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Committee on Rules of Practice and Procedure
Administrative Office of the United States Courts
One Columbus Circle, NE
Washington, D.C. 20544

Dear Committee:

Concerning the proposed rule changes that arise out of the Supreme Court's *Stern v. Marshall* opinion – specifically, 7008, 7012, 7016, 9027 and 9033 -- I submit for your consideration an article I wrote that was published in the American Bankruptcy Institute Journal. A copy of the article is attached in pdf format. By way of disclaimer, the views expressed in the article are my own and not necessarily those of my firm or any of its clients.

Respectfully,

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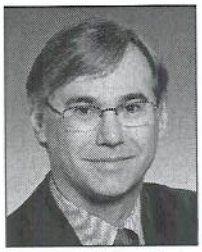
Feature

BY DOUGLAS N. CANDEUB

New Rules Amendments Would Excise Mention of Core or Noncore



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Like a slow train coming around the bend,[1] last year's *Stern v. Marshall*[2] ruling—the U.S. Supreme Court's long-awaited scrutiny of Congress's 1984 fix to the part of the Bankruptcy Reform Act of 1978 that the Court held unconstitutional in *Marathon Pipe Line*[3]—has shaken the ground of bankruptcy litigation. To be sure, the level of disruption caused by *Stern v. Marshall* has been—and remains—a subject of great debate, with the "narrow" camp and the "broad" camp staking out their competing views. But the evidence of a widespread impact from *Stern* is unmistakable. Now a set of revisions to the Federal Rules of Bankruptcy Procedure is being proposed in an effort to remedy a fissure exposed by *Stern*. This article takes a close look at the proposals.

Section 157 and the Core/ Noncore Distinction

To do so, the starting point is § 157 of the Judicial Code, the principal statutory provision governing bankruptcy court authority in relation to the district court.[4] Congress enacted it in response to the Supreme Court's determination in *Marathon* that Congress's broad grant of adjudicatory authority to the bankruptcy courts exceeded what Article III permits. In the 1984 Amendments, Congress attempted to describe the set of matters over which bankruptcy courts would have full adjudicatory authority, labeling them "core proceedings."[5]

Unfortunately, Congress did not describe this group of matters very well. Core proceedings are defined indirectly in the statute in two ways. First, in § 157(b)(1), Congress indicated, without directly stating, that for a proceeding to be "core," it must have either arisen *under* the Bankruptcy Code or arisen *in* a bankruptcy case.[6]

Second, in § 157(b)(2), Congress provided a nonexhaustive list of 15 different types of matters that constitute "core proceedings." Two of the items on this list—subsections (A) and (O)—are broad and somewhat vague, and have been referred to as "catch-all" provisions.[7] But the broad catch-alls have been subjected to a judicial gloss that has effectively limited them to matters that fall within Article III's limits.[8] As *Stern* showed, some of the more definite items on the § 157(b)(2) list are the most problematic because they are not as readily subject to a limiting interpretation.

Stern v. Marshall in a Nutshell

In *Stern*, the first level of the dispute was statutory construction: whether Vickie Marshall's counterclaim against Pierce Marshall had to be treated as a "core proceeding" under § 157(b)(2). The Court declined to add a judicial gloss to § 157(b) that could limit the treatment of counterclaims in the manner that the courts

1 *See* B. Dylan, "Slow Train" (1979) ("[M]an's...laws are outdated, they don't apply no more/you can't rely no more.").
2 131 S.Ct. 2594 (2011).
3 *Northern Pipeline Construction Co. v. Marathon Pipe Line Co.*, 458 U.S. 50 (1982). The Court's judgment was reflected in a plurality opinion by Justice William Brennan and an opinion concurring in the judgment by Justice William Rehnquist.
4 28 U.S.C. § 157. It was contained in the Bankruptcy Amendments and Federal Judgeship Act of 1984.
5 28 U.S.C. § 157(b). The term "core" was based on a phrase used in the plurality opinion in *Marathon* in discussing the "public rights doctrine," a doctrine that until then had remained in quiet obscurity for decades. 458 U.S. at 71.
6 28 U.S.C. § 157(b)(1). Cf. 28 U.S.C. § 157(c)(1) (if proceeding is only "otherwise related to a case under title 11," then it is noncore). A clause in the mandatory abstention provision in § 1334, with similar language about claims "related to" a bankruptcy case, "but not arising under title 11 or arising in a case under title 11," is consistently construed as referring to a noncore matter. 28 U.S.C. § 1334(c)(2). *See, e.g., Stoe v. Flaherty*, 436 F.3d 209, 213 (3d Cir. 2006).
7 28 U.S.C. § 157(b)(2)(A) and (O). *See, e.g., In re Castlerock Properties*, 781 F.2d 159, 161 (9th Cir. 1986) (describing (A) and (O) as catch-alls).
8 *See, e.g., In re Wood*, 825 F.2d 90 (5th Cir. 1987). To keep § 157 from running afoul of Article III, courts widely followed Judge Wisdom's judicial gloss on "core" determinations in *Wood*, whereby a claim can only be deemed core if (1) it invokes a substantive right provided by title 11 or (2) if it is a proceeding that *by its nature could arise only* in the context of a bankruptcy case. *In re Wolverine Radio Co.*, 930 F.2d 1132, 1144-45 (6th Cir. 1991); *Beard v. Braunstein*, 914 F.2d 434, 444 (3d Cir. 1990); *Wood*, 825 F.2d at 97.

had handled the catch-all provisions. Instead, the Court ruled that the plain text compelled characterizing the counterclaim as a "core proceeding," thus forcing the constitutional question.[9]

The Court ruled too that neither the filing of Pierce Marshall's complaint nor of his proof of claim constituted consent to having the bankruptcy court render final judgment on Vickie Marshall's counterclaim.[10] That conclusion altered prior assumptions about the effect of filing a proof of claim. The Court then held that it was a violation of Article III of the Constitution for the bankruptcy court—a court whose judges lack life tenure and protected salaries—to exercise full adjudicatory authority over Vickie Marshall's state law counterclaim against Pierce Marshall.[11]

Stern's Effect on the Core/ Noncore Distinction

Since *Stern v. Marshall*, bankruptcy courts and district courts have seen a relative flood of motions arguing that the bankruptcy court lacks authority to enter a final judgment, along with appeals challenging the bankruptcy court's exercise of such authority.[12] Litigants have argued that claims they agreed were "statutorily core" are not "constitutionally core."[13]

One clear effect of *Stern* has been to undermine the significance of litigants' averments that a matter is "core," as well as the sufficiency of "core proceeding" determinations. Previously, apart from matters as to which a party had a valid right to a jury trial,[14] a party's assertion that a matter was "core" was equivalent to—or a surrogate for—agreement that the bankruptcy court could enter final judgment on the matter. Now, that is not necessarily the case. The Supreme Court effectively forced a constitutional overlay upon "core proceeding" determinations because simply declaring that a proceeding is "core" could carry the risk of a constitutional challenge down the road.[15]

Some district courts—including ones in New York, Delaware and Florida—have, in response to *Stern*, changed their standing orders under § 157(a) for automatic referral to the bankruptcy courts.[16] Under these amended standing orders, if a bankruptcy or district court judge decides that the entry of final orders or judgments by a bankruptcy judge in a proceeding would violate Article III, then, unless the district judge orders otherwise (*e.g.*, where a jury trial is to be held), the bankruptcy court shall hear the proceeding and submit proposed findings of fact and conclusions of law to the district court.[17] Essentially, this functions to discourage motions to withdraw the reference in non-jury proceedings.

The most comprehensive means to repair the disruption caused by *Stern* would be legislative. Congress could narrow the definition of "core proceedings" in § 157 to comport with the Supreme Court's pronouncement on Article III. But the legislative process is painfully slow. On the other hand, the Judicial Conference, with its authority under the Rules Enabling Act,[18] can try to ameliorate this predicament by amending the Bankruptcy Rules.

Section 157(b)(3) continues to *require* a bankruptcy judge to determine, by the judge's own motion or the motion of a party, whether a proceeding is a "core proceeding" or one that is "otherwise related to" a bankruptcy case. The Supreme Court did not declare these provisions unconstitutional.

The Advisory Committee on Bankruptcy Rules and Its Proposals

In March 2012, the Judicial Conference's Advisory Committee on Bankruptcy Rules received a report from its Subcommittee on Business Issues concerning rule-making responses to *Stern v. Marshall*. The report noted that the committee had received a number of suggestions to amend the Bankruptcy Rules due to *Stern*, and each suggestion addressed "the possibility that *Stern* has destabilized the previous meaning of core and non-core proceedings in bankruptcy."[19] The report stated:

> Before *Stern*, a proceeding was treated by the Bankruptcy Rules as either core or noncore and, if core, the bankruptcy judge was empowered to hear and finally determine it. After *Stern*, courts have confronted the argument that some proceedings may be deemed core—as provided by 28 U.S.C. § 157(b)—and nevertheless fall beyond a bankruptcy judge's power to enter final judgment. The mischief these suggestions seek to avoid is that a party might allege (or agree) that a proceeding is "core" as a statutory matter but later assert that the proceeding is not "core" as a constitutional matter.[20]

After considering the various suggestions, the subcommittee developed a set of recommended rule changes. With some revisions, the advisory committee substantially adopted the recommendations at its meeting on March 29-30, 2012. The proposals were then submitted to the Judicial Conference's Standing Committee on Rules of Practice and Procedure, and the proposed rules were posted on the U.S. Courts website for public comment on Aug. 15, 2012.[21]

9 131 S.Ct. at 2605.
10 *Id.* at 2614.
11 *Id.* at 2616-20.
12 A Westlaw search shows *Stern* cited in more than 500 decisions. Many discuss it at great length.
13 *See, e.g.*, O. Alaniz, "A Survey of Cases Interpreting the *Stern* Decision, Part II," ABA website (May 30, 2012). The phrasing is not entirely apt, since Article III, as construed by the Supreme Court, does not describe what is "core" but rather limits what Congress can treat as "core."
14 The designation of a proceeding as "core" does not deprive the nondebtor party of his or her Seventh Amendment jury trial rights. *Granfinanciera, S.A. v. Nordberg*, 492 U.S. 33, 36 (1989).
15 The issue arises far more in adversary proceedings than in the main bankruptcy case.
16 *E.g.*, *Amended Standing Order of Reference*, 12 Misc. 0032 (S.D.N.Y. Jan. 31, 2012).
17 The standing order also provides that the district court may treat final rulings of the bankruptcy court only as proposed findings and conclusions if the district court concludes that the bankruptcy court exceeded its constitutional authority by rendering its ruling as final. This means that if the district court decides that the bankruptcy court's ruling should have been "proposed" and not "final," it will be reviewed under a *de novo* standard. It does not appear to affect how a party seeks review from a "final" judgment that should have just been "proposed."
18 28 U.S.C. § 2071-2077.
19 Memorandum, Subcommittee on Business Issues to Advisory Committee on Bankruptcy Rules (March 15, 2012) ("Memorandum"), Tab A8(A) at www.uscourts.gov/uscourts/RulesAndPolicies/rules/Agenda%20Books/bankruptcy/2012-03-BK_Addendum.pdf.
20 *Id.*, p. 1.
21 *See* www.uscourts.gov/uscourts/rules/rules-published-comment.pdf.

The proposals would amend Bankruptcy Rules 7008, 7012, 9027 and 9033 (*i.e.*, all of the rules that currently use the terms "core" or "noncore"), as well as Rule 7016.[22] Rules 7008, 7012 and 9027 each set forth pleading requirements (for complaints and counterclaims, answers and removal notices, and responses) aimed at ascertaining (1) the parties' position on the core or noncore status of a proceeding, and (2) where a proceeding is averred to be noncore, whether the parties consent to entry of final orders or judgments by the bankruptcy judge, notwithstanding that the bankruptcy court lacks full adjudicatory authority over noncore matters.[23] Rule 9033 governs the procedures for the review of proposed findings of fact and conclusions of law in "noncore proceedings" heard pursuant to 28 U.S.C. § 157(c)(1).[24]

The chief flaw recognized in current Rules 7008, 7012 and 9027 is that while they require a statement on consent from parties asserting the proceeding to be *noncore*, the rules fail to ascertain whether a party who has averred the proceeding to be *core* will consent to final adjudication from the bankruptcy court if the proceeding falls outside its full adjudicatory authority as a non-Article III court. The chief flaw seen in Rule 9033 is that it does not expressly provide for the submission of *proposed* findings of fact and conclusions of law by a bankruptcy court in "core proceedings."

In its report, the subcommittee stated that *Stern* resulted in an "ambiguity in the treatment of core and noncore proceedings," and an "ambiguity in the terms core and noncore."[25] In a sense, half of that statement may be inaccurate. The ambiguity generated by *Stern* is really only with respect to "core" matters; what was noncore before *Stern* remains noncore after *Stern*. The subcommittee further stated that one key principle it followed was to favor Bankruptcy Rule amendments that "could achieve the desired clarity *with the least disruption*."[26]

The surprising approach recommended by the subcommittee and adopted by the advisory committee in the proposed amended rules is to excise *all* mention of the terms "core" and "noncore" in the rules. Instead, the proposed amended rules focus exclusively on consent. *No* averment in *any* pleading as to the core or noncore status of the proceeding would be required any longer. Instead, the proposed rules would "simply require a statement as to whether a litigant does or does not consent to entry of final orders or judgments by the bankruptcy judge. If all litigants do not consent, the bankruptcy court would be required to decide whether it may nevertheless finally adjudicate the proceeding;" the proposed rules provide for this determination in an amended Rule 7016 on pretrial conferences.[27] The proposed amended rules also clarify that a bankruptcy court may issue proposed findings and conclusions in "core" proceedings where it lacks authority to enter final judgments.[28]

22 Rule 7016 governs pretrial conferences.
23 Fed. R. Bankr. P. 7008, 7012 and 9027.
24 Fed. R. Bankr. P. 7016, 9033.
25 *Id.*, p. 17.
26 *Id.*, p. 21.
27 *Id.*, p. 21; Proposed Amended Rule 7016.
28 *Id.*

Alternatives and a Critique

There are other ways that the advisory committee might have chosen to fix these rules to address the *Stern* problem. One suggestion that the subcommittee considered would have imposed a strict, time-limited pleading requirement on all parties, for example, by mandating that only in a party's initial pleading, through assertions both in the text and the caption, could a party demand that judgment be rendered by the district court; if the party should fail to do so, it would be "deemed" to have consented to full adjudication by the bankruptcy court, and its rights to have a judgment rendered by an Article III judge would be deemed waived. Happily, the subcommittee rejected this approach, seeing it as a "significant departure from the consent provisions currently in the rules."[29] Affirmative consent better protects the rights of litigants to have their disputes adjudicated in an Article III forum, the subcommittee report suggested.[30]

Other approaches might focus on filling in the pleadings gaps in the averments of parties who aver any claims in the adversary proceeding to be "core proceedings." For any claims that a party avers to be "core," the rules could require a statement as to (1) whether they also admit that the bankruptcy court has legal authority consistent with Article III to enter final rulings upon those claims, and/or (2) whether they also consent to the entry of final rulings by the bankruptcy court upon those claims (in case Article III would otherwise bar it). In other words, the former would close the gap in ascertaining the parties' position on the bankruptcy court's lawful authority to fully adjudicate core claims, *regardless of consent*; the latter would close the gap in ascertaining the parties' consent to full adjudication by the bankruptcy court in purportedly "core" matters that may exceed the court's full adjudicatory authority.

By amendment to its local bankruptcy rules, the U.S. Bankruptcy Court for the Southern District of New York has already pursued the latter approach. It now requires pleaders who have asserted that any part of a proceeding is "core" to also state whether they consent to the entry of final orders or judgment by the bankruptcy court if Article III would prevent the entry of final rulings absent the consent of the parties.[31]

Whether the approach in the proposed rules of eliminating all references to core and noncore is really the "least disruptive," as intended by the subcommittee, seems debatable. The approach almost seems subversive in its abandonment of the statutory category of "core proceedings." After all, § 157(b)(1) continues to provide that bankruptcy judges may "hear and determine" all bankruptcy cases (*i.e.*, petitions and the ensuing main cases) and all "core proceedings." Section 157(b)(3) continues to *require* a bankruptcy judge to determine, by the judge's own motion or the motion of a party, whether a proceeding is a "core proceeding" or one that is "otherwise related to" a bankruptcy case. The Supreme Court did not declare these provisions uncon-

29 *Id.*, p. 19. *See* Official Advisory Committee Note to Rule 7008, 1987 Amendment ("Failure to include the statement of consent does not constitute consent. Only express consent...is effective to authorize entry of a final order or judgment by the bankruptcy judge in a non-core proceeding.").
30 Memorandum, p. 19.
31 *See* Bankr. S.D.N.Y. Local Rules 7008-1. 7012-1, 9027-1 and 9027-2. The subcommittee considered a suggestion that was similar to this approach. Memorandum, p. 3.

stitutional; consequently, the statutory requirements for determining whether a proceeding is "core" remain intact. Moreover, there is no ambiguity where litigants agree that their claims are noncore.

Furthermore, the court and the litigants will still need to know the litigants' positions with respect to the core or noncore status of the proceedings, irrespective of consent or lack thereof. Even if the revised standing orders in some courts aim to reduce withdrawal of reference motions in non-jury matters, core or noncore status may be critical in matters of mandatory abstention, permissive abstention, motions to change venue, motions to remand removed state court actions, and the enforcement of forum-selection clauses.[32] In all these situations, courts look in part to the core or noncore status of the proceeding.

It will be interesting to see how the bankruptcy bar responds to these proposals. The public comment period runs until Feb. 15, 2013. abi

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32 *See, e.g., In re Exide Technologies*, 544 F.3d 196, 206, 218 and n. 14 (3d Cir. 2008); 28 U.S.C. § 157(b)(4).