Supreme Court Rules on Bankruptcy Courts’ Constitutional Authority, Leaves Key Question Unanswered

On June 9, 2014, a unanimous Supreme Court issued the latest in a series of key rulings regarding the extent of a bankruptcy court’s constitutional authority.\(^1\) Notably, while Monday’s Executive Benefits decision answered one important question arising out of the Court’s 2011 decision in Stern v. Marshall,\(^2\) it also left the primary question that resulted in a split in the Circuit Courts of Appeals to be decided another day.

The Aftermath of Stern v. Marshall

In Stern v. Marshall, the Supreme Court addressed the scope of judicial authority conferred upon courts under the Constitution. Pursuant to Article III of the Constitution, justices of the Supreme Court, circuit judges and district judges receive lifetime appointments and protection against reduction in salary.\(^3\) Congress created the bankruptcy courts pursuant to its power under Article I of the Constitution and Article I bankruptcy judges do not enjoy the tenure and salary protections afforded to Article III judges under the Constitution. The Supreme Court in Stern determined that the constitutional distinction between Article III and Article I courts creates a separation of powers issue that requires limitations on those matters on which bankruptcy judges may enter final orders.

Specifically, the Court held in Stern that with the exception of certain “public rights,”\(^4\) Congress cannot withdraw from adjudication by Article III judges any matter that would traditionally constitute a suit at common law. The Court left open, however, the question of whether a party could consent to a bankruptcy judge entering a final order on a matter that, absent such consent, would require final disposition by an Article III judge. In Stern’s aftermath, a number of courts weighed in on that question, including, among others, the Sixth and Ninth Circuit Courts of Appeals, creating a circuit split on the issue.

As explained below, notwithstanding this week’s Executive Benefits decision, the issue that has generated the most uncertainty and debate still remains undecided.

The Circuit Split: Executive Benefits\(^5\) and Waldman v. Stone\(^6\)

The Ninth Circuit

The Ninth Circuit Court of Appeals, in Executive Benefits, held that a party may consent to a bankruptcy judge entering a final order on a matter that, absent consent, would require final adjudication by an Article III judge. The court noted that the concerns expressed in Stern regarding the differences between Article III and Article I courts involved primarily the protection of personal, rather than structural, interests. Moreover, citing concerns with the tactics of litigants who might delay in raising an objection to a final determination being made by a bankruptcy judge, the panel explained that a party should not be permitted to remain silent about its objection throughout the course of litigation, only to belatedly raise the concern if it loses. Based on these considerations, the Ninth Circuit held that a party may effectively consent to a matter being decided by a non-Article III bankruptcy judge even though the judge
would not have the authority to decide the matter without consent.

The Ninth Circuit also addressed the procedure to be followed by bankruptcy courts where they lack constitutional authority to enter final orders on matters before them. The issue arises under 28 U.S.C. § 157 pursuant to which Congress conferred authority upon the bankruptcy courts to enter final orders on all “core” matters arising under the Bankruptcy Code or arising in a case under the Bankruptcy Code, and submit to the district court proposed findings of fact and conclusions of law on “non-core” matters otherwise related to a case under the Bankruptcy Code. The question presented to the Ninth Circuit was whether a bankruptcy court had the statutory authority under 28 U.S.C. § 157(c)(1) to submit proposed findings of fact and conclusions of law on matters identified in the statute as “core” but which, pursuant to the Supreme Court’s holding in *Stern v. Marshall*, the court lacked constitutional authority to adjudicate through entry of a final order. In light of what some suggested was a “statutory gap,” an argument could be made that bankruptcy judges lacked the power to consider such claims. After reviewing both Congress’s intent in drafting the statute and the *Stern* decision, the Ninth Circuit held that, notwithstanding any statutory gap, bankruptcy courts have the authority to submit proposed findings of fact and conclusions of law with respect to this category of core claims.

**The Sixth Circuit**

Shortly before the Ninth Circuit’s decision in *Executive Benefits*, the Sixth Circuit also confronted the question of whether parties to a lawsuit may consent to entry by the bankruptcy court of a final order on a matter on which the court otherwise lacked constitutional authority to finally adjudicate. The defendant in *Waldman* had expressly consented to entry of a final order by the bankruptcy court on all of plaintiff’s claims. Thus, the question became whether the defendant could effectively waive the requirement that only an Article III judge may, consistent with the Constitution, enter a final order with respect to a debtor/plaintiff’s damage claims. The Sixth Circuit held the defendant’s waiver to be ineffective because it implicated not only the defendant’s personal right, but also the structural principle advanced by Article III, a principle that was not the defendant’s to waive. Thus, according to the Sixth Circuit, the bankruptcy court could not enter a final order on the plaintiff’s affirmative claims, notwithstanding the defendant’s consent. The Ninth Circuit’s *Executive Benefits* decision just months later created a circuit split on the consent question.

As did the Ninth Circuit, the Sixth Circuit in *Waldman* also flagged the so-called statutory gap as a potential issue. However, because *Waldman* did not involve a claim that was statutorily core but outside the bankruptcy court’s constitutional authority, the court declined to address whether the statutory gap precluded bankruptcy judges from issuing proposed findings of fact and conclusions of law on such claims.

**The Supreme Court’s Decision in *Executive Benefits***

The Supreme Court granted *certiorari* seemingly for the purpose of resolving the split that had emerged among the circuits; however, the Court stopped short of ruling on the primary issue causing the split, instead determining that the federal statute creating the constitutional problem also contains a self-curing mechanism that allows “Stern Claims” (claims identified in the statute as “core” claims but which Article III of the Constitution prohibits bankruptcy courts from finally adjudicating) to be ruled upon by a bankruptcy court by issuance of proposed findings of fact and conclusions of law, subject to *de novo* review by the district court.

**“Stern Claims” and the Statutory Gap**

In its *Executive Benefits* decision, the Supreme Court expressly chose not to decide the consent issue. Instead, it laid down the procedure that must be followed by a bankruptcy court when addressing a Stern Claim.

The Court addressed the issue of the supposed “statutory gap” by explaining that the plain text of the relevant statute operates to close the gap. Because the statute contains a “severability provision,” which allows the remainder of the statute to apply to those portions of the statute that remain
constitutionally valid, the statute continues to apply to Stern Claims by treating them as what they are in reality—non-core claims. In other words, the statute’s severability provision cures its constitutional defect, by allowing Stern Claims to be decided by the bankruptcy court as non-core claims.

The statute also supplies the procedure that must be followed by a bankruptcy court deciding a Stern Claim: that is, it must submit proposed findings of fact and conclusions of law for de novo review by the district court. In this case, the district court had not, strictly speaking, treated the bankruptcy court’s order as proposed findings of fact and conclusions of law; however, because the district court did, in fact, review the bankruptcy court’s grant of summary judgment de novo and issue a written opinion affirming the bankruptcy court’s decision, the defendant received the equivalent review it would have received had the statutory procedure been precisely followed, and any resulting error was thus cured.

To the surprise of many observers, including, presumably, the petitioner and respondent in Executive Benefits, whose Supreme Court briefing focused, for the most part, on the issue of consent, the Supreme Court chose not to address the question of whether a party’s consent to bankruptcy court adjudication on a Stern Claim may operate to effectively negate any constitutional concerns. One can speculate that the Court’s unanimous decision to resolve the case on the basis of the severability provision in the underlying statute may well have been driven by a deep division in the Court on the fundamental constitutional question presented by Executive Benefits – a question that at some point will need to be resolved.

Where Do We Go From Here?

In light of Monday’s decision, the question becomes: Where does this leave us? The answer is that just as it did in Stern, the Court has left a number of unanswered questions in Executive Benefits.

The lower courts’ conflicting views on parties’ ability to consent will doubtless continue to sharpen, thus intensifying the debate. The ongoing ambiguity will, in turn, undoubtedly lead to the Supreme Court again taking up the issue of the extent of bankruptcy court constitutional authority, an issue that has troubled the bankruptcy system since the enactment of the current Bankruptcy Code in 1978. As we have pointed out before, quite notably, the implications are not necessarily limited to the bankruptcy system. Indeed, the same rationale that led the Sixth Circuit in Waldman (and other courts as well) to determine that parties may not consent to certain adjudications by Article I bankruptcy judges could also apply to other non-Article III judges, including federal magistrate judges.

Relatedly, the Judicial Conference had proposed several changes to the Federal Rules of Bankruptcy Procedure in light of Stern that were designed to force a party to affirmatively declare whether it consents to the bankruptcy court adjudicating and entering a final order in an adversary proceeding or other contested matter. However, given the unresolved circuit split on the consent issue, the future of those amendments appears to be in serious doubt.

In at least three circuits, a party may not consent to bankruptcy court adjudication of Stern Claims. In these jurisdictions (and any others that join them), all Stern Claims must be resolved by the district court. However, what claims constitute Stern Claims is not entirely clear. Until the universe of Stern Claims is more fully addressed, parties and courts in these circuits will need to expend additional resources and time determining whether their claims can be heard by the bankruptcy court or must be adjudicated instead by the district court.

For now, the Court has applied a Band-Aid fix to the question of the extent of the bankruptcy courts’ constitutional adjudicative authority. While this temporary measure will allow the bankruptcy system to adequately function for the time being, it leaves the fundamental question of consent completely unanswered during the interim.

At some point, the Supreme Court will need to rule definitively on the consent issue once and for all. Until such time, uncertainty within the bankruptcy system will continue to reign.
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3 U.S. Const. art III, § 1.

4 Under “public rights” doctrine, non-Article III courts may resolve matters that historically could have been determined exclusively by executive or legislative branches of government. Public rights include claims deriving from a federal regulatory scheme, or claims that by their nature must be resolved by a federal agency and are directly related to the agency’s function. “Private rights,” on the other hand, involve claims between private parties. In the context of bankruptcy, they include state law contract disputes and actions to augment the bankruptcy estate, as opposed to disputes related to the bankruptcy claims allowance process.

5 Executive Benefits Insurance Agency v. Arkinson (In re Bellingham Insurance Agency, Inc.), 702 F.3d 553 (9th Cir. 2012).


7 A number of courts outside the Sixth and Ninth Circuits also addressed the consent issue. Courts aligned with the Sixth Circuit include *BP RE, L.P v. RML Waxahachie Dodge, LLC (In re BP RE, L.P.)*, 735 F.3d 279, 288 (5th Cir. 2013) (parties cannot consent to circumvention of Article III that impinges on structural interests of judicial branch); and *Wellness International Network, Ltd. v. Sharif*, 727 F.3d 751, 771 (7th Cir. 2013) (consent is insufficient to overcome structural framework of Article III).

Courts aligned with the Ninth Circuit include *Executive Sounding Board Associates, Inc. v. Advanced Machine & Engineering Co. (In re Oldco M Corporation f/k/a Metaldyne Corporation)*, 484 B.R. 598 (Bankr. S.D.N.Y. 2012) (construing pre-*Stern* Second Circuit precedent in determining that party may impliedly consent to final adjudication by bankruptcy judge on matter that would otherwise implicate constitutional concerns); and *Bank of Nebraska v. Rose* (In re *Rose*), 483 B.R. 540 (B.A.P. 8th Cir. 2012) (defendant may consent to final bankruptcy court judgment on matter for which court would otherwise lack constitutional authority to enter judgment).


9 *Executive Benefits Insurance Agency*, 573 U.S. at ___.

10 It is worth noting that the “Stern Claim” at issue in *Executive Benefits* was a fraudulent transfer claim brought by the bankruptcy trustee against a non-creditor. In its opinion, the Supreme Court noted that the “Court of Appeals held, and we assume without deciding, that the fraudulent conveyance claims in this case are *Stern* claims.” *Executive Benefits Insurance Agency*, 573 U.S. at ___.