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Stern v. Marshall: Much Ado About Something

Karen Cordry
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There has been an enormous outpouring of concern from the bankruptcy community about the Supreme Court's recent decision in *Stern v. Marshall*.[1] The opinion clearly does have important implications for the bankruptcy system, but it seems clear that the most extreme initial reactions were overblown—perhaps not least because reports tended to misstate the Court's actual holding. Statements such as "[t]he Supreme Court held that bankruptcy courts did not have jurisdiction to rule on counterclaims" were certain to gain one's attention but were far from correct. A more calm appraisal indicates that the ruling will not necessarily undercut the Code's basic functioning but will clearly not be limited to a single, isolated circumstance.

I. Background

Vickie Lynn Marshall (also known as Anna Nicole Smith) was married to a much older man, J. Howard Marshall, when he died but received nothing under his will, nor was any provision made prior to his death for any substantial inter vivos gift trust to be set up for her benefit. She asserted that that state of affairs was contrary to Howard's wishes and occurred due to the machinations of his son, E. Pierce Marshall, who allegedly conspired to deprive her of moneys that Howard intended that she should

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have as inter vivos gifts. The district court's opinion on the merits of her complaint concluded, after a full review of documents and testimony by the interested parties, that Vickie had indeed been done wrong.[2] The opinion (which is definitely worth the time to read despite its 82-page length) best summarizes its results in this paragraph describing Vickie:

> Her life is best described as that of a person who was rescued by her wealthy pursuer and taught to spend money at a breathtaking pace that most Americans cannot fathom. While she detested being thought of as a gold-digger, her actions leave little doubt that money was the central facet of her relationship with J. Howard. Her appetite for money, once developed, was incessant and outlandish by everyday standards.
>
> …Her communication skills were poor as she frequently had trouble engaging counsel. Her illiteracy is striking…
>
> But education is no guarantor of integrity and a discredited profession does not mean a person lacks truthfulness. While Vickie certainly drew a more noble image of herself than the facts bear out, her testimony on the statements made by J. Howard are credible.[3]

In other words, just because you are a gold-digger doesn't mean you can't tell the truth.

Reacting to the actions of Pierce described in the district court's opinion,[4] Vickie's lawyers filed suit in Texas probate court seeking to invalidate his estate plan (which did not include her) based on alleged undue influence on Howard by Pierce. The lawyers made a number of derogatory remarks about Pierce and those associated with him at the time. A few months after Howard's death in 1995, Vickie filed bankruptcy in California. In May 1996, Pierce filed a timely adversary complaint, alleging that Vickie had defamed him (by way of the statements made by her attorneys) and seeking to have excepted from discharge any amounts he would be entitled to based on the defamation claim. A month later, he filed a proof of claim in the bankruptcy, specifying his right to payment by attaching his discharge complaint to the proof of claim form.

Vickie answered the discharge complaint a) denying the merits of the defamation claim and asserting truth as a defense; b) stating a variety of counterclaims, including tortious interference with an inter vivos gift, fraud, promissory estoppel; and c) seeking imposition of a constructive trust and an accounting, among other remedies. She also objected to Pierce's proof of claim. The bankruptcy court entered summary judgment against Pierce on his claim in November 1999, finding that Vickie had neither made the derogatory statements nor ratified them and was not otherwise vicariously liable for them. The trial on her counterclaims was held separately, and the court entered judgment in Vickie's favor in October 2000 (with a final decision issuing in December 2000), after excluding substantial amounts of Pierce's evidence based on alleged discovery abuses by Pierce. The judgment found that Vickie was entitled to half of everything that Howard owned at his death or more than $400 million.

Pierce had earlier sought a withdrawal of the reference, which was ultimately denied, and again sought to withdraw the reference after the bankruptcy court's decision. The district court denied that motion and also denied Pierce's argument that the probate exception barred it from hearing the case. The district court further concluded, however, that Vickie's claims were not core proceedings. Its reasoning on the subject was largely based on the same concerns later expressed by the Ninth Circuit and the Supreme Court; i.e., that the matter was too tenuously related to the claim filed by Pierce and that the constitutional considerations arising from *Northern Pipeline Construction Co. v. Marathon Pipe Line Co.*[5] required that one read the definition of "core proceeding" in § 157(b)(2)(C) narrowly so as to exclude this claim.[6] The court further concluded, though, that it was not bound by res judi-

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cata or collateral estoppel to accept the decision made in the meantime by the Texas probate court which, at the time of this second district court decision, was still not final.[7] In making that decision, the district court relied on factors relating to the timing of the *trials*, not the respective decisions of the different courts (i.e., since the bankruptcy court trial had occurred first, its decision would have primacy even if it occurred after a final decision by the Texas court was entered). The Ninth Circuit took the opposite view on that issue, so the relative timing of the decisions became crucial.

It is worthy of note that, although most readers greeted the Supreme Court's decision as if it were an unanticipated stroke of lightning from a clear sky, in fact, the district court had already concluded in 2002 that the bankruptcy court could not issue a final decision on the matters asserted by Vickie for precisely the same basic reasons that the Supreme Court relied on nine years later. In any event, after its de novo review, the district court also concluded that Pierce had interfered with his father's intention, and absent that interference, it was highly likely Vickie would have received a gift of half of everything that Howard had accumulated during their marriage (albeit not half of his entire fortune). That totaled about $44 million, and the district court added a like amount for punitive damages for a total award of approximately $88 million.

After a detour to the Supreme Court occasioned by the Ninth Circuit's erroneous ruling on the probate exception issue,[8] the matter returned to the Ninth Circuit for review of the district court's conclusions with respect to the "core proceeding" issue. Based on the same factual, legal, and constitutional concerns that led the district court to hold that Vickie's counterclaims were not "core proceedings" despite the literal language of § 157(c)(2)(C), the Ninth Circuit held that there were counterclaims (even mandatory/compulsory counterclaims) that were so detached from the basic issues asserted in the creditor's claim that they should be treated as only "related to" the case and not "arising in" the case or "arising under" the Code.[9] Thus, it held, one must take a two-step approach—first, are the matters counterclaims; and second, if so, are they sufficiently closely related that they should be treated as core proceedings? If not sufficiently closely related, the counterclaims cannot be determined with finality by the bankruptcy court. The Ninth Circuit agreed with the district court's conclusions about the separate nature of the two sets of claims and held that the bankruptcy court could not enter a final judgment on Vickie's counterclaims. Based on its analysis of the timing of events, the Ninth Circuit held that the Texas decision had to be given binding effect as the first "final decision" that issued.

II. The Supreme Court's Holding

A. Statutory Language Cannot Trump the Constitution

When the case returned to the Supreme Court, the majority focused on exactly the same factors that had troubled the district court and the Ninth Circuit. Emboldened perhaps by the fact that it is infallible,[10] the Court brushed aside the temporizing efforts of the district court and the Ninth Circuit to avoid dealing with a literal application of § 157(c)(2)(C). Vickie's action, the Court held, clearly was a "core proceeding" under the language of § 157(b)(2)(C) since it was filed in response to a creditor's claim, so the district court's "not a core proceeding" holding was incorrect. The Court also rejected the Ninth Circuit's suggestion that there was a category of core proceedings that does not "arise in" a case or "under" the Code and hence would not be covered by the "hear and determine" language for standard core proceedings.[11] All of the justices agreed that the statutory language makes any kind of counterclaim a core proceeding, no matter how attentuated the relationship between the counterclaim to the creditor's claim.

However, the majority held, in language reminiscent of its decision in *Seminole Tribe of Florida v. Florida*[12]: "Although we conclude that § 157(b)(2)(C) permits the Bankruptcy Court to enter final judgment on Vickie's counterclaim, Article III of the Constitution does not."[13]

It is that holding, of course, that has aroused considerable consternation. Had this matter involved a purely discretionary counterclaim asserted by the debtor, it is likely that the impact would have been far less. Courts have routinely given a narrowing construction to other portions of 28 U.S.C.A. § 157(b) in order to avoid the constitutional concerns considered in *Marathon*.[14]

In this case, though, the district court, Ninth Circuit, and Supreme Court all agreed that Vickie's claims would normally fall within the expansive definition of mandatory/compulsory counterclaims set out in Fed. R. Civ. P. 13 (Fed. R. Bank. P. 7013). Unlike the broad catch-all provisions that the courts had read narrowly as noted above, this very specific provision had been applied literally by most courts with little attention paid to its breadth. However, that broad definition—anything "arising out of the [same] transaction or occurrence"—can easily include matters that, while having

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some issues in common, also have many differences. As a result, litigation of counterclaims took place that had very little to do with the issues arising from the proof of claim that the creditor filed. It was that possibility that the district court, the Ninth Circuit, and the Supreme Court focused on, and that caused them to look beyond the mere label of "compulsory counterclaim."

When they did so, they all noted that Vickie's counterclaims would require determination of many additional issues beyond those needed to decide the relatively straightforward ones presented by Pierce's claims. Indeed, the fact that his claims were disposed of on summary judgment in 1999 (with nothing more ever being heard of them) while hers engendered a *Jarndyce v. Jarndyce*[15] litigation saga lasting until 2011 makes clear that satisfying the criteria for a compulsory counterclaims does not say a great deal about how closely the cases are actually entwined.[16] The reality is that the Rule 13 standard is established to further the court's judicial economy, not to serve as a basis for compliance with constitutional requirements, so meeting that standard does not inevitably answer the fundamental question. In any case, what is clear is that the Supreme Court's holding applies, at a minimum, to all asserted counterclaims, since if the bankruptcy court can be barred from making final decisions on at least some compulsory counterclaims, a fortiori, the same limits apply to its power to resolve permissive counterclaims.

B. Public Rights; Personal Consent

After concluding that the statute would allow a debtor to obtain a binding determination from the bankruptcy court with respect to any cause of action it asserted whatsoever, so long as the creditor filed any sort of claim, the Court then considered whether those powers could be constitutionally conferred on the bankruptcy court. Although its analytical approach is not a model of clarity, the majority's decision boils down to consideration of two possible approaches. First, is the litigation of counterclaims a "public right" such that the use of a non-Article III judge can be imposed on an unwilling party; or, second, can it be said that there was consent by the nondebtor party to the use of a non-Article III judge to resolve the issues.[17] The Court found that neither approach applied. and as a result, the bankruptcy court's opinion could not be treated as final. From that, the conclusion that the Texas court's decision took precedence followed.[18]

1. Public Rights in General

The Court noted that there have been numerous approaches to deciding if a defendant can be required to allow a non-Article III judge to enter a judgment against it that is binding without further involvement of an additional judicial officer. The scenarios where that has been allowed have generally been lumped under the rubric of "public rights"—i.e., where litigation involves a public right, it may not be necessary for it to proceed before an Article III judge.[19] The scenarios where such "public rights" may be asserted include a) litigation before an administrative agency that is a mere "adjunct" to a district court that makes the final rulings[20]; b) litigation over new rights created solely by the federal government and awarded under whatever scheme the government creates[21]; or c) cases where the government itself brings the litigation or is a party thereto. None of these, the Court had held in *Marathon*, applied to affirmative suits brought by debtors under nonbankruptcy law against nondebtor parties. The mere fact that a party had filed bankruptcy did not give that party the ability to deny the protections of an Article III judge to defendants.[22] The issue here then turned on whether the situation was different if the debtor was asserting a claim in response to a creditor having filed a claim against the estate.

2. Public Rights Vis-a-Vis Claims Resolution

In that regard, if one wishes to argue that a public right is involved in the litigation of counterclaims, it would be very helpful to be able to assert that resolving underlying creditors' claims is a public right. Then one could try to argue that, at least as to mandatory counterclaims, resolving the counterclaim is simply part of the process of resolving that initial public right. That argument failed here, though, as well—the Court noted that it had never explicitly decided that even the claims resolution process and/or the hierarchical ordering of creditor claims were such public rights. However, even if they were, the Court held, that would not automatically carry over into making resolution of the debtor's claims against nondebtor parties a public right.

The Court noted that it had considered some of those issues in *Katchen v. Landy*[23] and *Langenkamp v. Culp*,[24] cases that both dealt with preference claims. The outcome in those cases, the Court noted, was different based on whether or not 11 U.S.C.A. § 502(d) (or its predecessor, in the case of *Katchen*) applied. Under that section, the existence of an avoidable transfer is a defense to the allowance of the claim to begin with. As a result, the validity of the preference claim is necessarily adjudicated in the course of determining whether the creditor's claim should be allowed or disallowed. It is not a question of "waiver" or consent

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by the nondebtor party to the resolution of the preference claim; rather, it is simply that when a party files a claim, all defenses to that claim, whether arising under nonbankruptcy law or the Code, must be resolved.[25] When that litigation has been concluded, the resolution of the preference issues in the course of defending the claim leaves nothing to be resolved in a separate avoidance complaint.

The Court further noted that, in addition to the fact that determining the preferences in the § 502(d) context was an integral part of the claims allowance process, the debtor was also asserting a right created by the Code. While fraudulent transfers are a well-established branch of the law that may be asserted outside the bankruptcy arena, preference actions are unique to, and created by, the Code. Thus they arguably fit the notion of a newly created "public right" that may be administered as Congress sees fit and that does not require resolution by an Article III judge. (Note, though, that the "due process" analysis in *Teleservices* might not agree with this approach since preference actions are still a means of removing assets from the third party in order to augment the bankruptcy estate.)

The Court's conclusion was that to allow a debtor to demand the right to have a binding decision by a non-Article III judge there must be either a right created by the Bankruptcy Code or a necessary resolution of the debtor's counterclaim in the process of allowing the creditor's claim or both. Neither occurred here, and as a result, the determination of Vickie's claims could not be made as a final matter by the bankruptcy court—at least where the nondebtor party objected thereto.

3. Current Realities

a. Decision Making by Bankruptcy Courts

Much of the concern expressed to date has not been so much with the specific holding of the case as with the implication of the Court's holding that non-Article III judges might not even be able to litigate matters even if all that they intend to do is issue a set of proposed findings and conclusions.[26] A corollary of this concern is uncertainty as to the effect of consent of the parties on the extent of bankruptcy court's authority and the ability of those courts to continue to function as they now do.

To evaluate the effect of the decision, one must start with the statutory framework imposed after *Marathon*. 28 U.S.C.A. § 157(b)(1) allows bankruptcy courts to hear and issue final determinations on core proceedings. Section 157(c)(1) allows the bankruptcy judge to hear noncore proceedings and issue proposed findings of fact and conclusions of law with any "final order or judgment… [to] be entered by the district judge after considering the bankruptcy court's proposed findings and conclusions and after reviewing de novo those matters to which any party has timely and specifically objected." Finally, under § 157(c)(2), the district court, "with consent of all the parties to the proceeding," may refer a "related to" (i.e., noncore) matter to the bankruptcy court for it to hear and determine (i.e., to enter a final judgment). By its literal terms, this suggests a specific reference of a particular matter based on expressed consent.

Thus the statute envisions three scenarios: 1) the bankruptcy court may enter final decisions with or without the parties' consent on core proceedings; 2) it may only make proposed findings and conclusions in noncore proceedings without consent; and 3) it may enter final decisions on noncore proceedings if all parties consent. That trichotomy is reinforced by § 157(d), which allows the district courts to withdraw their reference of any proceeding from the bankruptcy court for "cause shown" and requires that they do so for any matter where "resolution of the proceeding requires consideration of both title 11 and other laws of the United States regulating organizations or activities affecting interstate commerce."

As the courts now operate in practice, these requirements are only sketchily adhered to. The provisions regarding submission of decisions on noncore "related to" matters to the district court and entry by that court of judgments after parties are allowed to object generally appear to have been congenially ignored by all concerned. As part of the pleading process in adversary cases (see Bankruptcy Rules 7008(a) and 7012(b)), parties are required to state whether a matter is core or not and, if noncore, whether they consent to a final ruling by the bankruptcy court. Regardless of whether consent is expressed, bankruptcy courts hold essentially the same form of hearings and issue the same form of decisions in most instances whether the matter is core or noncore. At most, it may state "this is my opinion if this is core and these are my recommendations if this is found not to be core," but the opinion is generally entered by the bankruptcy court clerk on the bankruptcy docket regardless. At that point, everyone waits to see if there is an appeal. If not, then the decision—whether on core or noncore matters and whether or not consent was expressly granted—goes into effect, without involvement by the district court or submission of any document to

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it. It is only if an appeal is filed that the district court sees the case and then must consider the difference in the level and nature of the review for a core versus a noncore proceeding.

In short, under the current scenario, even the existing distinctions between core and noncore matters have little relevance to the way that the hearings and decisions are actually held and entered. As the court noted in *In re Olde Prairie Block Owner, LLC*,[27] the practical reality is that parties consent to final decisions by the bankruptcy court most of the time, even on noncore matters. Parties need to have decisions made and move on; bankruptcy does not readily accommodate lengthy appellate processes on even the most major issues such as plan confirmation, much less run-of-the-mill contract disputes and the like. Thus if consent can validate the bankruptcy court's exercise of power, this could vitiate most of the potential impact of the decision.

b. Withdrawal Motions

In the related context of motions to withdraw the reference, the language in § 157(d) was plainly intended to ensure that any initial referral of a matter to the bankruptcy court was subject to being withdrawn and returned to the control of the district court. This would appear to be an important part of satisfying *Marathon*'s requirement that Article III district judges retain meaningful authority with respect to bankruptcy cases. Under the evolving case law, though, that retained authority has often been exercised only with great reluctance. This can most readily be seen with regards to "mandatory" withdrawals. Despite the relatively low standard required for such a withdrawal—one must merely show that "consideration" of other federal law is involved—many courts have imposed a much higher standard to allow a withdrawal.[28]

> It is difficult to understand the meaning or purpose of this provision. If its reference to "other laws of the United States" is read literally, it applies to (and requires withdrawal of) enormous numbers of claims against bankrupts and would effectively defeat the attempts of the Code to rationalize bankruptcy litigation. After carefully examining the legislative history, the District Court for the Northern District of Ohio concluded *In re White Motor Corp*., 42 Bankr. 693, 703 (N.D. Ohio 1984), that withdrawal is mandatory "only when" consideration of non-Code federal statutes " is necessary for the *resolution* of a case or proceeding" and that "substantial and material consideration" of those non-bankruptcy statutes must be involved before withdrawal will be mandatory…
>
> Precisely where the substantial and material line falls is open to dispute. It would seem incompatible with congressional intent to provide a rational structure for the assertion of bankruptcy claims to withdraw each case involving the straightforward application of a federal statute to a particular set of facts. It is issues requiring *significant interpretation of federal laws* that Congress would have intended to have decided by a district judge rather than a bankruptcy judge.[29]

It is fascinating to watch the decision segue without explanation from the nonexceptional—"consideration" requires some degree of meaningful relevance of the federal law—to the much more problematic conclusion that "consideration" means that there must be "significant interpretation" of the federal statute, and that such consideration does not involve the mere "application" of federal law. That progressive narrowing of § 157(d) (which goes far beyond its literal words) builds on itself in later cases.[30]

While one understands that district courts do not want to have the work of bankruptcy courts moved to their shoulders, the concerns seem somewhat overblown since the vast majority of bankruptcy court work does not turn on consideration of other federal statutes, as opposed to state nonbankruptcy law, to begin with. To use concerns that withdrawal of such claims would create a huge "escape hatch" from bankruptcy jurisdiction to justify dramatically contracting the statutory language seems inappropriate, particularly in light of the constitutional significance of these provisions. If Congress truly intended to limit mandatory withdrawal to areas of "first impression" or "conflicting statutes" or constitutional issues, it surely could have come up with a more limiting criteria than the bland requirement for "consideration" of the other federal laws.

The other corollary of this narrow reading of the withdrawal provisions is that district courts routinely leave all pre-trial matters with the bankruptcy court, even for proceedings that they concede must be withdrawn eventually. Only when (and if) the matter actually is set for trial do the district courts intend to resume control over the matter. It appears, though, that the vast majority of such tentatively withdrawn cases settle since there seem to be far more decisions about whether to withdraw a case than there are ones in which the district court takes the case back and actually tries the issues. Thus under the current procedures, even

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if a matter is noncore in whole or in part, and even if it is subject to mandatory withdrawal, it will most likely be retained in the bankruptcy court through all of the important pre-trial stages. If it is not subject to such withdrawal, then all aspects of the hearing will likely be before the bankruptcy court, and its decision will be the final word unless one or more parties appeal. In short, it is highly likely that the "courthouse steps" where most matters settle will remain those of the bankruptcy court.

4. Redrafting § 157 after *Stern*

The current approach has worked largely because everyone pretty much accepted the way the system worked, even if it did not literally follow the requirements of § 157. If one did have to go strictly by the existing statute—and now expand its impact to cover "core proceedings" that cannot be finally litigated by the bankruptcy court—there could be several effects. First, the statute will now need to be read differently to deal with core matters falling under the conceptual framework established by *Stern*, i.e., those not created by the Code and not necessarily resolved in a claim proceeding initiated by the creditor. At the very least, that means we need a name for them. There are probably not that many matters that fall into that category other than counterclaims (avoidance actions being the most likely other candidates), but even if limited only to counterclaims, such litigation does form a significant part of the court's jurisdiction along with the standard noncore matters.

So, let us start by coining the phrase "non-final core proceedings." We can then use the term "non-final proceedings" for both noncore and "non-final core proceedings" collectively. Then, one could amend § 157(c)(1) to provide that the court may hear all "non-final proceedings" and submit proposed findings and conclusions to the district court. That change would take care of the problem that, as of now, "non-final core proceedings" do not fall under either § 157(c)(1) or § 157(b)(1), and if read literally, § 157 has no means of dealing with them.[31]

Then, as to those "non-final proceedings" (core and noncore alike) strict adherence to § 157(c)(1) would require the bankruptcy court to send its "proposed findings and conclusions" to the district court, and objections (not appeals) would then be filed directly with the district court. The district court would then be the court to enter the first (and only) binding decision on the issues. Using this approach, though, would require some rewriting of the Bankruptcy Rules. Currently, under Fed. R. Bankr. P. 8002, one files a "notice of appeal" from any form of bankruptcy court decision, and then a separate "statement of issues" under Fed. R. Bankr. P. 8006. Under the objection process, there should presumably be a single deadline for the dissatisfied party to file "timely and specific[] object[ions]" with the district court identifying which portions of the bankruptcy court's findings and conclusions it wants the district court to review de novo.

After receiving those objections, the district court would begin its review and consider whether to adopt the decision or to make sua sponte changes. That process would be separate from the normal appeal of a decision by the bankruptcy court on the portions of the proceeding upon which it could issue a final determination. If both aspects were present in a single case, the bankruptcy court might have to issue two decisions, and the objecting party might have to follow two separate paths to register its disagreement. Thus strict adherence to the "submission of proposed findings and conclusions" approach now embodied in § 157 would likely require that the Bankruptcy Rules be substantially rewritten to deal with the two kinds of review.[32]

While all of this may create procedural problems, they could be addressed relatively easily. Rewriting § 157 and/or the Rules to conform to the approach that courts actually use for noncore proceedings (issuing the decision but noting that it constitutes proposed findings and conclusions) and allowing de novo review thereof is simple enough. If done, it is unlikely that there is constitutional significant difference between that procedure and one where the decision is physically submitted first to the district court with the right of parties to object before the district court issues an order. One difference might be if there were any obligation on the district court to independently review and evaluate a proposed findings and conclusions if no objections are raised. If so, that could create substantial delays; if not, the bankruptcy court's findings and conclusions could automatically become effective as soon as the objection period expired.

In that regard, in the closely related field of decisions issued by non-Article III magistrate judges, the Supreme Court has already spoken. In *Hagan v. Okony*,[33] a pre-*Stern* case, the district court received a "Report and Recommendation" from the bankruptcy court on a noncore proceeding. No objections were filed, and the district court considered whether it needed to do anything more than simply sign off on the bankruptcy court's proposed decision. The district

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court looked at the Federal Magistrate Act and noted that in *Thomas v. Arn*,[34] the Supreme Court had held that de novo review was needed only if objections were filed. Similarly, in *Peretz v. United States*,[35] the Supreme Court stated that:

> The statutory provision we upheld in [*United States v. Raddatz*, 447 U.S. 667, 100 S. Ct. 2406, 65 L. Ed. 2d 424 (1980),] provided for *de novo* review only when a party objected to the magistrate's findings or recommendations… *[T]o the extent 'de novo review is required to satisfy Article III concerns, it need not be exercised unless requested by the parties.'"*[36]

Thus assuming the two non-Article III adjudicators (bankruptcy judges and magistrate judges) are functionally similar (as discussed further below), it would seem that there is no need for active district court involvement, absent objections. As noted above, there seems to be no meaningful difference between the bankruptcy court itself issuing a decision that can be appealed or its sending a decision to the district court to which parties can object. If so, then minor changes to § 157 and the Rules should eliminate the confusion and/or the need for bifurcated proceedings. At most, one would only have bifurcated review although the possibility for expanded de novo review could cause additional work for the district courts. That possibility is undercut by the reality that few noncore cases that are appealed receive de novo review now, so it is not all that likely that the numbers will swell significantly with the addition of non-final core proceedings. That small number is based in large part presumably on the consent of the parties to have the bankruptcy court enter final decisions in such matters pursuant to § 157(c)(2).

The real angst following *Stern* is the concern of many that perhaps, except as to "public rights" (which might or might not even include claims litigation, according to *Stern*), bankruptcy courts might not be able to adjudicate matters at all. If they are exercising the judicial power of the United States to resolve private rights and such power is a jurisdictional matter or one involving separation of powers, then the consent of the parties might be irrelevant to the scope of the bankruptcy court's adjudicatory powers—one cannot create jurisdiction by consent. If so, then perhaps much or all of the jurisdictional scheme for bankruptcy cases may totter on the brink of collapse. Put another way, if the right to an Article III adjudicator is akin to subject-matter jurisdiction, then bankruptcy judges may find themselves limited to playing in a much smaller sand box.

III. Consent Does Matter

Before one wonders about the apocalypse, one should see if there is any similar judicial scheme where these same issues might arise and where the Supreme Court has expressed a view about the nature of the rights with respect to trial by an Article III adjudicator. The answer is, of course, yes—the Magistrate Judge system, set out in 28 U.S.C.A. §§ 631 to 639, creates a very similar set of powers and jurisdictional rights in non-Article III judges.[37] Those judges are, if anything, even more non-Article III than bankruptcy judges. They are appointed by the district courts, not the courts of appeals; they serve for only eight years rather than 14; their office can be abolished if the district court decides that they are no longer needed; they serve after age 70 only with the annual approval of the district court; and they can be removed by a simple majority vote of the district court judges.

Despite those obvious non-Article III characteristics, they may automatically handle a variety of matters in minor criminal cases under 28 U.S.C.A. § 636(a), and under § 636(b)(1)(A), the district court may designate them to "hear and determine" pretrial matters in civil and criminal matters, subject to certain exclusions. Under § 636(b)(1)(B), the district court may further designate the magistrate judge to make "proposed findings and conclusions of law" on all of the matters excluded under subsection (A). As to those proposed decisions, parties may object within 14 days and the district judge shall then make a de novo determination as to the portions to which objections are raised. The judge may also accept, reject, or modify the proposed decision (but as noted above, need not do so absent objections).

The most significant provision, though, is § 636(c)(1): It provides that "[u]pon consent of the parties, a… magistrate judge… may conduct any or all proceedings in a jury or nonjury civil matter and order the entry of judgment in the case, when specially designated to exercise such jurisdiction by the district court or courts he serves."[38] The parties are to be given specific notice, pursuant to § 636(c)(2), that they need not accept the use of a magistrate judge but, if they agree, the magistrate judge may enter final judgment—and that judgment is appealed not to the district court but directly to the court of appeals under § 636(c)(3). In short, these provisions set up a situation very akin to that used with reference of matters to bankruptcy judges.

Upon designation (i.e., referral) by the district court, the magistrate judge may make final determinations on § 636(b)(1)(A) matters (the equivalent of

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core proceedings) and may make proposed findings on § 636(b)(1)(B) matters (the equivalent of noncore proceedings). District court judges "reconsider" the subsection (A) determinations, while the subsection (B) determinations are subject to an objection process like that used with respect to bankruptcy court decisions on noncore matters. In addition, just as bankruptcy courts are empowered to enter final decisions on noncore matters under 28 U.S.C.A. § 157(c)(2) with the parties' consent, so too may the magistrate judges with respect to all proceedings in any civil matter. Moreover, while those consent decisions by bankruptcy courts remain subject to district court review, magistrate judge decisions entered by consent are fully binding with no involvement of the district court and are reviewed only by the court of appeals.

While there are some difference in the precise procedures used under § 636(b) compared to § 157, they do not appear to rise to constitutional significance whether one considers the approach prescribed by § 157 or that generally actually practiced in bankruptcy courts. What is significant is that the parties' consent is explicitly allowed to grant authority to a non-Article III judge to enter a binding judgment that substitutes for any decision or review by the district court, de novo or otherwise.

If the consent provisions in the Federal Magistrates Act are valid, this would appear to give strong support to similar language in the Bankruptcy Code and to make clear that this sort of tripartite approach is valid. While there is still the need to move some core proceedings from category 1 (automatically binding decisions) into either category 2 (proposed decisions) or category 3 (binding decisions with consent), at least this would keep the overall foundation of the Code in play. Moreover, with some relatively minor reworking of § 157, as discussed above, it should be possible to create a process that is not overly burdensome or difficult to implement. Thus one must see what the Supreme Court has said about the Federal Magistrates Act and analyze how its remarks would translate to bankruptcy.

In that regard, in the last decade the Supreme Court has considered those provisions in both the civil and criminal contexts and, in both areas, has made clear that consent is a valid basis for deciding issues relative to the need to use an Article III judge. In *Gonzalez v. United States*,[39] the Court held that not only could one consent to having a magistrate judge conduct voir dire (the prisoner was entitled to a district judge if he objected to use of the magistrate for that process), but that consent could be granted by the prisoner's counsel and need not be given by the prisoner directly. In *Roell v. Withrow*,[40] the Court held that where parties made a general appearance before a magistrate and failed to object the magistrate judge's deciding their case after being informed a) of their right to demand a district court judge and b) the magistrate judge's intention to enter a final judgment, they could be held to have waived any right to trial before an Article III judge and to have consented to the magistrate judge's authority despite any express stated consent. In discussing the Magistrate Act, the Court noted:

> In giving magistrate judges case-dispositive civil authority, Congress hoped to relieve the district courts' "mounting queue of civil cases" and thereby "improve access to the courts for all groups." S. Rep. No. 96-74, p 4 (1979); *see* H. R. Rep. No. 96-287, p 2 (1979) (The Act's main object was to create "a supplementary judicial power designed to meet the ebb and flow of the demands made on the Federal judiciary"). At the same time, though, Congress meant to preserve a litigant's right to insist on trial before an Article III district judge insulated from interference with his obligation to ignore everything but the merits of a case. *See Commodity Futures Trading Comm'n v. Schor*, 478 U.S. 833, 848, 92 L. Ed. 2d 675, 106 S. Ct. 3245 (1986) (Article III protects litigants' "'right to have claims decided before judges who are free from potential domination by other branches of government'" (quoting *United States v. Will*, 449 U.S. 200, 218, 66 L. Ed. 2d 392, 101 S. Ct. 471 (1980))). It was thus concern about the possibility of coercive referrals that prompted Congress to make it clear that "the voluntary consent of the parties is required before a civil action may be referred to a magistrate for a final decision." S. Conf. Rep. No. 96-322, p. 7 (1979); *see also* S. Rep. No. 96-74, at 5, U.S. Code Cong. & Admin. News 1979, pp. 1469, 1473 ("The bill clearly requires the voluntary consent of the parties as a prerequisite to a magistrate's exercise of the new jurisdiction. The committee firmly believes that no pressure, tacit or expressed, should be applied to the litigants to induce them to consent to trial before the magistrates"); H. R. Rep. No. 96-287, at 2 (The Act "creates a vehicle by which litigants can consent, freely and voluntarily, to a less formal, more rapid, and less expensive means of resolving their civil controversies").[41]

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In reading the discussion, it is clear that the Court treats the right to an Article III adjudicator as one personal to the litigant that it may exercise or waive at its option. Thus although this might appear to be similar to other aspects of Article III power, which cannot be expanded or diminished by the parties' consent, the Court treats this right as more akin to that of states whose sovereign immunity is protected from the forced imposition of the federal court's Article III powers but who can waive that immunity and invoke those powers if they so choose. In short, it appears clear that consent does suffice to satisfy a litigant's right to demand trial before an Article III adjudicator.

That is not quite the end of the discussion because, as *Commodity Futures Trading Commission v. Schor*[42] notes, the requirement for Article III adjudications is also a matter of separation of powers, and to the extent it is implicated, it is not a matter that may be waived by an individual litigant. As regards that issue, *Schor* further explained that "the Court has declined to adopt formalistic and unbending rules" preferring to allow Congress "to take needed and innovative action pursuant to its Article I powers."[43] The Court did spend time in *Schor* distinguishing the agency's powers from those of the bankruptcy court under the pre-1984 amendments, particularly in light of the nature of the deciding body in *Schor*—the legislative branch agency Commodities Future Trading Corporation (the CFTC). While in some respects, the CFTC has a more limited adjudicatory function than bankruptcy courts even under the post-*Marathon* jurisdictional scheme, the separation of powers issue is perhaps more salient in that the CFTC is a legislative branch agency.

That concern is perhaps greatly lessened or nonexistent when considering alternative adjudicators operating within the overall confines of the federal judiciary so that there is not a conflict between different branches of government. The Supreme Court has not explicitly ruled on this issue with respect to the Federal Magistrates Act but has issued a sufficient number of decisions ruling on various aspects of the application of that law that it would be odd indeed if it were for the first time, decades later, suddenly to announce that the whole system was constitutionally infirm. In *Olde Prairie*, the bankruptcy court noted that eight circuits had upheld the constitutionality of the Federal Magistrate system against challenges as to both the rights of the litigants and the Article III system generally.[44] Those cases largely held that if the parties consented to the magistrate's power to decide the issues, separation of powers issues would not preclude the magistrate from doing so.

Similarly here, although the Supreme Court has stoutly refused to actually decide if the core aspects of the bankruptcy system actually create public rights, its silence, when coupled with almost 35 years of operating under that law, suggest that it is unlikely that it will suddenly decide to invalidate the entire system in the future. To the contrary, the repeated emphasis in the majority's opinion in *Stern* on the limited nature of its ruling strongly indicates that the Court intends only to affect the allocation of power to issue binding decisions, not the right of bankruptcy judges to adjudicate at all.

IV. Thoughts About the Future

All of that said, one must still consider what "consent" entails in the unique construct of a bankruptcy case. It is certainly clear that in the case of magistrate judges and in the *Schor* case, a party's decision to litigate before a non-Article III adjudicator must be a wholly unconstrained choice. Section 636(c)(2) of the Federal Magistrates Act makes clear that parties must be informed that "they are free to withhold consent without adverse substantive consequences" and that the rules "shall include provisions to protect the voluntariness of the parties' consent."[45] Similarly, in *Schor*, the parties had a choice between appearing before an administrative agency or filing suit in federal court.

Bankruptcy, on the other hand, does not offer the same range of free choice. Although there are a substantial number of provisions for abstention and remand with respect to certain types of claims, the working assumption is that bankruptcy is meant to create a centralized, mandatory forum for the assertion of claims against the estate and the distribution of assets. Even while a party "chooses" to file a claim, the party in most cases has no other option. If a party does not file its claim, it will be lost, unless it falls in the small category of claims that are excepted from discharge. Moreover, even in that category, discharge complaints for claims such as Pierce's (for willful and malicious injury arising from the defamatory remarks), must be filed in the bankruptcy court or they are lost as well.[46] In *Stern*, Pierce could have simply filed his discharge complaint (but not a proof of claim), and that might have shielded him from Vickie's argument that her counterclaims were core proceedings, but if he did so, he would have lost any ability to collect anything from her estate should his claim be upheld.

So, it may not be possible to infer "truly voluntary" consent from actions such as filing a proof of claim, if such consent is necessary to allow the bankruptcy court to enter a binding order in what would otherwise

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be a non-final proceeding. However, that does not suggest that there is any constitutional problem with taking several steps to rationalize and simplify the process to determine if constitutionally adequate consent exists. I suggest these:

1. Amend § 157(b)(2)(C) to limit counterclaims to those described by the Court in *Stern*; i.e., something like "compulsory counterclaims to the extent that they create a defense to the allowance of the creditor's claim against the estate." Doing this would essentially adopt the approach used by the district court—where a counterclaim is merely permissive or its connection (even as a compulsory counterclaim) is too attenuated to the creditor's claim, then it is noncore and should be handled in accordance with those rules.[47]
2. Rule 7008(a) already requires that in adversary proceedings, such as discharge complaints, parties must state whether they believe the pleadings they file assets core or noncore matters and, if noncore, whether they consent to entry of final orders by the bankruptcy judge.
3. A similar rule should be added in the context of claims objections to the extent that the issues raised go beyond merely defeating the claim asserted by the creditor. In the example cited by Judge Breyer,[48] a tenant-debtor might contest a landlord's claim for rent by arguing that the funds were, in fact, paid. Clearly such a defense would fall within the parameters set by the Court. However, to the extent that the debtor conceded that the rent was not paid but sought to use the claim filing as a basis to file a class action suit for all tenants in his building, alleging that the landlord had left the place uninhabitable and that treble damages were owed under a state housing law, that might well fall within the same concerns articulated by the majority in *Stern*. At the least, in order to short-circuit some problems, the Rules could require that parties identify how they characterize the claims and whether they consent to adjudication of the full scope of issues that arise from the claims objection process.
4. Once the court has the parties' positions, it can rule on whether the matters are core or noncore and whether there has been consent.
5. Section 157(c)(1) should be revised to provide that the bankruptcy court should prepare its decision as to both core and noncore matters, delineating therein which matters it believes to fall within which categories. It should then state that the decision will be served on the parties by the bankruptcy court (as now happens) and that parties shall appeal the decision under § 158 and Rules 8001 to 8005 (as now happens). The section should then provide that,if parties do not appeal some or all parts of the decision, the parts not appealed shall be treated as having been consented to and will have a final and binding effect, whether core or noncore. The appeal may also contest the bankruptcy court's core/noncore distinction and argue the standard of appeal for those areas accordingly.
6. Either amend § 157(d) to impose some more restrictive standard for mandatory withdrawal (but one that is defined and not left to the differing conclusions of every judge hearing the issues) or resolve that courts will actually apply the statute as written.

With those relatively straightforward amendments, it should be possible to accommodate the Supreme Court's concerns about the rights of parties to demand the protections of Article III judges while largely preserving the current system and allowing it to work as intended with the consent of the parties. The reality is that, with 1.5 million bankruptcy cases a year, there are only a few hundred published decisions a month, a few thousand in the course of a year. Quite clearly, in most situations, the decisions of the bankruptcy court are the final word. Nothing in *Stern* requires that that reality change in any marked degree.

Without trying to address all of the possibilities, it appears that most core proceedings will remain core since they deal with the administration of the estate and or relate to actions dealing with the debtor's asserted property interests as opposed to merely claims by or against it with respect to unsecured claims. As noted in *Teleservices*, there is generally a distinction between interests and claims that generally corresponds to the difference between in rem and in personam actions, with the latter falling at the heart (or the core) of what the Bankruptcy Clause deals with, if it deals with anything. As *Teleservices* further notes, much of what the bankruptcy court is called on to do is to review and control the actions of the debtor in ways that would not even exist absent the bankruptcy filing (i.e., requiring approval to obtain credit or to sell property outside of the ordinary course of business). The debtor certainly

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must have consented to such controls by filing its petition and can hardly demand some other forum or process than what it invoked, and other parties likely would have no greater standard. To the extent that other rights, such as the automatic stay or the discharge, are specifically created by and operate only under the auspices of the Code, they will also likely pass muster under the "public rights" analysis used by the majority.

The one area that is likely to generate ongoing controversy (beyond deciding the specifics relating to whether a particular counterclaim is sufficiently related) is the realm of avoidance actions. Some of the rights are clearly Code-created and largely unique to bankruptcy (i.e., § 547 preference actions), while others exist both in and out of bankruptcy (§ 548 fraudulent transfer actions are akin to state law fraudulent transfer actions), and some rely solely on substantive state law (§ 544(b)(1) avoidance actions) with the only federal gloss being the grant of standing to the trustee to stand in the shoes of an actual state law creditor with an actual state law claim. The effects of *Stern* on those issues (and the corollary question of how § 106(a)(1) immunity abrogation will play into the analysis of § 544(b)(1) actions) is a topic that the courts will likely be grappling with for some time.

1. Stern v. Marshall, __ U.S. __, 131 S. Ct. 2594, 180 L. Ed. 2d 475 (2011).
2. The facts recited here are taken from the district court's opinion, which sets out the background of the case and the parties' respective positions in far more detail than the Ninth Circuit or Supreme Court opinion.
3. Marshall v. Marshall (In re Marshall), 275 B.R. 5, 19-20 (C.D. Cal. 2002), vacated and remanded, 392 F.3d 1118 (9th Cir. 2004), rev'd and remanded, 547 U.S. 293, 126 S. Ct. 1735, 164 L. Ed. 2d 480 (2006), and rev'd, 600 F.3d 1037 (9th Cir. 2010).
4. If the district court's fact finding is accurate, the actions of Pierce and his lawyer were egregious, verging on, if not actually becoming, criminal. Marshall, 275 B.R. 26-50.
5. Northern Pipeline Constr. Co. v. Marathon Pipe Line Co., 458 U.S. 50, 102 S. Ct. 2858, 73 L. Ed. 2d 598 (1982).
6. Marshall v. Marshall (In re Marshall), 264 B.R. 609 (C.D. Cal. 2001).
7. Marshall v. Marshall (In re Marshall), 271 B.R. 858 (C.D. Cal. 2001).
8. Marshall v. Marshall, 547 U.S. 293, 126 S. Ct. 1735, 164 L. Ed. 2d 480 (2006).
9. Marshall v. Marshall (In Marshall), 600 F.3d 1037 (9th Cir. 2010).
10. Brown v. Allen, 344 U.S. 443, 533, 73 S. Ct. 397, 97 L. Ed. 469 (1952) ("We are not final because we are infallible, but we are infallible only because we are final") (Jackson, J., dissenting).
11. The Court's unequivocal statement that all core proceedings arise in the case or arise under the Code is an unalloyed benefit to those writing manuals for bankruptcy novices. It seemed likely that there was a one-to-one equivalence between those two concepts (and between noncore proceedings and "related to" jurisdiction), but Congress did use two different sets of terms to describe exactly the same legal concept. At least now, one may, with the Supreme Court's blessing, say with complete assurance that the two terms can be used interchangeably.
12. Seminole Tribe of Florida v. Florida, 517 U.S. 44, 116 S. Ct. 1114, 134 L. Ed. 2d 252 (1996). "Having concluded that Congress clearly intended to abrogate the States' sovereign immunity through [25 U.S.C.A.] § 2710(d)(7), we turn now to consider whether the Act was passed 'pursuant to a valid exercise of power.'… The Eleventh Amendment restricts the judicial power under Article III, and Article I cannot be used to circumvent the constitutional limitations placed upon federal jurisdiction." Seminole, 517 U.S. at 57-8, 72-3. This similarity in tone is not a coincidence. As will be discussed below, this decision may have much to say about sovereign immunity issues as well as bankruptcy court jurisdiction.
13. Stern v. Marshall, 131 S. Ct. at 2608.
14. See, e.g., Orion Pictures Corp. v. Showtime Networks, Inc. (In re Orion Pictures Corp.), 4 F.3d 1095, 1102 (2d Cir. 1993) (section 157(b)(2)(A) cannot be read literally because to do so "creates an exception to Marathon that would swallow the rule"); Southeastern Sprinkler Co. v. Meyertech Corp. (In re Meyertech Corp.), 831 F.2d 410, 416 (3d Cir. 1987) ("It is difficult to perceive of a proceeding which would not fall under the all-encompassing language of either § 157(b)(2)(A) or § 157(b)(2)(O), but we are cautioned that an expansive interpretation of these provisions may lead to some seemingly incorrect and overbroad results regarding core proceedings.") (citation omitted); Piombo Corp. v. Castlerock Props. (In re Castlerock Props.), 781 F.2d 159, 161 (9th Cir. 1986) (same as *Orion*).
15. Charles Dickens, Bleak House (1853).
16. To return to the sovereign immunity area, this was a point that the states attempted to point out (usually with little success) in cases where the filing of a claim for a student loan, for instance, was taken as conferring compulsory counterclaim status on issues regarding alleged stay or discharge violations, even though those issues involved different facts and different legal theories are were rarely, if ever, tried at the same time as questions about the validity and amount of the student loan at issue.

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17. The Court did not actually discuss in any detail what would be the effect of a finding of consent (and that is perhaps what has engendered the more expansive concerns about the effects of the decision). Consent does in fact turn out to be vital.

18. I leave it to others to judge whether, based on the extraordinarily tangled history of the case, that result should have followed, even assuming that the bankruptcy court decision was not final. However, resolution of that issue is immaterial for purposes of the issues being discussed now.

19. Note that none of these situations preclude involvement of Article III judges in a normal appellate review context, but they do represent scenarios where such review is not conducted de novo.

20. Crowell v. Benson, 285 U.S. 22, 52 S. Ct. 285, 76 L. Ed. 598 (1932).

21. Congress has wide leeway in devising the mechanisms for enforcing the rights that it creates. For instance, the National Labor Relations Act enforces employees' rights to be free from discrimination for their union activities and uses the mechanisms of hearings before an administrative law judge, appeal to a Presidentially appointed National Labor Relations Board (serving for terms of five years), and further appeal to the court of appeals, which must accept findings of fact of the Board that are supported by "substantial evidence on the record considered as a whole." See 29 U.S.C.A. § 160(e). On the other hand, civil rights discrimination cases are litigated before the district courts through complaints initiated by either the claimant or by the Equal Employment Opportunity Commission. Either approach meets constitutional muster.

22. In a post-*Stern* opinion, Meoli v. Huntington National Bank (In re Teleservices Group, Inc.), No. 07-80037, 2011 WL 3610050 (Bankr. W.D. Mich. Aug. 17, 2011), Judge Jeffrey Hughes engaged in a very detailed analysis of one of the Supreme Court's prior opinions, Murray's Lessee v. Hoboken Land & Improvement Co., 59 U.S. (18 How.) 272, 15 L. Ed. 372 (1855). In his view, *Murray's Lessee* establishes that the real question is one of due process. That is, can a party be deprived of its property without the right to present his defenses to an Article III judge. While the Court did not discuss that approach, the results are consistent with the case law, which has been primarily concerned with efforts by debtors to obtain affirmative relief against nondebtor parties, not with the court's power to administer the debtor's own estate.

23. Katchen v. Landy, 382 U.S. 323, 86 S. Ct. 467, 15 L. Ed. 2d 391 (1966).

24. Langenkamp v. Culp, 498 U.S. 42, 111 S. Ct. 330, 112 L. Ed. 2d 343 (1990).

25. Returning to sovereign immunity, that is the same analysis used in Gardner v. New Jersey, 329 U.S. 565, 573-74, 67 S. Ct. 467, 91 L. Ed. 504 (1947), where the Court held that when the state filed a claim in the case litigation of objections to the claim did not infringe the state's sovereign immunity. While the state argued that the objections had already been litigated prior to the bankruptcy filing, that argument merely went to the merits of the objections; it did not mean that the objections created a new, affirmative claim against the state. While *Gardner* is often cited as dealing with counterclaims, there were, in fact, none asserted, only objections to the states' claims and liens.

26. See Sitka Enters., Inc. v. Segarra-Miranda, Civ. 10-1847CCC, 2011 U.S. Dist. LEXIS 90243 (D.P.R. Aug. 12, 2011) (holding that the bankruptcy court could not exercise any adjudicative role with respect to a fraudulent transfer).

27. In re Olde Prairie Block Owner, LLC, No. 10 B 22668, 2011 WL 3792406 (Bankr. N.D. Ill. Aug. 25, 2011).

28. See, e.g., United States v. Johns-Manville Corp. (In re Johns-Manville Corp.), 63 B.R. 600, 602 (S.D.N.Y. 1986).

29. Johns-Manville, 63 B.R. at 602 (citations omitted) (emphasis added).

30. See, e.g., In re Vicars Ins. Agency, Inc., 96 F.3d 949 (7th Cir. 1996) ("The most restrictive interpretations have identified particular contexts as the only situations appropriate for mandatory withdrawal. These have included proceedings where non-title 11 issues 'dominated' bankruptcy issues, see [United States v. Lenard (In re Lenard)], 124 B.R. 101, 102 (D. Colo. 1991), or where the proceeding presented a conflict between statutes, a question of first impression, or a constitutional challenge. See [O'Connell v. Terranova (In re Adelphi Institute)], 112 B.R. 534, 537 (S.D.N.Y. 1990).")); City of New York v. Exxon Corp., 932 F.2d 1020, 1026 (2d Cir. 1991) (adopting the "significant interpretation, as opposed to simple application" test); Green v. FDIC (In re Tamalpais Bancorp), 451 B.R. 6 (N.D. Cal. 2011) (there must be "interpretation, as opposed to mere application" or "'analysis of significant open and unresolved issues regarding the non-title 11 law.'" Mere existence of federal law defenses does not show that they present "novel" issues. Agency's claim that seven separate federal laws apply does not show that consideration of any of those laws will necessarily be "substantial." The more well-settled the law is and the more meritorious the agency's position, the less likely that it will be able to assert mandatory withdrawal, since the settled law will merely be "applied" not "interpreted.").

31. Most courts apparently are overlooking that minor problem and assuming that they should use the procedure for noncore proceedings for these non-final core proceedings.

32. That bifurcated process might well convince district courts that they should take withdrawal requests more seriously so that only one decision issues.

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Moreover, they might also see the value of retaining withdrawn cases from the start rather than leaving them in the bankruptcy court until trial.

33. Hagan v. Okony, No. 1:08-cv-732, 2008 WL 4722747 (W.D. Mich. Oct. 22, 2008) (unpublished).

34. Thomas v. Arn, 474 U.S. 140, 141-42, 149-50, 106 S. Ct. 466, 88 L. Ed. 2d 435 (1985).

35. Peretz v. United States, 501 U.S. 923, 939, 111 S. Ct. 2661, 115 L. Ed. 2d 808 (1991).

36. Peretz v. United States, 501 U.S. at 939 (citations omitted) (emphasis added).

37. *Olde Prairie* and In re Safety Harbor Resort & Spa, No. 8:10-bk-25886, 2011 WL 3849639 (Bankr. M.D. Fla. Aug. 30, 2011) both rely on analogy to the Federal Magistrates Act to uphold the powers of the bankruptcy court.

38. 28 U.S.C.A. § 636(c)(1).

39. Gonzalez v. United States, 553 U.S. 242, 128 S. Ct. 1765, 170 L. Ed. 2d 616 (2008) (the third of a series of criminal cases considering this provision of the Federal Magistrates Act).

40. Roell v. Withrow, 538 U.S. 580, 588-89, 123 S. Ct. 1696, 155 L. Ed. 2d 775 (2003).

41. Roell v. Withrow, 538 U.S. at 588-89 (internal citations and footnote omitted).

42. Commodity Futures Trading Comm'n v. Schor, 478 U.S. 833, 848, 106 S. Ct. 3245, 92 L. Ed. 2d 675 (1986).

43. Commodity Futures Trading Comm'n v. Schor, 478 U.S. at 851.

44. In re Olde Prairie Block Owner, LLC, 2011 WL 3792406, at *8 ("it is well established 'that litigants may waive their personal right to have an Article III judge preside over a civil trial'"); Peretz v. United States, 501 U.S. 923, 936, 111 S. Ct. 2661, 115 L. Ed.2d 808 (1991) (citing Schor, 478 U.S. at 848). This concept is not peculiar to the bankruptcy system: magistrate judges, who like bankruptcy judges are also Article I judges, can try civil matters and enter final judgments if the parties consent. 28 U.S.C.A. § 636(c). The constitutionality of that system has been consistently upheld. Goldstein v. Kelleher, 728 F.2d 32, 34–35 (1st Cir.1984); Collins v. Forman, 729 F.2d 108, 109 (2d Cir.1984); Wharton–Thomas v. United States, 721 F.2d 922, 924–930 (3d Cir.1983); Gairola v. Va. Dep't of Gen. Servs., 753 F.2d 1281, 1284–85 (4th Cir.1985); Puryear v. Ede's, Ltd., 731 F.2d 1153, 1154 (5th Cir.1984); K.M.C. Co. v. Irving Trust Co., 757 F.2d 752, 755 (6th Cir.1985); Geras v. Lafayette Display Fixtures, Inc., 742 F.2d 1037, 1038 (7th Cir.1984); Lehman Bros. Kuhn Loeb, Inc. v. Clark Oil & Ref. Corp., 739 F.2d 1313, 1314 (8th Cir.1984) (en banc); Pacemaker Diagnostic Clinic of Am., Inc. v. Instromedix, Inc., 725 F.2d 537, 540 (9th Cir.1984) (en banc); Fields v. Wash. Metro. Area Transit Auth., 743 F.2d 890, 893 (D.C. Cir.1984).").

45. 28 U.S.C.A. § 636(c)(2).

46. Justice Breyer suggested, Stern v. Marshall, 131 S.Ct. at 2627-28 (Breyer, J., dissenting), that Pierce could have stayed outside the case and brought his nondischargeable claim later, but he failed to note the effect of § 523(c), which requires assertion of a § 523(a)(6) allegation only during the bankruptcy case. Thus Pierce did not have any alternative way to pursue his claim absent proceeding in the bankruptcy case.

47. This standard is similar to the standard that the Supreme Court has articulated (at least outside of bankruptcy) with respect to the scope of counterclaims that may be raised in response to a state (or other sovereign) that voluntarily invokes federal jurisdiction by filing suit. In general, such counterclaims are limited to defenses that do not seek relief "different in kind or in amount" from the affirmative relief sought by the sovereign's claim. That is, the filing of the claim does not affect a "waiver" of immunity; rather, it only allows the party responding to the sovereign's claim to use its claims to defend itself up to, but not exceeding, the amount necessary to defeat the state's claim. See Oklahoma Tax Comm'n v. Citizen Band Potawatomi Indian Tribe of Okla., 498 U.S. 505, 509-10, 111 S. Ct. 905, 112 L. Ed. 2d 1112 (1991) (where a tribe sued a state for injunctive relief against collection of taxes, and the state's counterclaim for injunctive relief allowing collection could be allowed but not its request for an order that the taxes that were lawfully owed must be paid: "a tribe does not waive its sovereign immunity from actions that could not otherwise be brought against it merely because those actions were pleaded in a counterclaim to an action filed by the tribe…. We uphold the Court of Appeals' determination that the Tribe did not waive its sovereign immunity merely by filing an action for injunctive relief."). See also United States v. Murdock Machine & Eng'g Co. of Utah, 81 F.3d 922, 931, 933 (10th Cir. 1996) (holding that under the Bankruptcy Act (which has no equivalent of § 106) the filing of a claim was not a waiver as to the other party's counterclaims).

A defensive claim for recoupment can be asserted "because recoupment is in the nature of a defense arising out of some feature of the transaction upon which the plaintiff's action is grounded." Bull v. United States, 295 U.S. 247, 262, 55 S. Ct. 695, 79 L. Ed. 1421 (1935). For the same reason, recoupment is not treated as a claim in bankruptcy so that it does not trigger the automatic stay and is not subject to discharge. See, e.g., Megafoods Stores, Inc. v. Flagstaff Realty Assocs. (In re Flagstaff Realty Assocs.), 60 F.3d 1031 (3d Cir. 1995) (recoupment not subject to automatic stay); Brown v. General Motors Corp., 152 B.R. 935 (W.D. Wis. 1993) (recoupment of overpayments not subject to discharge). Similarly, it is often stated that a party may only bring defensive claims that arise out of some feature of the government's transaction—i.e., mandatory counterclaims—and only insofar as they serve to defeat the

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government's recovery. No affirmative recovery may be had, and counterclaims that do not form part of the same transaction as the government's claim may not be brought at all, absent an independent jurisdictional basis. See Miller v. Tony & Susan Alamo Found., 134 F.3d 910, 916 (8th Cir. 1998); United States v. Forma, 42 F.3d 759 (2d Cir. 1994); Anadarko Prod. Co. v. New Mexico (In re Department of Energy Stripper Well Exemption Litigation), 956 F.2d 282 (Temp. Emer. Ct. App. 1992); Jones v. Yorke (In re Friendship Med. Ctr., Ltd.), 710 F.2d 1297, 1300-1301 (7th Cir. 1983); Ohio v. Madeline Marie Nursing Homes No.1 & No.2, 694 F.2d 449 (6th Cir. 1982) (taking the same approach under the Bankruptcy Act).

That analysis is very much akin to that expressed by the Court when it noted that "it is hard to see why Pierce's decision to file a claim should make any difference with respect to the characterization of Vickie's counterclaim." Stern v. Marshall, 131 S. Ct. at 2618. Put another way, filing a claim does not serve as a broad waiver of any and all constitutional rights otherwise enjoyed by the filing party; rather, it merely invokes the claim adjudication process for that claim and the defenses thereto. As the Court noted, even in *Katchen*, it expressly reserved any analysis of the question whether the trustee could have obtained affirmative relief or relief that did not follow directly from ruling on objections to the creditor's claim. Stern v. Marshall, 131 S. Ct. at 2616-17. Under this analysis, once one has defeated the claim, one has exhausted the limits of the federal jurisdiction invoked by the filing party.

In light of this close correlation between these forms of analysis, there may well be room to bring a sovereign immunity challenge back to a Supreme Court that is receptive to the arguments being made herein about the limits of bankruptcy court jurisdiction. See Sossamon v. Texas, __ U.S. __, 131 S.Ct. 1651, 1658, 179 L. Ed. 2d 700 (2011) (The Court used the bankruptcy cases of United States v. Nordic Village, Inc., 503 U.S. 30, 112 S. Ct. 1011, 117 L. Ed. 2d 181 (1992), and Hoffman v. Connecticut Department of Income Maintenance, 492 U.S. 96, 109 S. Ct. 2818, 106 L. Ed. 2d 76 (1989), to illustrate the limits of construing statutes allowing relief against the sovereign with no suggestion that they might be affected by the holding in Central Virginia Community College v. Katz, 546 U.S. 356, 126 S. Ct. 990, 163 L. Ed. 2d 945 (2006). The states believe that the analysis in *Katz* is seriously flawed; given a chance to revisit the issues, they think a different result might well occur. At the very least, the sort of constitutional analysis that is used in sovereign immunity cases could be informative about the scope of counterclaims that could still be deemed core.

48. Justice Breyer cites Taubman Western Associates, No. 2 v. Beugen (In re Beugen), 81 B.R. 994 (Bankr. N.D. Cal. 1988). Stern v. Marshall, 131 S. Ct. at 2629-30 (Breyer, J., dissenting).

Must Credit Bidding Be Permitted in Plan Sales to Satisfy the Bankruptcy Code's Fair and Equitable Standard?: How the Third and Seventh Circuits Reached Different Answers to the Same Question

Lawrence V. Gelber and James T. Bentley*

Several recent court decisions regarding asset sales under "cramdown" reorganization plans have considered whether secured creditors have a statutory right to credit bid (i.e., to bid their secured claim as currency for the purchase of their collateral). In *In re Philadelphia Newspapers, LLC*,[1] the Third Circuit held that a plan sale could provide for the public auction of a secured creditor's collateral free of its prepetition liens without affording the creditor an opportunity to credit bid and still satisfy the Bankruptcy Code's "fair and equitable" standard. More recently, however, in *River Road Hotel Partners, LLC v. Amalgamated Bank*,[2] the Seventh Circuit held, on substantially similar facts, that a plan sale must afford a secured creditor an opportunity to credit bid in order for the proposed plan to be "fair and equitable."[3]

These cases are complex and address two fundamental questions about secured creditors' rights to credit bid at plan sales. First, must a plan proponent provide the secured creditors the right to credit bid at a plan sale in order to satisfy the fair and equitable standard for plan confirmation in § 1129? Second, even if § 1129 does not mandate credit bidding, are secured creditors nevertheless entitled to credit bid under a broader reading of the Bankruptcy Code as a whole?

This article begins with a discussion of the "fair and equitable" standard, followed by an analysis of the two circuit court answers to these questions.

Treatment of a Secured Creditor Must Be Fair and Equitable

The Bankruptcy Code generally requires that, to be confirmed, a plan must either (i) not impair a creditor's claim, or (ii) be acceptable to the creditor if its

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claim is impaired.[4] Even if it fails to meet either of these requirements, however, a bankruptcy court can still confirm a plan over the objection of a class of impaired creditors if the plan is found to be "fair and equitable."[5] Plans confirmed over the objection of a class of creditors are colloquially referred to as "cram-down" plans because they are "crammed down the throats of objecting creditors."[6]

Section 1129(b)(2)(A) of the Bankruptcy Code provides three scenarios under which a plan will be found "fair and equitable" to secured creditors.

The Lien Transfer Prong: Scenario (A)(i) provides for (a) the retention by the debtor or transfer to a third party of the assets subject to the secured creditor's existing lien and (b) deferred cash payments to the secured creditor in an amount equal to the present value of the allowed amount of its claim.[7]

The Sale Prong: Scenario(A)(ii) provides for the sale of the secured creditor's collateral free and clear of its liens, provided the creditor has the opportunity to credit bid at the sale, with its liens to attach to the sale proceeds.[8] The credit bid component of the Sale Prong incorporates § 363(k) of the Bankruptcy Code, which mandates that, unless the court for cause holds otherwise, a secured creditor may credit bid at a sale of its collateral.

The Indubitable Equivalent Prong: Scenario (A)(iii) provides for the realization by the secured creditor of the "indubitable equivalent" of its claim.[9]

Importantly, the three alternatives contained in § 1129(b)(2)(A) are crafted in the disjunctive.

Debtors seeking confirmation of a cramdown plan historically have relied most often on the Sale Prong.[10] A plan that proposes to sell encumbered assets under the Sale Prong can be confirmed over a secured creditor's objection if the sale complies with § 363(k), i.e., if it permits secured creditors to credit bid "unless the court for cause orders otherwise."[11]

As evidenced by *Philadelphia Newspapers* and *River Road*, however, some plan proponents more recently have sought confirmation of sale plans under the Indubitable Equivalent Prong rather than the Sale Prong as a means of depriving undersecured creditors of the right to credit bid for their collateral at auction. Plan proponents assert that prohibiting credit bidding by undersecured creditors with large deficiency claims actually will encourage bidding because third-party bidders will no longer fear competing with secured creditors that have plenty of credit bid currency and little downside. The Indubitable Equivalent Prong also is attractive to proponents looking to craft novel plans because the language used is "both sparse and general."[12] The Bankruptcy Code does not specify what types of plans fall within the scope of the Indubitable Equivalent Prong, or even what constitutes the "indubitable equivalent" of a secured creditor's claim.

Is the Right to Credit Bid Required to Satisfy the Bankruptcy Code's Fair and Equitable Standard for Plan Confirmation?

The parties in both *Philadelphia Newspapers* and *River Road* agreed that § 1129 was the starting point to determine whether a secured creditor has a right to credit bid; however, they disagreed about whether that section is ambiguous. The debtors in both cases asserted that the statute was unambiguous. According to the debtors, the use of the word "or" to separate the three prongs means a plan proponent has the right to choose between the Sale Prong and the Indubitable Equivalent Prong when determining how to sell encumbered assets free of liens under a plan.[13] The debtors noted that the Bankruptcy Code's rules of construction state that "or" is not exclusive.[14] Thus the debtors claimed that each prong was intended to be an alternative path to meeting the "fair and equitable" test.[15]

The lenders charged that the debtors were misconstruing the statute, which was ambiguous.[16] A traditional canon of statutory interpretation requires that "the specific term prevails over the general term."[17] Thus, the lenders argued, because the Sale Prong contains more specific elements that must be satisfied to sell collateral free of its prepetition lien, it acts as a limitation on the Indubitable Equivalent Prong. The prongs thus are exclusive of one another, and it is the proposed treatment of the collateral that determines which prong will apply.[18] Plans proposing the sale of assets encumbered by their original liens must proceed under the Lien Transfer Prong. Sales free and clear of a lender's liens must proceed under the Sale Prong. Only those plans proposing a disposition not covered by the Lien Transfer Prong or the Sale Prong, most notably the substitution of collateral, may proceed under the Indubitable Equivalent Prong.[19] Permitting debtors to sell assets free of liens under the Indubitable Equivalent Prong would render the Sale Prong superfluous.[20]

The Third Circuit's Holding Regarding Ambiguity

The Third Circuit held that § 1129(b) was unambiguous and that the specificity of the Sale Prong did not act as a limitation on the more general Indubitable Equivalent Prong.[21] The court stated that while the Sale Prong specifically refers to a "sale" and incorporates

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a credit bid right under § 363(k), there is "no statutory basis to conclude that it is the only provision under which a debtor may propose to sell its assets free and clear of liens."[22] The court held that it was "apparent" that Congress's inclusion of the Indubitable Equivalent Prong and the use of the disjunctive "or" intentionally left the door open for other methods of conducting asset sales, as long as those methods sufficiently protected the secured creditor's interest.[23]

In so holding, the court found that the lenders' argument that the Sale Prong was the exclusive means to sell encumbered assets free of liens under a cramdown plan proved too much. If the lenders' interpretation of § 1129 were correct, no sale free of a creditor's liens could ever be permitted under the Indubitable Equivalent Prong—even one that would pay the secured creditor in full.[24] Reading the statute so narrowly would significantly curtail the ways in which a debtor could fund its reorganization—an outcome at odds with the fundamental function of the asset sale, which is to permit the debtor to "provide adequate means for the plan's implementation."[25] The Third Circuit thus held that a more flexible approach "consistent with the disjunctive nature of the statute" was warranted.[26]

The Seventh Circuit's Holding Regarding Ambiguity

Adopting much of Judge Thomas Ambro's well-reasoned dissent in *Philadelphia Newspapers*, the Seventh Circuit held that nothing in the text of § 1129(b)(2)(A) specifies whether the Indubitable Equivalent Prong can be used to confirm any type of plan at all or whether it can be used only to confirm plans that treat or dispose of assets in ways other than those covered by the Lien Transfer and Sale Prongs.[27] Thus the court held that there are two plausible interpretations of the statute: One that reads the Indubitable Equivalent Prong as having global applicability and one that reads it as having a much more limited scope.[28] The existence of multiple interpretations means the statutory language is ambiguous.[29] The Seventh Circuit looked beyond the statute's plain meaning to determine which interpretation is correct.

The court first noted that statutory interpretations rendering other provisions of the statute superfluous are highly disfavored.[30] Permitting a debtor to use the Indubitable Equivalent Prong to sell assets unencumbered by prepetition liens under a cramdown plan would effectively swallow the Sale Prong entirely, which clearly was not Congress's intent when enacting the Bankruptcy Code.[31] The "infinitely more plausible interpretation" of the statute, according to the court, is that each prong sets forth the requirements for a particular type of sale; each of the subparagraphs must be construed as conclusively governing the category of proceedings that it addresses.[32]

The court noted that other Bankruptcy Code provisions related to sales of encumbered property free of liens afford creditors protections to ensure that they are properly compensated.[33] In contrast, the Bankruptcy Code does not contain any provision that permits auction sales free of a creditor's liens without allowing credit bidding.[34] The court held that the debtor's suggested reading of the Indubitable Equivalent Prong would "nullify its neighboring subsections and ignore the protections for secured creditors recognized in other Code provisions."[35] Thus the court held that the Bankruptcy Code requires that cramdown plans that contemplate auction sales of encumbered property free of liens must satisfy the requirements of the Sale Prong to be deemed "fair and equitable."[36]

Does the Bankruptcy Code Afford Secured Creditors Special Rights That Guarantee Their Ability to Credit Bid?

According to the debtors in *River Road* and *Philadelphia Newspapers*, plan sales of assets free of prepetition liens can be "fair and equitable" provided that the secured creditor receives the indubitable equivalent of the value of its interest in its collateral (i.e., its secured claim), which the debtors asserted the lenders received via public auctions. The lenders disagreed.

In particular, the lenders countered that they could not receive the indubitable equivalent of their secured claims unless they were permitted to credit bid at those auctions.[37] In *Philadelphia Newspapers*, the lenders pointed to *Cohen v. KB Mezzanine Fund II, LP (In re SubMicron Systems, Corp.)*[38] as a case demonstrating the incongruity between the debtor's position and prior Third Circuit precedent. In *SubMicron Systems*, a decision authored by Judge Ambro, the Third Circuit held that credit bidders in a 11 U.S.C.A. § 363 asset sale were entitled to bid up to the face amount of their loan and that the amount of the credit bid became the "value" of the lender's secured interest in its collateral. The lenders asserted that an auction under a plan sale should be no different than a § 363 sale, either in terms of a secured creditor's ability to credit bid or in how the value of that creditor's collateral was determined.

The lenders in *Philadelphia Newspapers* also contended that reading the Bankruptcy Code as a whole demonstrated Congress's intent to provide secured creditors with the right to credit bid at plan sales. According to the lenders, the Bankruptcy Code provides secured creditors with two immutable rights: The right to elect to treat their deficiency claim as secured under 11 U.S.C.A. § 1111(b) and the right to credit bid under

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the Sale Prong and § 363(k).[39] When a secured creditor has recourse against the debtor for its deficiency claim, however, the § 1111(b) election is not available.[40] The lenders posited that the exemption of secured recourse creditors from the § 1111(b) election is limited to situations in which they have the opportunity to credit bid—specifically, a § 363 sale in which their right to credit bid is preserved by § 363(k) and a cramdown reorganization plan under which their right to credit bid is incorporated into the Sale Prong. The Sale Prong and § 1111(b) thus are best understood as alternative protections for the secured creditor, one to apply when its collateral is sold free and clear of liens and the other to apply when its collateral is treated other than in a sale.[41] According to the lenders, Congress clearly intended that any sale of collateral—whether under § 363 or a plan—must permit credit bidding by secured lenders.[42]

The Third Circuit's Holding Regarding Secured Creditor's Special Rights Under the Bankruptcy Code

The Third Circuit held that secured creditors were not entitled to any special rights that were not already delineated under the Bankruptcy Code. The court found *SubMicron Systems* to be consistent with its holding that a secured creditor is not absolutely entitled to credit bid at an auction under a plan sale.[43] A vastly undersecured creditor is not entitled to win at auction by bidding the face amount of its claim for assets worth substantially less. Rather, a bankruptcy court is called upon at plan confirmation to determine only whether a lender has received the indubitable equivalent of its secured claim. According to the Third Circuit majority, it is the reorganization plan and not the auction that must generate the indubitable equivalent of a secured creditor's claim.[44]

The Third Circuit also dismissed the lenders' contention that reading the Bankruptcy Code as a whole demonstrates Congress's intent to provide secured creditors with the right to credit bid at plan sales. The court found that asserting an absolute right to such preferential treatment is plainly contrary to other provisions of the Bankruptcy Code that limit a secured creditor's recovery to the value of its secured interest even when it is not permitted to make a § 1111(b) election.[45] The court further found that secured creditors are not entitled to any special rights not specifically delineated in the Bankruptcy Code, using as an example sales under the Lien Transfer Prong. If a debtor proceeds with a sale of encumbered assets under the Lien Transfer Prong, there is no § 1111(b) election because the assets are "sold under a plan."[46] Nevertheless, the Lien Transfer Prong still caps the value of the creditor's allowed secured claim, as established by judicial valuation and limited to the present value of the deferred cash payments.[47] Thus when a debtor proceeds under the Lien Transfer Prong, the secured creditor is still limited in its recovery to the judicial valuation of its secured interest in the collateral.[48] Moreover, a secured creditor is not absolutely guaranteed the right to credit bid under § 363(k) because the statute specifically authorizes a court to deny credit bidding "for cause."[49] Finally, the Third Circuit noted that the Bankruptcy Code does not entitle a secured creditor to participate in the upside of its collateral.[50]

Judge Ambro's dissent maintained that the majority's analysis of the Lien Transfer Prong was not necessary because it was not implicated by the question before the court and that the default rule under § 363(k) is that a secured creditor may credit bid unless the debtor can convince the court that it should not be permitted to do so.[51] According to Judge Ambro, the Third Circuit's approach allows the debtor to unilaterally decide to deny credit bidding, with only a belated court inquiry at confirmation to determine whether the denial of credit bidding was "fair and equitable" to the secured lenders. Thus the burden that Congress placed on the debtor under § 363(k) and the Sale Prong is improperly shifted to secured creditors through the majority's interpretation of § 363(k).

The Seventh Circuit's Holding Regarding Secured Creditor's Special Rights Under the Bankruptcy Code

The Seventh Circuit held that determining the value of the secured creditor's collateral is difficult if the creditor is undersecured.[52] If the creditor is oversecured, then the value of its interest in the collateral is the face amount of its claim.[53] If the creditor's claim is undersecured, however, the indubitable equivalent of the creditor's claim is the current value of the asset. Determining the value of an undersecured creditor's claim thus becomes problematic because it is "usually difficult to discern the current market value of the types of assets sold in corporate bankruptcies."[54] The *River Road* plans thus were unconfirmable because there was an increased risk that the winning bid would not provide the lenders with the current market value of their collateral. According to the Seventh Circuit, "[n]othing in the text of Section 1129(b)(2)(A) indicates that plans that *might* provide secured lenders with the indubitable equivalent of their claims can be confirmed under [the Indubitable Equivalent Prong]."[55]

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The court held, accordingly, that a plain-meaning reading of the Indubitable Equivalent Prong "does not establish that it can be used to confirm plans that propose auctioning off a debtor's encumbered assets free and clear of liens without allowing credit bidding."[56]

The *River Road* court disagreed with the Third Circuit further, finding that a reading of other provisions of the Bankruptcy Code dealing with sales of a secured creditor's collateral free of its liens does, in fact, demonstrates Congress's intent to provide secured creditors with the right to credit bid at plan sales.[57] The Seventh Circuit did not consider the issue raised by the *Philadelphia Newspapers* court that sales pursuant to the Lien Transfer Prong do not provide for credit bid protections, tacitly adopting Judge Ambro's dissenting view that the Lien Transfer Prong analysis was inapplicable to the question before the court.

Conclusion

While both *Philadelphia Newspapers* and *River Road* are well-reasoned decisions, the Third and Seventh Circuits each were compelled to gloss over weaknesses inherent in both cases. For example, it is counterintuitive that the "value" of an undersecured creditor's interest in its collateral can be determined in a § 363 sale by the amount that it credit bids—which can be up to the face amount of its claim—yet that same creditor can be prohibited from credit bidding at a plan sale, leaving any determination of the value of its collateral to the whim of other bidders whose economic incentive is to pay as little as possible for the assets.

On the other hand, it is difficult to escape the fact that § 1129(b)(2)(A) is drafted in the disjunctive. The *River Road* court dismissed the statute's use of "or" in a footnote, stating that its "mere presence" is insufficient to resolve the issue because there are several judicially recognized exceptions to its standard use.[58] Despite this delicate tap-dance around the plain meaning of "or," the Seventh Circuit's overall analysis of the statute is immensely more compelling as, unlike the Third Circuit's analysis, it avoids rendering the Sale Prong superfluous.

These two decisions create a clear spilt in the circuits. The *River Road* debtors have petitioned the Supreme Court for certiorari, a petition that has yet to be considered. Thus the stage is set for the possibility of a resolution by the Supreme Court, which, absent Congressional intervention, would have the last word on whether secured creditors must be permitted to credit bid in sales under cramdown plans.

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1. In re Philadelphia Newspapers, LLC, 599 F.3d 298 (3d Cir. 2010).
2. River Road Hotel Partners, LLC v. Amalgamated Bank, 651 F.3d 642, 648-52 (7th Cir. 2011).
3. A slightly older decision from the Fifth Circuit also addressed whether a secured creditor has a statutory right to credit bid at a plan sale. Bank of New York Co., NA v. Official Unsecured Creditors' Committee (In re Pacific Lumber Co.), 584 F.3d 229, 246-47 (5th Cir. 2009), held that a plan could be confirmed even if the secured creditors were not afforded an opportunity to credit bid at an auction of their collateral because the lenders were guaranteed to receive the judicially determined "indubitable equivalent" of their claims. Because the bankruptcy court had held an evidentiary hearing and actually determined the value of the secured lenders' collateral, *Pacific Lumber* is distinguishable from *Philadelphia Newspapers* and *River Road*, where the value of the lenders' collateral was being "determined" at a public auction and not by judicial review.
4. 11 U.S.C.A. § 1129(a)(8).
5. 11 U.S.C.A. § 1129(b); River Road, 651 F.3d at 646-47.
6. River Road, 651 F.3d at 646-47.
7. 11 U.S.C.A. § 1129(b)(2)(A)(i).
8. 11 U.S.C.A. § 1129(b)(2)(A)(ii).
9. 11 U.S.C.A. § 1129(b)(2)(A)(iii).
10. River Road, 651 F.3d at 647-48.
11. 11 U.S.C.A. § 363(k).
12. River Road, 651 F.3d at 648.
13. Philadelphia Newspapers, 599 F.3d at 305.
14. See 11 U.S.C.A. § 102(5); see also Philadelphia Newspapers, 599 F.3d at 305 (The statutory note to § 102(5) states that "if a party may do (a) or (b), then the party may do either or both" (citation omitted)).
15. Philadelphia Newspapers, 599 F.3d at 305-06.
16. The creditors in *Philadelphia Newspapers* also asserted that the term "indubitable equivalent" itself was ambiguous. The Third Circuit held that the term "indubitable equivalent," while not defined in the Bankruptcy Code, is unambiguous. "Indubitable" means "'not open to question or doubt'" while "equivalent" means "'equal in force or amount'… or 'equal in value.'" Philadelphia Newspapers, 599

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F.3d at 310. Thus the indubitable equivalent of a secured lender's claim is "the unquestionable value of a lender's secured interest in the collateral." Philadelphia Newspapers, 599 F.3d at 310.

17. Philadelphia Newspapers, 599 F.3d at 307.
18. Philadelphia Newspapers, 599 F.3d at 306.
19. Philadelphia Newspapers, 599 F.3d at 306.
20. Philadelphia Newspapers, 599 F.3d at 308; River Road, 651 F.3d at 651-52.
21. Philadelphia Newspapers, 599 F.3d at 310.
22. Philadelphia Newspapers, 599 F.3d at 308.
23. Philadelphia Newspapers, 599 F.3d at 308.
24. Philadelphia Newspapers, 599 F.3d at 308.
25. Philadelphia Newspapers, 599 F.3d at 308.
26. Philadelphia Newspapers, 599 F.3d at 308.
27. River Road, 651 F.3d at 649-50.
28. River Road, 651 F.3d at 650-51 (citing Philadelphia Newspapers, 599 F.3d at 324-27 (Ambro J., dissenting)).
29. River Road, 651 F.3d at 649-50.
30. River Road, 651 F.3d at 649.
31. River Road, 651 F.3d at 651-52.
32. River Road, 651 F.3d at 652 ("We cannot conceive of a reason why Congress would state that a plan must meet certain requirements if it provides for the sale of assets in particular ways and then immediately abandon these requirements in a subsequent subsection" (footnote omitted)).
33. River Road, 651 F.3d at 652.
34. River Road, 651 F.3d at 652-53.
35. River Road, 651 F.3d at 653.
36. River Road, 651 F.3d at 653.
37. Philadelphia Newspapers, 599 F.3d at 311; River Road, 651 F.3d at 652-53.
38. Cohen v. KB Mezzanine Fund II, LP (In re SubMicron Sys., Corp.), 432 F.3d 448 (3d Cir. 2006).
39. Philadelphia Newspapers, 599 F.3d at 314.
40. Philadelphia Newspapers, 599 F.3d at 316; 11 U.S.C.A. § 1111(b).
41. Philadelphia Newspapers, 599 F.3d at 334.
42. Philadelphia Newspapers, 599 F.3d at 316.
43. Philadelphia Newspapers, 599 F.3d at 312 ("Our holding that a credit bid sets the value of a lender's secured interest in collateral does not equate to a holding that a credit bid must be the successful bid at public auction").
44. In *Philadelphia Newspapers*, the plan provided for the lenders to receive the debtor's corporate headquarters building, albeit subject to a two-year rent-free lease for the entity that would operate the newspaper. Philadelphia Newspapers, 599 F.3d at302. Thus at plan confirmation, the bankruptcy court would be required to consider the auction proceeds plus the value of the building when determining whether the lenders had received the indubitable equivalent of their claim.
45. Philadelphia Newspapers, 599 F.3d at 316 & n.15.
46. Philadelphia Newspapers, 599 F.3d at 316.
47. Philadelphia Newspapers, 599 F.3d at 316 (citing 11 U.S.C.A. § 506(a)).
48. Philadelphia Newspapers, 599 F.3d at 316.
49. Philadelphia Newspapers, 599 F.3d at 316.
50. Philadelphia Newspapers, 599 F.3d at 316 (citing Pacific Lumber, 584 F.3d. at 247).
51. Philadelphia Newspapers, 599 F.3d at 333.
52. River Road, 651 F.3d at 649.
53. River Road, 651 F.3d at 649-50.
54. River Road, 651 F.3d at 650.
55. River Road, 651 F.3d at 651.
56. River Road, 651 F.3d at 651.
57. River Road, 651 F.3d at 651-52.
58. River Road, 651 F.3d at 649-50 & n.5.

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