terms in our Article III decisions."

Stern at p. 2614 (citing *Granfinanciera, S.A. v. Nordberg*, 492 U.S. 33, 109 S.Ct. 2782, L.Ed.2d 26 (1989)).

2011 Decisions: All Over the Map

- *In re Teleservices Group, Inc.* (*Meoli v. The Huntington National Bank*), 2011 WL 3610050 (Bankr. W.D. Mi. 2011)(bankruptcy court submitted findings to the district court as a non-core matter on report and recommendation).

- *In re Hudson* (*Tibble v. Wells Fargo Bank, N.A.*), 2011 WL 3583278 (Bankr. W.D. Mi. 2011)(avoidance claim pertaining to the determination of the validity, extent, or priority of asserted mortgage lien)("Except for the types of counterclaims addressed in *Stern v. Marshall,* a bankruptcy judge remains empowered to enter final orders in all core proceedings.")

- *In re Safety Harbor Resort and Spa a/k/a S.H.S. Resort, LLC*, 2011 WL 3849639 (M.D. Fla. 2011)("Of course, years from now, the Supreme Court may hold that section 157(b)(2)(F) dealing with fraudulent conveyances is unconstitutional, just as it did with section 157(b)(2)(C). But the job of bankruptcy courts is to apply the law as it is written and interpreted today. 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. The Supreme Court does not ordinarily decide important questions of law by cursory dicta. 76 And it certainly did not do so in *Stern.")*

2011 Decisions: All Over the Map (Con't)

- *In re Fairfield Sentry Ltd.*, 2011 WL 4359937 (Bankr. S.D.N.Y. 2011)(Clawback claims were found to be non-core claims)("After reviewing the parties' submissions to the Bankruptcy Court and to this Court, the Court concludes that these cases do not fall within the Bankruptcy Court's core jurisdiction for two reasons. First, these cases do not "arise under" title 11 nor do they "arise in" a title 11 case. Second, the assertion of subject matter jurisdiction over these cases by an Article I court contravenes the principle of separation of powers enshrined in Article III of the Constitution. The Court discusses each of these rationales in turn.")

- *Development Specialists, Inc. v. Akin Gump Strauss Hauer & Feld LLP*, 462 B.R. 457 (S.D.N.Y. 2011) (In granting the motion to withdraw the reference, the court specifically noted in respect to the one defendant asserting a fraudulent conveyance counterclaim, "Meanwhile, [defendant's] fraudulent conveyance counterclaim against [the Debtor] is precisely the kind of claim found to involve only private rights in *Granfinanciera."*)

Blixseth (Montana) 2011 vs. 2012

The Bankruptcy Court in 2011

"Since Trustee's fraudulent conveyance claim is essentially a common law claim attempting to augment the estate, does not stem from the bankruptcy itself and would not be resolved in the claims allowance process, it is a private right that must be adjudicated by an Article III court. This Court's jurisdiction over that claim as a core proceeding is therefore unconstitutional…. Since this Court may not constitutionally hear the fraudulent conveyance claim as a core proceeding, and this Court does not have statutory authority to hear it as a noncore proceeding, it may in no case hear the claim." *In re Blixseth (Samson v. Blixseth),* 2011 WL 3274042, 11 (Bankr. D. Montana 2011)

The Bankruptcy Court in 2012

"For the reasons discussed above, the Court finds it has constitutional authority to enter a final judgment on Counts I, III, V and VI of the Trustee's Amended Complaint." *In re Blixseth (Samson v. Western Capital Partners LLC)*, 2012 WL 1981719, 2.

Heller Ehrman (California) 2011 vs. 2012

The Bankruptcy Court in 2011

"They no doubt will argue, as was done in Stern, that even though fraudulent transfer actions are core under the statute, bankruptcy judges cannot enter final judgments. Stated otherwise, they might denominate these proceedings as "unconstitutional core" proceedings because of the delegation of authority to bankruptcy judges. If I determine that these are core proceedings, I can issue a final judgment. The statute says so and Stern does not hold to the contrary. If timely objections to my doing so are raised before me and preserved on appeal, the district court can decide the issue on appeal.

"If I keep these matters and the district court on appeal disagrees with my determination that a matter is core, or perhaps is "unconstitutionally core," it can simply treat my findings of fact as "proposed findings" and review them de novo. I can simplify the process by committing that any findings of fact I make at trial should be treated as proposed if the district court concludes that I lacked authority to enter those findings." *In re Heller Ehrman LLP (Heller Ehrman LLP v. Arnold & Porter LLP)*, 2011 WL 4542512 (Bankr. N.D. Cal. 2011).

The District Court in 2012

"While fraudulent conveyance actions are also designated as "core" in the bankruptcy statute, they were not at issue in *Stern.* Thus, the question is whether the holding of Stern applies to other "core" matters in the statute. Upon examination, the Court determines the reasoning of *Stern* does apply to the fraudulent conveyance claims in this case, and that the bankruptcy court cannot enter a final judgment on these claims." *In re Heller Ehrman LLP (Heller Ehrman LLP v. Arnold & Porter LLP)*, 464 B.R. 348, 352 (N.D. Cal. 2011).

Invitation for Amicus Briefs from the 9th Circuit

- "The court invites supplemental briefs by any amicus curiae addressing the following questions: Does *Stern v. Marshall,* ––– U.S. ––––, 131 S.Ct. 2594, 180 L.Ed.2d 475 (2011), prohibit bankruptcy courts from entering a final, binding judgment on an action to avoid a fraudulent conveyance? If so, may the bankruptcy court hear the proceeding and submit a report and recommendation to a federal district court in lieu of entering a final judgment?" In re Bellingham Ins. Agency, Inc. (Executive Benefits Insurance Agency v. Arkison), 661 F.3d 476 (9th Cir. 2011).
- Amicus briefs filed by (among others):
  - The United States Attorney's Office
  - The National Association of Bankruptcy Trustees
  - Concerned Chapter 7 and 11 Trustees and Plan Administrators

Other 2012 Decisions (Delaware)

- "This Court disagrees that the *Stern* decision stands for the Broad Interpretation and proposition that a non-Article III court does not have authority to enter a final judgment on a preference or fraudulent conveyance claim brought by the Debtor to augment the estate, or any other core claim (as defined in 28 U.S.C. section 157(b)(2)) that is not a state law counterclaim. The Broad Interpretation is based on a holding that the Supreme Court has never made, namely, that restructuring of the debtor-creditor relationship is not a public right, nor falls within any other exception that would permit a non-Article III court to finally adjudicate those matters. As previously stated, the Supreme Court expressly took measures to limit the reach and breadth of its opinion and its interpretation by lower courts. The Court adopts the Narrow Interpretation and holds that *Stern* only removed a non-Article III court's authority to finally adjudicate one type of core matter, a debtor's state law counterclaim asserted under section 157(b)(2)(C). By extension, the Court concludes that *Stern* does not remove the bankruptcy courts' authority to enter final judgments on other core matters, including the authority to finally adjudicate preference and fraudulent conveyance actions like those at issue before this Court."… *In re Direct Response Media, Inc. (Burtch v. Seaport Capital, LLC, et al.)*, 466 B.R. 626, 644 (Bankr. D. De. 2012).

- "I agree with my colleagues that Stern's holding should be read narrowly and thus restricted to the case of a "state-law counterclaim that is not resolved in the process of ruling on a creditor's proof of claim." 131 S.Ct. at 2620. I note also that numerous other recent decisions have agreed with the narrow interpretation."… "I conclude that I can enter a final judgment on the core preference, post-petition transfer, fraudulent transfer, and unjust enrichment claims and issue proposed findings of fact and conclusions of law on the non-core causes of action." *In re DBSI, Inc. (Zazzali v. 1031 Exchange Group, et al.)*, 467 B.R. 767, 772-773 (Bankr. D. De. 2012).

Other 2012 Decisions (Delaware continued)

- "With respect to the counts based on 11 U.S.C. section 548, I find that these counts clearly fall within 28 U.S.C. section 157(b)(2)(H). These counts are founded solely on bankruptcy law. With respect to the counts based on 11 U.S.C. section 544(b)(1), it is not so obvious that these are core proceedings since, in part, they rely upon "applicable law" other than the Bankruptcy Code. Nevertheless, it clearly falls within the language of 28 U.S.C. section 157(b)(2)(H). Since the Supreme Court's ruling in *Stern v. Marshall*, ____ U.S. _____, 131 S.Ct. 2594, 180 L.Ed.2d 475 (2011), there has been considerable debate among the courts as to whether a section 544(b)(1) cause of action is a core proceeding. I am persuaded by the analysis of the *Stern* decision undertaken by the Court in *In re Refco, Inc.*, 2011 WL 5974532 (Bankr. S.D.N.Y. 2011) that it is and I therefore determine that 11 U.S.C. section 544(b)(1) counts are core proceedings." *In re DBSI, Inc. (Zazzali v. Swenson),* 466 B.R. 664, 665-666 (Bankr. D. De. 2012).

Other 2012 Decisions (New York)

- "Having now fully considered the parties' briefs, notices of supplemental authority, oral arguments, and the opinions of the various district courts and bankruptcy courts around the country likewise attempting to reconcile *Stern v. Marshall* with settled bankruptcy practice, the Court, for the reasons that follow, answers the questions thusly: (1) Under the doctrine of *Stern v. Marshall*, the Bankruptcy Court lacks the constitutional authority to enter final judgment on the Trustee's claims against the Movants, and therefore these claims must be adjudicated by an Article III court. (2) Nonetheless, the Bankruptcy Court does have lawful authority to conduct proceedings and issue a report and recommendation to the District Court on Movants' motion to dismiss, provided it is subject to *de novo* review." *Kirschner v. Agoglia*, 2012 WL 1622496, (S.D. N.Y. 2012)(Hon. Jed S. Rakoff).

- "A number of recent cases have clarified that the balance in workload between the bankruptcy court and the district court due to the narrow ruling in *Stern* actually has not changed very much and that the bankruptcy system is continuing to function without as many disruptions as had been feared by some observers. The standard order of reference in this district has been amended to resolve procedural issues in relation to the holding in *Stern*." *In re Lehman Brothers Holdings, Inc. (Lehman Brothers Holdings, Inc. v. JPMorgan Chase Bank, N.A.)*, 469 B.R. 415, 432 (Bankr. S.D. N.Y. 2012)(Hon. James M. Peck).

- "Courts in this district have consistently held that, after *Stern*, bankruptcy courts lack authority to issue final judgments on fraudulent conveyance claims brought against a person who has not submitted a claim against the estate. That is the case here. Moreover, just as in *Stern*, the claims were brought solely to augment the bankrupt estate."… "I therefore conclude that the Bankruptcy Court lacks the authority to finally adjudicate the fraudulent conveyance claims." *In re Madison Bentley Associates, LLC (Messer v. Bentley Manhattan, Inc.)*, 474 B.R. 430, (S.D. N.Y. 2012).

Other 2012 Decisions (New York continued)

- "The fraudulent transfer claims involve a private right; the adjudication of this claim will not necessarily be decided in ruling on a third party proof of claim; and Defendants have not consented to final adjudication by the Bankruptcy Court. In light of those findings, the fraudulent transfer action here is beyond the Bankruptcy Court's final adjudicatory power." Adelphia Recovery Trust v. FLP Group, Inc., 2012 WL 264180, 5 (S.D. N.Y. 2012).

- "Fraudulent conveyance actions by a bankruptcy trustee against a person who has not submitted a claim against a bankruptcy estate 'are quintessentially suits at common law . . . .'" "The bankruptcy court's authority to enter final judgment on claims is not determinative in deciding whether to withdraw the reference, however. *Orion* also requires an investigation into whether this matter is legal or equitable and considerations of 'efficiency, prevention of forum shopping, and uniformity in the administration of bankruptcy law.' In this case, these other factors are decisive." *Weisfelner v. Blavatnik (In re Lyondell Chem. Co.)*, 467 B.R. 712 (S.D.N.Y. 2012).

Changes to Standing Orders

- United States District Courts for the Southern District of New York and District of Delaware:
  - "…If a bankruptcy judge or district judge determines that entry of a final order or judgment by a bankruptcy judge would not be consistent with Article III of the United States Constitution in a particular proceeding referred under this order and determined to be a core matter, the bankruptcy judge shall, unless otherwise ordered by the district court, hear the proceeding and submit proposed findings of fact and conclusions of law to the district court. The district court may treat any order of the bankruptcy court as proposed findings of fact and conclusions of law in the event the district court concludes that the bankruptcy judge could not have entered a final order or judgment consistent with Article III of the United States Constitution."

Findings of Fact and Conclusions of Law Where the Bankruptcy Court Cannot Enter Final Judgment

- "Since Congress delegated broader authority to bankruptcy courts in core matters than non-core matters, 28 U.S.C. § 157(b)(1), (c)(1), and the delegation included the authority to hear and determine all cases and enter appropriate orders, 28 U.S.C. § 157(b)(1), there appears to be no reason why bankruptcy courts cannot continue to hear all pretrial proceedings and enter as an appropriate order proposed findings of fact and conclusions of law in the manner authorized by Section 157(c)(1)." *In re Heller Ehrman LLP (Heller Ehrman LLP v. Arnold & Porter LLP)*, 464 B.R. 348, 355 (N.D. Cal. 2011).

- "Thus, for the foregoing reasons, the Court finds the bankruptcy court has statutory authority to enter proposed findings of fact and conclusions of law in the matter, which then would be subject to *de* ***357** *novo* review and final judgment in the district court." *In re Heller Ehrman LLP (Heller Ehrman LLP v. Arnold & Porter LLP)*, 464 B.R. 348, 356-357 (N.D. Cal. 2011).

Issue # 2

District Courts withdrawing the reference.

Motions to Withdraw the Reference

"…the permissive withdrawal analysis does not end at the core/non-core determination. Considering other factors like the efficient use of judicial resources, the Court finds the Bankruptcy Court is the appropriate forum to first hear this case. To start, the Bankruptcy Court has greater familiarity with the facts and holds a unique vantage point from the center of the overall bankruptcy proceeding. Withdrawal is also likely to increase costs… Under the circumstances, a de novo review here would be an efficient use of judicial resources. The decision to decline withdrawal is further bolstered by the knowledge that bankruptcy courts routinely resolve these types of disputes, as stated above. Accordingly, the Court declines to permissively withdraw the reference of this non-core proceeding."

Siegel v. FDIC (In re Indymac Bancorp. Inc.), 2011 WL 2883012, 7.

District Courts Still Do Not Seem Anxious To Withdraw the Reference

- "…this Court finds the bankruptcy court has authority to enter proposed findings of fact and conclusions of law on the fraudulent transfer claims, and thus, mandatory withdrawal of the reference is not required. In addition, the Court determines that it would be the most efficient use of judicial resources for the bankruptcy court to keep the actions at this point, and thus, declines to exercise its discretion to withdraw the reference." *In re Heller Ehrman LLP (Heller Ehrman LLP v. Arnold & Porter, LLP)*, 464 B.R. 348, 354 (N.D. Cal. Dec. 2011).

- "Removing fraudulent conveyance actions from core bankruptcy jurisdiction, and also determining bankruptcy courts could not enter proposed findings of fact and conclusions of law on such actions, would meaningfully change the division of labor in the statute between bankruptcy and district courts. This Court does not believe that such a meaningful change is consistent with the intention of the Supreme Court. Rather, the logical conclusion is that the bankruptcy court may enter proposed findings of fact and conclusions of law on such actions even though it may no longer finally decide them." *In re Heller Ehrman LLP (Heller Ehrman LLP v. Arnold & Porter, LLP)*, 464 B.R. 348, 355-356 (N.D. Cal. Dec. 2011).

District Courts Still Do Not Seem Anxious To Withdraw the Reference (continued)

- "Removing fraudulent transfer actions from bankruptcy court jurisdiction would meaningfully change the division of labor between bankruptcy and district courts."… "Thus, "the logical conclusion" (and the most realistic one too) is that bankruptcy courts may issue proposed findings of fact and conclusions of law in such fraudulent transfer actions."... "The Bankruptcy Court has a wealth of knowledge and experience with fraudulent transfer claims, and with this case in particular, having overseen the Adelphia bankruptcy for ten years and this action for seven years. Considerations of efficiency thus strongly weigh in favor of keeping the referral to Bankruptcy Court." *Adelphia Recovery Trust v. FLP Group, Inc.*, 2012 WL 264180, (S.D. N.Y. 2012).

- "The fraudulent conveyance claims here presented are core claims. The Bankruptcy Court has already spent three years working on this adversary proceeding and is intimately familiar with its details, While it will now have to issue a report and recommendation, rather than a final judgment, and the district court will have to review the matter *de novo,* experience strongly suggests that the benefit of the report and recommendation will save the district court and the parties an immense amount of time. And, while Movants cite to their jury demand as a reason to withdraw the reference now, the Court may withdraw the reference if and when a trial is necessary, rather than at this early stage of deciding a motion to dismiss." *Kirschner v. Agoglia*, 2012 WL 1622496, 6 (S.D. N.Y. 2012).

Issue # 3

What Does a De Novo Review by the District Court Look Like?

De Novo Review

- "*De novo review* does not mean a *de novo* hearing; rather, it means that "district judge may accept, reject, or modify the proposed findings of fact or conclusions of law, receive further evidence, or recommit the matter to the bankruptcy judge with instructions. Fed. R. Bankr. P. 9033(d)."… "Thus, there will not be "two trials." *In re DBSI, Inc. (Zazzali v. 1031 Exchange Group, et al.),* 467 B.R. 767, 775 (Bankr. D. De. 2012).

Issue # 4

Impact on 9019 motions and motions for default judgment.

9019 Motions

- "Whatever *Stern v. Marshall* may ultimately be held to mean, this Court is confident that, as a matter of law and practice, it most certainly does not stand for the proposition that the bankruptcy court cannot approve the compromise and settlement of a claim which is indisputably property of a debtor's estate." *In re Ambac Financial Group, Inc.*, 2011 WL 4436126, 8 (Bankr. S.D.N.Y. 2011).

- "In the dispute at bar, the Debtor is requesting this Court to approve a settlement under an express bankruptcy provision, i.e. Bankruptcy Rule 9019. This Rule gives bankruptcy courts discretion to approve a compromise. State law has no equivalent to Bankruptcy Rule 9019. Moreover, the factors which bankruptcy courts are required to review in making a determination of whether or not to approve a settlement have been developed entirely by the federal courts, including the Supreme Court of the United States. *See United States v. Key,* 397 U.S. 322 (1970); *Rivercity v. Herpel (In re Jackson Brewing Co.),* 624 F.2d 599, 602 (5th Cir.1980). Accordingly, because the resolution of the Motion is not based on state common law, but entirely on federal bankruptcy law (both the Rule and the case law instructing how to apply the Rule), the holding in *Stern* is inapplicable, and this Court has the constitutional authority to enter a final order in this contested matter pursuant to 28 U.S.C. § § 157(a) and (b)(1)." *In re Okwanna-Felix*, 2011 WL 3421561 (Bankr. S.D. Tx. 2011)

Motions for Default Judgment

- "The defendant has not responded to the complaint. If the proceeding were contested, the court might constitutionally be restricted to entering proposed findings of fact and conclusions of law for consideration by the district court. *Stern v. Marshall,* 131 S.Ct. 2594 (2011). Nevertheless, the proceeding is a core proceeding, and thus the bankruptcy court statutorily is authorized to enter a final order. The plaintiff does not seek punitive damages or other relief beyond recovering the amounts the defendant took from the debtor, a sum certain. The only task is that of entering a default judgment, and the motion does not present any circumstances in which the court would be required to make findings of fact or exercise discretion (being presented instead with a task that presents only a question of law). The bankruptcy court's judgment will be fully subject to de novo review by way of appeal as it involves only a question of law. Accordingly, it makes little difference whether this court enters a default judgment or instead sends proposed conclusions of law to the district court recommending that it enter a default judgment. Either way, there will be de novo review. In that circumstance, Article III of the Constitution will not be offended by this court's entering a default judgment." In re Butler Innovative Solutions (Bankr. D.D.C., Oct. 4, 2011, 08-00065) 2011 WL 4628746

Issue # 5

Express and Implied Consent As a Means of Avoiding *Stern* Issues

IN RE BEARINGPOINT, INC., 2011 WL 2709295 (Bankr. S.D.N.Y. July 11, 2011)

"But in *Stern v. Marshall,* the majority, while repeatedly stating that Pierce had consented to the bankruptcy court's determination, ***nevertheless found his consent, under the facts there, inadequate***
. . . . [I]t's fair to assume that it will now be argued, that consent, no matter how uncoerced and unequivocal, will never again be sufficient for bankruptcy judges ever to issue final judgments on non-core matters. ***That huge uncertainty presages litigation over that issue with the potential to tie up this case, and countless others, in knots.*** It also would at least seemingly invite litigants to consent, see how they like the outcome, and then, if they lose, say their consents were invalid."

IN RE TELESERVICE GROUP, INC., 2011 WL 3610050 (Bankr. W.D. Mich. Aug. 17, 2011)

"But, with this said, I believe that I could still enter a final judgment against Huntington in this case were Huntington and Trustee both to consent. As the Court in *Stern* emphasized early in its opinion, the delegation of authority by the district courts to the bankruptcy courts as their adjuncts is not jurisdictional. *Stern,* 131 S.Ct. at 2606-7. Indeed, the Court concluded that the stepson's consent in *Stern* to having his own claim decided by the bankruptcy court would have precluded him from objecting to that court's authority under 28 U.S.C. 157(b)(2)(C) to also adjudicate the estate's counterclaim against him had not the constitutional issue been raised. ***And common sense also suggests that if the parties before a district court may consent to binding arbitration as a form of alternative dispute resolution, then they certainly should be able to choose the bankruptcy judge as their arbiter if that is the alternative they prefer.***"

IN RE SAFETY HARBOR RESORT AND SPA, 2011 WL 3849639 (Bankr. M.D. Fla. Aug. 30, 2011)

"Despite the limitations imposed by ***Stern,*** this Court's authority to enter final judgments in the core proceedings identified in section 157 (b)(2) is not necessarily diminished as practical matter. ***Parties may, even after Stern, consent to bankruptcy courts entering final judgments in non-core matters.*** In fact, section 157(C)(2) expressly authorizes bankruptcy courts to enter final judgment in non-core proceedings if the parties consent.

"Admittedly, the ***Stern*** Court did not address that specific issue; there was no need to since, at the time the case was tried, the Supreme Court had not yet held section 157(b)(2)(C) unconstitutional. But the Court, in response to Pierce's argument that bankruptcy courts do not have jurisdiction over defamation claims under section 157(1)(5), held that he consented to the bankruptcy court's resolution of his defamation claim given his conduct before the bankruptcy court. ***In doing so, the Stern Court "recognized 'the value of waiver and forfeiture rules' in 'complex' cases." The Court also recognized that '[n]o procedural principle is more familiar to this Court than that a constitutional right, or a right of any other sort, may be forfeited***."'

See NYU Hosps. Ctr. V. HRH Constr. LLC (In re HRH Constr. LLC), 2011 WL 3359576 (Bankr. S.D.N.Y. Aug. 2, 2011) (debtor removed state court suit to district court which referred it to bankruptcy court where parties consented to bankruptcy court entering final judgment, bankruptcy court citing section 157(c)(2) and *Stern*).

IMPLIED CONSENT:

In re Coudert Brothers LLP, 11-2785 (CM) (S.D.N.Y. Sept. 23, 2011):

"***Following Stern, it is doubtful whether mere participation in litigation is enough to imply consent***. Even if it were, a finding of consent is not consistent with the record in this case. First, the Trust filed a demand for a jury trial of 'all issue so triable in the matter' immediately upon removal, thereby expressing its intention to reserve whatever Article III rights it had. . . . cf. Granfinanciera, 492 U.S. at 33. Where a jury trial is demanded, it can only be held before the Bankruptcy Court when the parties give their *express* consent 28 U.S.C. § 157(e). As noted, no express consent was given in this case. Later, the Trust denied that the Bankruptcy Court had any jurisdiction at all, by arguing that its Claims were not even 'related to' the Coudert bankruptcy. . . . These objections are inconsistent with a finding that the Trust was 'happy' to or otherwise consented to litigate in Bankruptcy Court, changing its mind only after it lost."

STERN ON CONSENT

"Vickie asserts that in case Pierce consented to the Bankruptcy Court's adjudication of his defamation claim, and forfeited any argument to the contrary, by failing to seek withdrawal of the claim until he had litigated it before the Bankruptcy Court for 27 months."

* * *

"We need not determine what constitutes a 'personal injury tort' in this case because we agree with Vickie that § 157(b)(5) is not jurisdictional, and that ***Pierce consented to the Bankruptcy Court's resolution of his defamation claim***. Because '[b]randing a rule as going to a court's subject-matter jurisdiction alters the normal operation of our adversarial system,' *Henderson* v. *Shinseki*, 562 U.S. ____ (2011) (slip op., at 4-5), we are not inclined to interpret statutes as creating a jurisdictional bar when they are not framed as such. See generally *Arbaugh* v. *Y & H Corp.*, 546 U.S. 500, 516 (2006) ('when Congress does not rank a statutory limitation on coverage as jurisdictional, courts should treat the restriction as nonjurisdictional in character')."

STERN ON CONSENT (cont'd)

"Given Pierce's course of conduct before the Bankruptcy Court, we conclude that he consented to that court's resolution of his defamation claim (and forfeited any argument to the contrary). We have recognized 'the value of waiver and forfeiture rules' in 'complex' cases, *Exxon Shipping Co.* v. *Baker*, 554 U.S. 471, 487-488, n. 6 (2008), and this case is no exception. In such cases, as here, the consequences of 'a litigant . . . 'sandbagging' the court -- remaining silent about his objection and belatedly raising the error only if the case does not conclude in his favor. . . can be particularly severe.'"

"***If Pierce believed that the Bankruptcy Court lacked the authority to decide his claim for defamation, then he should have said so - and said so promptly***. See *United States* v. *Olano*, 507 U.S. 725, 731 (1993) ('No procedural principle is more familiar to this Court than that a constitutional right,' or a right of any other sort, 'may be forfeited . . . by the failure to make timely assertion of the right before a tribunal having jurisdiction to determine it' (quoting *Yakus* v. *United States*, 321 U.S. 414, 444 (1944))).

In re TOUSA, Inc. (Bank. S.D. Fla.)

- Pre-petition TOUSA debtors pay over $400 million to Transeastern Lenders to settle claims against TOUSA Parent.
- TOUSA Parent was guarantor of that loan.
- TOUSA Subsidiaries had no liability on loan.
- TOUSA Subsidiaries borrow new money and pledge their assets to pay settlement.
- Creditors' Committee brings fraudulent conveyance claims.
- Bankruptcy Court finds conveyances by TOUSA Subsidiaries to be fraudulent.

In re TOUSA, Inc. (Bank. S.D. Fla.) (cont.)

- Enters detailed findings and final judgment.
- District Court reverses, rejecting some factual findings by Bankruptcy Court as clearly erroneous.
- Committee appeals to 11th Circuit, challenging District Court's clearly erroneous findings.
- Supreme Court issues *Stern v. Marshall* decision after Transeastern Lenders' brief to 11th Circuit submitted.
- Transeastern Lenders did not file proof of claim.

In re TOUSA, Inc. (Bank. S.D. Fla.) (cont.)

- Subsequently, the Transeastern Lenders sent a letter to 11th Circuit raising the *Stern v. Marshall* issue.
- Transeastern Lenders' Position:

  "The statutory scheme governing bankruptcy courts provides that a bankruptcy judge *may hear* a non-core proceeding, but that the bankruptcy judge may only 'submit proposed findings of fact and conclusions of law to the district court, and any final order or judgment shall be entered by the district judge . . . After reviewing *de novo*' any matters objected to by the parties.'" 28 U.S.C. Sect. 157(c)(1).

  "In light of Stern, the final judgment that should be reviewed by this Court 'under traditional appellate standards,' 131 S. Ct. at 2604, including the 'clearly erroneous' standard for any findings of fact, is the district court's order, and not the bankruptcy court's decision."

In re TOUSA, Inc. (Bank. S.D. Fla) (cont.)

The Committee's Response:

> "By failing to assert arguments below, the Transeastern Lenders forfeited their right to assert them now. 'No procedural principle is more familiar … than that a constitutional right, or a right of any other sort, may be forfeited … by the failure to make timely assertion of the right before a tribunal having jurisdiction to determine it.'" *United States v. Olano*, 507 U.S. 725, 731 (1993).
>
> "Parties may forfeit their rights to have a district court, rather than a bankruptcy court, make factual findings and enter final judgments in non-core proceedings; the allocation of authority in § 157 'does not implicate questions of subject matter jurisdiction.'"

11th Circuit Decision does not address issue directly, but applied a clearly erroneous standard to the Bankruptcy Court's factual findings.

In re TOUSA, Inc. (Bank. S.D. Fla) (cont.)

Transeastern Lenders File Petition on Rehearing *En Banc* on June 15, 2012 arguing:

> "But until *Stern* – decided years after this action was commenced – bankruptcy courts seemingly had constitutional authority to issue final judgments on fraudulent transfer claims, as *Granfinanciera* involved only the right to a jury trial. As explained in *Adelphia Recovery Trust v. FLP Group, Inc.*, 2012 WL 264180 (S.D.N.Y. Jan. 30, 2012), courts 'will not read defendants' pre-*Stern* conduct as an implied consent to final adjudication by the Bankruptcy Court because any such consent was not knowingly made.'" 2012 WL 264180, at *5.

Petition denied. No discussion of *Stern*.

Issue # 6

Practical Approaches to the *Stern* Problem

Southern District of Florida March 27, 2012 Order of Reference

- "If a bankruptcy judge or district judge determines that entry of a final order or judgment by a bankruptcy judge would not be consistent with Article III of the United States Constitution in a particular proceeding referred under this order and determined to be a core matter, the bankruptcy judge shall, unless otherwise ordered by the district court, hear the proceeding and submit proposed findings of fact and conclusions of law to the district court made in compliance with Fed. R. Civ. P. 52(a)(1) in the form of findings of fact and conclusions stated on the record or in an opinion or memorandum of decision."
- "The district court may treat any order of the bankruptcy court as proposed findings of fact and conclusions of law in the event that the district court concludes that the bankruptcy judge could not have entered a final order or judgment consistent with Article III of the United States Constitution."

Lehman Brothers v. JPMorgan Chase Bank, Adv. Pro. 10-03266 (JMP) (Bankr. S.D.N.Y.)

Case Management Order Aug. 15, 2011

"More detailed statement regarding counts. Each of the parties is directed to state in writing on or before the *Stern* Deadline:

i. why each count of the Amended Complaint either is or is not susceptible to a ruling by the bankruptcy court with respect to the pending motion to dismiss,

ii. why each count of the Amended Complaint either is or is not susceptible to final adjudication by the bankruptcy court and

iii. why each count of the Amended Complaint either is or is not susceptible to the issuing of a report and recommendation to the district court regarding each such count."

"**Consent to final adjudication.** Each of the parties is directed to advise the Court in writing on or before the Stern Deadline whether it expressly consents to the authority of the Court to hear and determine some or all of the counts of the Amended Complaint and enter final judgments in the Adversary Proceeding with an indication as to those counts, if any, that may be decided with consent. In the event the parties do not expressly consent, or are not deemed to have impliedly consented, and no motion for withdrawal of the reference has been filed and granted, the Court intends to proceed in accordance with Rule 9033 of the Federal Rules of Bankruptcy Procedure."