

Bankruptcy Court Subject Matter Jurisdiction: Assessing the Limits of the Judicial Power of Article I Courts

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Bankruptcy judges, like federal magistrate judges, are Article I judges. And like magistrate judges, bankruptcy judges generally derive their right to exercise federal judicial powers by way of “statutory reference” of district court powers. For magistrate judges, the reference of federal judicial power is found in 28 U.S.C. § 636, and in many district court local rules (e.g., LR 73-1, U.S. District Court Local Rules for the District of Oregon), with the role of the parties’ consent playing a very significant role. For bankruptcy judges, the statutory reference of federal judicial power, is made under 28 U.S.C. § 157, and also under district court local rules (e.g., LR 2100, District of Oregon). On its face, the reference to bankruptcy judges of district court power under § 157 is very broad, with a long list of “core matters” related to or arising in bankruptcy cases that are handed off to the bankruptcy court, ostensibly without the need for the consent of any party. Such matters include, by way of example, “all counterclaims of the bankruptcy estate against creditors,” all matters relating to “allowance or disallowance of claims,” all “suits for recovery of fraudulent transfers and preferences,” and all matters relating to “the adjustment of debtor-creditor and equity security holder relationships.”

Without such reference of judicial power under 28 U.S.C. § 157, all pronouncements by bankruptcy judges could only be suggestions, not final determinations. As a practical matter, then, without such references of judicial power, bankruptcy judges would not be able to issue any orders or judgments of any kind, and they could only issue, in any contested or adversary matter, a report and recommendation (R&R) to the district court, which then would be required to adopt or to reject such R&R in order for the R&R to become a final order.

Although the range of “core” matters statutorily referred under § 157 to bankruptcy judges is surprisingly broad, there are Article III constitutional limits on the ability of Congress to enact such a statute. These limits

have created an unusual new category of civil matters, called “*Stern* claims,” which involve technically one of the core matters listed in § 157, but over which an Article I judge, such as a bankruptcy judge, may not constitutionally enter a final order.¹ For four years after the Supreme Court issued its opinion in *Stern*, it was unclear whether a party could waive its jurisdictional objections in cases involving *Stern* claims and thereby allow bankruptcy judges to enter a final order, but it is now clear, as a result of the Supreme Court’s recent decision in *Wellness International Network v. Sharif*,² that bankruptcy court subject matter jurisdiction can be created by the parties’ consent, even over matters involving *Stern* claims.

The exercise of federal judicial power over bankruptcy cases is exercised pursuant to 28 U.S.C. § 1334, which provides that the district courts shall hold “original and exclusive” jurisdiction over all “cases” filed under Title 11 of the U.S. Code, which is the substantive law generally known as “the Bankruptcy Code.” The word “case,” as it is used in § 1334(a), is a term of art that means the file created by the filing of a petition for relief with the clerk of the bankruptcy court, such as a voluntary or involuntary petition under Chapter 11, Chapter 7, or Chapter 13. More important is the vesting of judicial power in the district courts, under 28 U.S.C. § 1134(b), over “all civil proceedings arising under Title 11, or arising in or *related to* cases” filed under Title 11. This means that every possible civil dispute “arising in” or “related to” a bankruptcy “case” is placed within the subject matter jurisdiction of a federal court exercising bankruptcy jurisdiction, regardless of the governing law or the nature of the dispute and without regard to the state or states in which the parties reside or the minimum contacts of the parties to the local jurisdiction.³

The “core matters,” which can be loosely defined as the most commonly encountered “civil proceedings arising in or related to bankruptcy cases,” are then referred (by way of 28 U.S.C. § 157(b)) to

the bankruptcy courts. Section 157(b) defines “core proceeding” incredibly broadly and includes a long list of specific civil proceedings, as quoted above, that are statutorily referred. Unlike diversity matters in district court, none of these referred “core matters” are subject to minimum or maximum dollar amounts and can include any matter governed by applicable non-bankruptcy law.

Section 157(b) was enacted by Congress in 1984 in response to the Supreme Court’s decision in *Northern Pipeline v. Marathon Oil*,⁴ which invalidated as unconstitutional the entirety of the 1979 bankruptcy court subject matter jurisdiction statute that purported to hand directly to the then newly created Article I bankruptcy courts, without any form of “reference” of Article III judicial powers from the district court, jurisdiction over “all civil proceedings arising in or related to” bankruptcy “cases.” To avoid the practical nightmare that might have thereafter arisen over the invalidity of then three years’ worth of decisions by our nation’s bankruptcy courts, the *Northern Pipeline* court did not apply its decision to the parties in that case and instead gave Congress until the end of 1982 to correct the unconstitutional statute governing bankruptcy court jurisdiction. Consistent with its usual finite wisdom, Congress eventually took action in 1984, resulting in the adoption of 28 U.S.C. § 157 and the “referred jurisdiction” approach that was patterned after the magistrate statute of the Federal Magistrates Act,⁵ which the Court approved as constitutional in 1980’s *United States v. Raddatz*.

Subsequently, the Supreme Court issued a line of decisions, beginning with Justice John Paul Stevens’ opinion in *Granfinanciera v. Nordberg*,⁶ that have had the effect of invalidating, as an unconstitutional delegation of federal judicial power to an Article I court, parts of § 157’s specific reference to bankruptcy courts of certain listed “related to core proceedings,” such as litigation over fraudulent transfers, when such matters involve a party holding a Seventh Amendment right to a trial by jury and that had not previously filed a claim against the bankruptcy estate.

Most important in this line of Supreme Court decisions addressing the constitutional limits of the delegation of federal judicial power to Article I courts, notwithstanding specific delegation and itemization of such power by Congress itself in § 157, was the case of *Stern v. Marshall*,⁷ where the Court held that state tort law counterclaims filed by the bankruptcy estate as a “related to core proceeding” against a creditor that had earlier filed an unrelated claim for defamation against the bankruptcy estate was an impermissible delegation of Article III power to an Article I court (notwithstanding § 157(b)’s specific referral to bankruptcy courts of all counterclaims

of the estate). Such civil proceedings that are specifically referred but unconstitutionally so, under § 157(b), are now called *Stern* claims. Such claims are not easy in practice to identify, for the reason that they are authorized and itemized in the referral statute but prohibited from being referred by the Constitution, a far more vague document.

Under the most recent Supreme Court case addressing these issues, *Wellness International Network v. Sharif*,⁸ the Court concluded that jurisdiction over *Stern* claims, (i.e., for matters over which the federal judicial power may not be constitutionally referred by statute to Article I judges), may nonetheless be properly constitutionally determined by final order from a bankruptcy judge, if the parties consent, as of course is and has been the long-standing practice under the Federal Magistrates Act. Of great practical importance, the *Wellness* court also concluded that such consent by a party may be inferred by the bankruptcy court and need not be expressly stated.

As a consequence, many local bankruptcy court rules require that each party’s first filed adversary matter pleading include a statement as to whether consent is given for the entry of final orders and judgments by a bankruptcy judge, and that, without such a statement, consent will be presumed to have been given (e.g., U.S. Bankruptcy Court, District of Oregon Local Bankruptcy Rules, LBR 7008-1 & 7012-1). As a practical matter, this has meant that bankruptcy judges rarely offer non-final R&Rs to district judges.

We have come a long way in addressing the limits of the judicial powers of Article I judges since the adoption of the 1978 Bankruptcy Code and its related then-new scheme for bankruptcy court jurisdiction. Finally, with the synchronicity of jurisdictional standards between magistrate and bankruptcy judges, we have finally reach near-clarity of just how far judges without life tenure can extend their judicial reach. ☉

Endnotes

¹See *Stern v. Marshall*, 564 U.S. 462 (2011).

²*Wellness Int’l Network v. Sharif*, 135 U.S. 1932 (2015).

³See Conde T. Cox, *Personal Jurisdiction Defense in Bankruptcy Court: No Such Thing*, 66 FED. LAW. (forthcoming 2019).

⁴*Northern Pipeline v. Marathon Oil*, 458 U.S. 50 (1982).

⁵28 U.S.C. § 636.

⁶*Granfinanciera v. Nordberg*, 492 U.S. 33 (1989).

⁷*Stern v. Marshall*, 131 U.S. 2594 (2011).

⁸564 U.S. 462 (2011)

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