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The Res Judicata Effect of Bankruptcy Court Judgments: The Procedural and Constitutional Concerns

George A. Martinez[*]

I. INTRODUCTION

Should a bankruptcy court's judgment bar further litigation of claims arising out of the series of events at issue in the bankruptcy proceeding based on the doctrine of res judicata? Or should res judicata apply only where the subsequent action would constitute a core,[1] as opposed to non-core, but related proceeding? These questions raise important procedural and constitutional issues about which the courts of appeals are currently split.[2]

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1. *See infra* notes 49-62 and accompanying text (explaining distinction between core and non-core proceedings).

2. *See* Howell Hydrocarbons, Inc. v. Adams, 897 F.2d 183, 189 (5th Cir. 1990) (decisions in bankruptcy courts act as a bar only to core proceedings); Barnett v. Stern, 909 F.2d 973, 979 (7th Cir. 1990) (same); Sure-Snap Corp. v. State Street Bank and Trust Co., 948 F.2d 869, 873 (2d Cir. 1991) (whether or not a claim was a core proceeding had no bearing on its preclusion); Sanders Confectionery Prod., Inc. v. Heller Fin., Inc., 973 F.2d 474, 482 (6th Cir. 1992) (bankruptcy proceedings can also be binding on non-core proceedings).

This issue has arisen in the wake of the Supreme Court's decision in *Northern Pipeline Construction Company v. Marathon Pipe Line Company*.[3] There, the Supreme Court held that the jurisdictional provision of the 1978 Bankruptcy Reform Act was unconstitutional because it impermissibly vested Article III judicial powers in bankruptcy judges by authorizing them to decide state common law actions without the parties' consent.[4] The plurality opinion in *Northern Pipeline*, however, recognized that non-Article III tribunals were permitted to adjudicate cases involving "public rights."[5] As to bankruptcy matters, the plurality suggested that only "core proceedings" could involve public rights allowing jurisdiction.[6]

In 1984, Congress responded to *Northern Pipeline* by enacting 28 U.S.C. § 157, which authorizes bankruptcy judges to hear all core proceedings arising under the bankruptcy code.[7] The 1984 Act provides that as to non-core proceedings, bankruptcy judges may hear such proceedings but that they may not enter a final order or judgment absent consent of the parties.[8] As to such proceedings, a bankruptcy judge may only make proposed findings of fact and conclusions of law to the district court.[9] The distinction between core and non-core matters is meant to ensure that bankruptcy courts will not encroach impermissibly in the area reserved by the Constitution to Article III courts.

Despite this, the distinction between core and none-core proceedings has generated a significant problem in the area of res judicata. As mentioned above, the courts of appeals are currently split over the question of whether a bankruptcy court's judgment bars further litigation of any claim that arises out of the series of events at issue in the bankruptcy proceeding, including non-core claims. There is a dearth of scholarship on this important issue. Given this, this article seeks to resolve the conflict in the circuits and argues that bankruptcy court judgments should not bar the assertion of non-core claims because to do so violates the basic principles of res judicata and

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3. 458 U.S. 50 (1982).

4. *See id.* at 87. Bankruptcy judges' positions were created under Article I of the Constitution and did not possess the life tenure and guaranteed compensation protections found in Article III. *See* 28 U.S.C. §§ 153, 154 (1982).

5. *Northern Pipeline*, 458 U.S. at 68-70. *See infra* notes 24-25 and accompanying text (explaining notion of public rights). For recent articles on non-Article III legislative courts, see Daniel J. Meltzer, *Legislative Courts, Legislative Power, and the Constitution*, 65 IND. L.J. 291 (1990); Paul M. Bator, *The Constitution as Architecture: Legislative and Administrative Courts Under Article III*, 65 IND. L.J. 233 (1990); Richard H. Fallon, Jr., *Of Legislative Courts, Administrative Agencies, and Article III*, 101 HARV. L. REV. 915 (1988).

6. *Northern Pipeline*, 458 U.S. at 71.

7. 28 U.S.C. § 157(b)(1) (1994).

8. *See* 28 U.S.C. § 157(c)(1) (1994).

9. *See* 28 U.S.C. § 157(c)(1) (1994).

threatens to undermine fundamental Article III values or create judicial inefficiencies in an effort to preserve such values.

Part II of the article provides the relevant Article III background, and identifies the key Article III cases: *Northern Pipeline Construction Company v. Marathon Pipe Line Company*[10] and *Commodity Futures Trading Commission v. Schor.*[11] This section explores the impact of *Northern Pipeline* which held that the 1978 Bankruptcy Reform Act was unconstitutional because it impermissibly gave Article III judicial powers to bankruptcy judges. Describing the Congressional response to *Northern Pipeline*, Part III explains the Bankruptcy Amendments and Federal Judgeship Act of 1984. The next section examines the current split in the courts over whether a bankruptcy court's judgment bars further litigation of any claim, including non-core claims, that arises out of the transaction at issue. Finally, part V seeks to resolve the split in the circuits by arguing that the general principles of res judicata, concerns about fundamental Article III values and judicial economy support the proposition that bankruptcy court judgments should not bar non-core claims.

II. ARTICLE III AND THE BACKGROUND CASES: *NORTHERN PIPELINE* AND *SCHOR*

A. The Policies Served By Article III

To understand the Article III issues at stake, it is important to consider the policies behind Article III. Article III provides that the "judicial power of the United States, shall be vested in one Supreme Court, and in such inferior Courts, as the Congress may from time to time ordain and establish."[12] Article III further directs that these federal courts shall be staffed by judges who hold their offices during good behavior and receive a compensation which shall not be diminished during their time in office.[13] The Good Behavior Clause provides Article III judges with life tenure.[14] The Compensation Clause grants Article III judges an irreducible salary.[15] These provisions serve both to protect the independence of the Judiciary from the

10. 458 U.S. 50 (1982).

11. 478 U.S. 833 (1986).

12. U.S. CONST. art. III, § 1.

13. U.S. CONST. art. III, § 1.

14. Northern Pipeline Construction Co. v. Marathon Pipe Line Co., 458 U.S. 50, 59 (1982) (citing United States *ex rel.* Toth v. Quarles, 350 U.S. 11, 16 (1955)).

15. *Northern Pipeline*, 458 U.S. at 59 (citing United States v. Will, 449 U.S. 200, 218-221 (1980)).

control of the Executive and the Legislative Branches of government,[16] and the litigant's right to have claims decided before judges who are free and impartial.[17]

Article III, then, was designed to maintain the checks and balances of the constitutional structure, and also to guarantee impartial adjudication.[18] Long ago, Alexander Hamilton explained that Article III's provision for an independent judiciary was also necessary in order to preserve the ideal of the rule of law.[19]

The Supreme Court has recognized that other purposes animate Article III. Article III's provisions help to (1) promote public confidence in judicial

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16. *Northern Pipeline*, 458 U.S. at 59.

17. Commodity Futures Trading Comm'n v. Schor, 478 U.S. 833, 848 (1986) (citing United States v. Will, 449 U.S. 200, 218 (1980)). *See also* ERWIN CHEMERINSKY, FEDERAL JURISDICTION 181 (1989) (Article III protections were "intended to insulate federal judges from direct political pressure and ensure that they would uphold the Constitution and federal laws without regard to the popularity of their actions."); MARTIN H. REDISH, FEDERAL JURISDICTION: TENSIONS IN THE ALLOCATION OF JUDICIAL POWER 53 (2d ed. 1990) ("The essential characteristic of the Article III courts . . . is the independence their judges possess with respect to the executive and legislative branches of the federal government. This independence is a result of two specific requirements of Article III: first, judges of the courts created pursuant to its provision have tenure during good behavior, and second, the salaries of these judges cannot be reduced").

18. *Northern Pipeline*, 458 U.S. at 58. *See also* REDISH, *supra* note 17, at 53 ("The business of the judiciary is often to review the constitutional legitimacy of the actions of the legislative or executive branches. To the extent that these branches retain power to retaliate against judges who displease them, it is at least conceivable that courts will be unable to review the activities of those branches with proper neutrality. It was for this very reason that the framers inserted the independence requirements in Article III.").

19. THE FEDERALIST No. 78, at 489 (Alexander Hamilton) (H. Lodge ed. 1888):

> Periodical appointments, however regulated or by whomsoever made, would in some way or other, be fatal to [the court's] necessary independence. If the power of making them was committed either to the executive or legislature, there would be a danger of an improper complaisance to the branch which possessed it; if to both, there would be an unwillingness to hazard the displeasure of either; if to the people, or to persons chosen by them for the special purpose, there would be too great a disposition to consult popularity, to justify a reliance that nothing would be consulted but the Constitution and the laws.

See also Richard H. Fallon, Jr., *Of Legislative Courts Administrative Agencies, and Article III*, 101 HARV. L. REV. 915, 937 (1988) ("To subject federal judges to political influence by Congress or the national executive would, [in the view of the framers], have threatened the rule of law").

determinations, (2) attract well qualified persons to the federal bench and (3) insulate the individual judge from improper influences not only by other branches but by colleagues as well, thereby promoting judicial individualism.[20]

B. Northern Pipeline and Schor

1. The *Northern Pipeline* Decision

In the wake of the Supreme Court's decision in *Northern Pipeline*, the question arises whether bankruptcy court judgments will have res judicata effect on non-core claims.[21] In *Northern Pipeline*, the Supreme Court held that the jurisdictional provisions of the 1978 Bankruptcy Reform Act (the Reform Act) were unconstitutional because the Act impermissibly gave Article III judicial powers to bankruptcy judges.[22] Authorized under Article I of the Constitution, bankruptcy judges' positions do not possess the life tenure or guaranteed salary protection given to Article III judges. Therefore, bankruptcy judges cannot adjudicate a debtor's claims for breach of contract and breach of warranty against a private company.[23] In a plurality opinion, the *Northern Pipeline* Court recognized three exceptions to Article III's restriction of judicial power to courts whose judges had its protections: (1) territorial courts; (2) military courts and (3) "public rights" cases.[24] Since bankruptcy courts are not territorial courts or military courts, they could be upheld only if their jurisdiction was limited to the determination of public rights.[25] As

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20. *See Northern Pipeline*, 458 U.S. at 59 n.10.

21. Professor Chemerinsky has commented that "[w]ithout a doubt, the *Northern Pipeline* case is the most important Supreme Court decision limiting the power of Congress to create legislative courts." CHEMERINSKY, *supra* note 17, at 202.

22. The 1978 Reform Act was designed to eliminate wasteful litigation by providing bankruptcy courts with jurisdiction over all disputes that could affect the debtor's bankruptcy. *See* STEPHEN E. SNYDER & LAWRENCE PONOROFF, COMMERCIAL BANKRUPTCY LITIGATION 2, 3 (1992). Under this broad jurisdictional grant, the bankruptcy court could decide debtor's claims against third parties that were based on state or federal non-bankruptcy law. *Id. See also* CHEMERINSKY, *supra* note 17, at 202 ("Under the Bankruptcy Act of 1978, bankruptcy judges appointed to fourteen-year terms had broad jurisdiction to decide private civil disputes.").

23. *Northern Pipeline*, 458 U.S. at 76.

24. *Id.* at 64-70. Public rights cases involve disputes "between the government and others." *Id.* at 69. On the other hand, private right cases involve "the liability of one individual to another." *Id.* at 69-70.

25. *See* REDISH, *supra* note 17, at 66 ("Under Justice Brennan's opinion, then, the public-private right dichotomy serves as the standard for determining the division of authority between Article III and Article I courts"). Commentators have questioned

to bankruptcy proceedings, the plurality opinion suggested that only so called "core proceedings" could involve public rights. The Court stated:

> [T]he restructuring of debtor-creditor relations, which is at the core of the federal bankruptcy power, must be distinguished from the adjudication of state-created private rights, such as the right to recover contract damages that is at issue in this case. The former may well be a "public right," but the latter obviously is not.[26]

Thus, the Court concluded that because the bankruptcy courts had the authority to decide state law private right claims, their jurisdiction went beyond public right cases. According to the plurality, private right cases "lie at the core of the historically recognized judicial power," and must be heard by an Article III court.[27] Given this, the constitutionality of the Reform Act could not be sustained on the theory that bankruptcy courts fit within the historical exceptions.[28]

The plurality also considered whether the constitutionality of the bankruptcy courts could be upheld on the ground that such courts were adjuncts of the district courts and subject to their control.[29] Since the powers of the bankruptcy courts were essentially as broad as that of the district court, and the district court did not exercise sufficient control over the bankruptcy court, the Court could not uphold the constitutionality of the bankruptcy courts under the adjunct theory.[30] Thus, in *Northern Pipeline*, the Supreme Court

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whether the public-private right dichotomy is justified. *See, e.g.*, REDISH, *supra* note 17, at 66. Professor Redish has argued that the use of the public-private right dichotomy to determine the proper Article III-Article I division is contrary to the policies and language of Article III. *Id.* at 66-67.

26. *Northern Pipeline*, 458 U.S. at 71.

27. *Id.* at 70.

28. *See* CHEMERINSKY, *supra* note 17, at 204 ("Justice Brennan's plurality opinion stressed that legislative courts were permitted only in a few instances—for territories, the military, and public rights disputes—and that bankruptcy did not fit into these exceptions.").

29. In *Crowell v. Benson*, 285 U.S. 22 (1932), the Supreme Court held that Article I courts could decide private right cases only if there was substantial oversight by an Article III court. *See* CHEMERINSKY, *supra* note 17, at 198. In such situations, the Article I courts are viewed as adjuncts to the Article III courts. *See* CHEMERINSKY, *supra* note 17, at 199.

30. The plurality concluded that the bankruptcy courts were exercising power far greater than had been approved in *Crowell v. Benson*. *Northern Pipeline*, 458 U.S. at 86. For further discussion of *Northern Pipeline*, see Martin H. Redish, *Legislative Courts, Administrative Agencies, and The* Northern Pipeline *Decision*, 1983 DUKE L.J. 197 (1983). Professor Redish analyses the reasoning of *Northern Pipeline* and provides two alternative methods for allocating judicial power between Article III and

suggested that bankruptcy courts could adjudicate core proceedings because they involve public rights. The Court, however, did not directly address the question at issue—can bankruptcy judgments, consistent with Article III, bar non-core (non-public right) claims?

2. The *Schor* Decision

To determine whether allowing bankruptcy judgments to bar non-core claims is consistent with Article III, it is also necessary to consider the Supreme Court's recent decision, *Commodity Futures Trading Commission v. Schor*,[31] concerning the use of Article I courts. *Schor* represented a shift away from the plurality decision in *Northern Pipeline*.[32] In *Schor*, the Commodity Futures Trading Commission (CFTC) had promulgated a regulation allowing it to adjudicate counterclaims arising "out of the transaction or occurrence or series of transactions or occurrences set forth" in a complaint filed with the CFTC alleging violation of the Commodity Exchange Act.[33] This permissive counterclaim rule allowed the respondent to seek relief in other fora. Schor argued that Article III barred any adjudication of state law counterclaims by the CFTC decisionmakers since they did not enjoy the Article III salary and tenure protections. The court held that the CFTC's assumption of jurisdiction over common law counterclaims did not violate Article III.[34]

The Court stated that Article III serves both to protect "the role of the independent judiciary within the constitutional scheme of tripartite government" and "to safeguard litigants' rights to have claims decided before judges who are free from potential domination by other branches of government."[35] As to the latter safeguard, the Court emphasized that "this guarantee serves to protect primarily personal, rather than structural,

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non-Article III bodies. *See also* Erwin Chemerinsky, *Ending the Marathon: It is Time to Overrule* Northern Pipeline, 65 AM. BANKR. L. J. 311 (1991) (stating that *Northern Pipeline* stands for the proposition that Congress may not vest in a non-Article III court the power to adjudicate, render final judgment, and issue binding orders in a traditional contract action arising under state law, without consent of the litigants, and subject only to ordinary appellate review).

31. 478 U.S. 833 (1986). For analysis of *Schor*, see Richard B. Saphire & Michael E. Solimine, *Shoring Up Article III: Legislative Court Doctrine in the Post* CFTC v. Schor *Era*, 68 B.U. L. REV. 85 (1988); Ralph U. Whitten, *Consent, Caseload and Other Justifications for Non-Article III Courts and Judges: A Comment On* Commodity Futures Trading Commission v. Schor, 20 CREIGHTON L. REV. 11 (1986).

32. *See* REDISH, *supra* note 17, at 77.

33. 17 C.F.R. § 12.23(b)(2) (1985).

34. *Schor*, 478 U.S. at 858.

35. *Id.* at 848 (citing United States v. Will, 449 U.S. 200 (1980)).

interests."[36] In determining whether the CFTC's jurisdiction over state law counterclaims violated Article III, the Court said that the congressional interests in providing for administrative adjudication must be weighed against the purposes underlying the requirements of Article III.[37]

Applying these principles, the Court recognized that the Congressional interest was to provide an inexpensive alternative to litigation in federal court and to exploit the expertise of the CFTC.[38] The Court weighed this interest against the personal interest of the litigant in having a fair and independent tribunal and the structural interest of preserving the role of the federal courts in our tripartite scheme of government.[39] As to the litigant's interest in fairness, the Court concluded that Schor waived his right to an independent tribunal. When Schor asserted his counterclaim before the CFTC, instead of asserting the claim before a federal district court, the court determined that he consented to CFTC's jurisdiction over the claim. Thus, Schor waived his personal right to an Article III tribunal. As to the structural interest in preserving our system of checks and balances, the court considered four factors[40] in determining whether the Congressional decision to authorize a non-Article III tribunal impermissibly threatened the institutional integrity of the Judicial Branch. After examining these factors, the Court concluded that the congressional scheme did not intrude on the province of the judiciary.[41]

Regarding the question at issue, whether bankruptcy judgments should bar

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36. *Id.*

37. *Id.* at 851.

38. *Id.* at 855.

39. *See id.* at 857-58.

40. The court identified the factors to be considered as "the extent to which the 'essential attributes of judicial power' are reserved to Article III courts, and, conversely, the extent to which the non-Article III forum exercises the range of jurisdiction and powers normally vested only in Article III courts, the origins and importance of the right to be adjudicated, and the concerns that drove Congress to depart from the requirements of Article III." *Id.* at 851.

41. *Id.* at 857. The use of a balancing analysis has been criticized on the ground that it "does not appear to be authorized by the language of Article III." REDISH, *supra* note 17, at 71. In addition, the balancing analysis has been criticized for the reason that any balancing analysis would invariably favor the legislative interest in freeing the government from the constraints of Article III at the expense of the constitutional values expressed in Article III. REDISH, *supra* note 17, at 71-72. *See also* CHEMERINSKY, *supra* note 17, at 212 ("the Court's balancing approach raises concerns that Congress can eviscerate the jurisdiction of Article III courts by the slow transfer of power on a case-by-case basis").

non-core claims, *Schor* is particularly relevant. In *Schor*, the Court emphasized that Article III provides litigants with a personal right to an independent tribunal. As discussed in Part V, allowing bankruptcy court judgments to bar non-core claims threatens to undermine a litigant's Article III right to an independent tribunal or create judicial inefficiencies in an effort to preserve that Article III right.[42] Thus, the reasoning in *Schor* supports the proposition that bankruptcy judgments should not bar non-core claims in order to avoid Article III problems or judicial inefficiency.

III. CONGRESSIONAL RESPONSE TO *NORTHERN PIPELINE*

In an effort to resolve the concerns of the *Northern Pipeline* Court, Congress enacted the Bankruptcy Amendments and Federal Judgeship Act of 1984.[43] The bankruptcy jurisdiction scheme created by the 1984 Act has a number of major features. First, the Act grants the district courts original and exclusive jurisdiction over bankruptcy matters.[44] The Act also grants them original, but non-exclusive, jurisdiction of all civil proceedings arising under, arising in or related to the bankruptcy case.[45]

Although district courts have jurisdiction over bankruptcy matters, they rarely exercise that jurisdiction.[46] This is because the Act authorizes each district court to refer all cases within the district court's section 1334(a) and (b) jurisdiction to the non-Article III bankruptcy judges of the district.[47] The

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42. *See infra* notes 171-209 and accompanying text.

43. Pub. L. No. 98-353, 98 Stat. 344 (1984). The *Northern Pipeline* decision "created serious and immediate problems for Congress by forcing it to restructure the method of bankruptcy adjudication." REDISH, *supra* note 17, at 65. Prior to the 1984 Act, the Congress had adopted emergency rules in response to *Northern Pipeline*. For example, see *In re* Grabill Corp., 967 F.2d 1152 (7th Cir. 1992). The Seventh Circuit dealt with the issue of the authority of bankruptcy courts to conduct jury trials in core proceedings. The court noted that subsequent to *Northern Pipeline* decision, Congress had twice declined to elevate the bankruptcy courts to Article III status. *Id.* at 1157. *See also* Vern Countryman, *Scrambling to Define Bankruptcy Jurisdiction: The Chief Justice, the Judicial Conference, and the Legislative Process*, 22 HARV. J. ON LEGIS. 1, 29-32 (1985) (referring to Congress' refusal to extend Article III status to bankruptcy court judges).

44. 28 U.S.C. § 1334(a) (1994).

45. 28 U.S.C. § 1334(b) (1994).

46. *See* SNYDER & PONOROFF, *supra* note 22, § 2.02, at 2-13.

47. 28 U.S.C. § 157(a) (1994). *See also* WILLIAM N. NORTON, JR., 1 NORTON BANKRUPTCY LAW AND PRACTICE § 5.02 (1992) ("Under the 1984 system, the district courts were granted power to retain and adjudicate all bankruptcy cases and proceedings or refer them in whole or in part to the bankruptcy courts either by specific orders of reference or by general orders of reference covering all present and

district courts in each judicial district have now promulgated local rules providing for automatic referral of all bankruptcy matters.[48]

Section 157(a) and (b) of the 1984 Act governs the bankruptcy court's power over referred proceedings.[49] Section 157(b)(1) authorizes bankruptcy judges to hear and determine all bankruptcy cases, and all core proceedings arising under the bankruptcy code or arising in a bankruptcy case.[50] The bankruptcy judge may enter final judgments in these cases.[51] Parties can appeal such judgments to the district court.[52]

Section 157(c)(1) provides that the bankruptcy judge may hear a proceeding that is not a core proceeding but that is otherwise related to a bankruptcy case.[53] The bankruptcy judge, however, cannot enter final judgments in these non-core proceedings.[54] Instead, the bankruptcy judge is to submit proposed findings of fact and conclusions of law to the district court.[55] After considering the bankruptcy judge's proposed findings and conclusions and reviewing de novo those matters to which any party has timely and specifically objected, the district judge then enters a final order.[56]

Section 157(c)(2) authorizes bankruptcy judges with the consent of all parties, to enter final judgments in non-core proceedings.[57] Section 157 does not define core or non-core proceedings.[58] Instead, Section 157(b)(2) provides a non-exhaustive list of examples of core proceedings.[59] In general, the examples constitute claims that are created by the Bankruptcy Code or that relate to the administration of a bankruptcy case.[60]

In any event, the distinction between core and non-core proceedings is, of course, designed to avoid Article III problems in allowing district courts to

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future bankruptcy cases and proceedings").

48. *See* SNYDER & PONOROFF, *supra* note 22, at 2-16. *See also* NORTON, *supra* note 47, § 5.02 ("Every federal District Court in each of the 106 federal districts opted to issue a general order of reference of all present and future bankruptcy cases and proceedings").

49. 28 U.S.C. § 157(a), (b) (1994).

50. *See* SNYDER & PONOROFF, *supra* note 22, at 2-16.

51. *See* SNYDER & PONOROFF, *supra* note 22, at 2-16.

52. *See* SNYDER & PONOROFF, *supra* note 22, at 2-16.

53. *See* SNYDER & PONOROFF, *supra* note 22, at 2-16.

54. *See* SNYDER & PONOROFF, *supra* note 22, at 2-16.

55. 28 U.S.C. § 157(c)(1) (1994).

56. 28 U.S.C. § 157(c)(1) (1994).

57. *See* SNYDER & PONOROFF, *supra* note 22, at 2-16.

58. *See* SNYDER & PONOROFF, *supra* note 22, at 2-17.

59. *See* NORTON, *supra* note 47, § 5.14 ("The Judicial Code, in 28 U.S.C. § 157(b)(2), sets forth a non inclusive list of 15 categories of bankruptcy proceedings that are deemed to constitute 'core proceedings'").

60. *See* SNYDER & PONOROFF, *supra* note 22, at 2-17.

refer bankruptcy matters to bankruptcy judges.[61] It is still an open question, however, as to whether this jurisdictional scheme meets the requirements of Article III.[62]

IV. THE SPLIT IN THE COURTS OF APPEALS

In the wake of *Northern Pipeline* and the 1984 Act, courts of appeals are divided over whether a bankruptcy court's judgment bars further litigation of any claim, including a non-core claim, that arises out of the series of events at issue. This section of the article discusses these cases.

A. Courts Taking the Position That Bankruptcy Judgments Do Not Bar Non-Core Claims

One of the early cases to address the res judicata effect of bankruptcy orders is *Howell Hydrocarbons, Inc. v. Adams*.[63] In *Howell*, Tomlinson Oil Company (TOC), Tomlinson Refining Inc., and Pioneer Refining Ltd. filed for reorganization under Chapter 11. Howell, a creditor, filed a proof of claim in the proceeding.[64] The bankruptcy court confirmed the reorganization plan.[65]

Subsequently, Howell filed a federal RICO claim in federal district court against the shareholders of TOC alleging that they operated TOC and Pioneer in a fraudulent manner. The district court entered summary judgment. The court held that, based on the prior order of the bankruptcy court confirming the reorganization plan, the doctrine of res judicata barred the RICO claim.[66]

The Fifth Circuit reversed, holding that res judicata did not bar Howell's RICO claim because the bankruptcy court would not have had jurisdiction over it. The court stated that under 28 U.S.C. § 157, a bankruptcy court has the power to "hear and determine all cases under Title 11 and all core proceedings arising under Title 11, or arising in a case under Title 11."[67] The court observed that a bankruptcy court may hear a non-core proceeding and make proposed findings of fact and conclusions of law to the district

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61. *See* SNYDER & PONOROFF, *supra* note 22, at 2-18.

62. *See* SNYDER & PONOROFF, *supra* note 22, at 2-7. For a survey of the constitutional issues that have arisen under the 1984 Act, see Jeffrey T. Ferriell, *Constitutionality of the Bankruptcy Amendments and the Federal Judgeship Act of 1984*, 63 AM. BANKR. L. J. 109 (1989).

63. 897 F.2d 183, 189 (5th Cir. 1990).

64. *Id.* at 187. Howell received all of the required notices.

65. *Howell*, 897 F.2d at 187.

66. *Id.* at 187-88.

67. 28 U.S.C. § 157(b)(1) (1994).

court, but it may not enter a final order of judgment.[68] Thus, the court concluded that the RICO claim should have been asserted in the bankruptcy court only if Howell's claim would have constituted a core proceeding in the earlier bankruptcy proceeding.[69] Since the RICO claim did not invoke a substantive right provided by Title 11, it invoked a completely independent federal right, and did not arise solely in the context of bankruptcy proceedings. Therefore, the RICO claim was a non-core claim and could not be barred by res judicata.[70]

The Seventh Circuit addressed the same issue in *Barnett v. Stern*.[71] In *Barnett*, Levit, the trustee of the Stern bankruptcy estate, initiated an adversary proceeding in the bankruptcy court against the Nationwide Trust ("N.W. Trust"). Levit alleged that the N.W. Trust was the alter ego of Burton, and sought to have the bankruptcy court declare all the trust's assets property of the bankruptcy estate. The bankruptcy court entered judgment for Levit.[72]

Subsequently, Levit filed a RICO claim in the federal district court alleging that Burton's son, Todd, violated RICO by using the N.W. Trust to conceal assets. The district court held that res judicata barred Levit's RICO claim because of the previous bankruptcy proceedings in which Levit sought to have the N.W. Trust funds declared property of the estate.[73]

Following the reasoning of *Howell*, the Seventh Circuit held that previously unasserted claims could be barred by res judicata only if those claims would have been core proceedings in the bankruptcy court.[74] Applying this doctrine, the court reversed because the RICO claim would not have been a core proceeding in the bankruptcy case.[75] Thus, Levit was not required to assert his RICO claim in the adversary proceeding.[76]

Howell Hydrocarbons and *Barnett* correctly concluded that bankruptcy judgments should not bar non-core claims. Those decisions, however, do not provide a comprehensive rationale for their decisions. Part V of this article seeks to provide such a rationale.

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68. 28 U.S.C. § 157(c)(1) (1994).

69. *Id.* at 190. The court noted that a "proceeding is core under Section 157 if it invokes a substantive right provided by Title 11 or if it is a proceeding that, by its nature, could arise only in the context of a bankruptcy proceeding." *Id.* at 189-90.

70. *Id.* at 190.

71. 909 F.2d 973 (7th Cir. 1990).

72. *Id.* at 975.

73. *Id.* at 976.

74. *Id.* at 979.

75. *Id.* at 981-82.

76. *Id.*

B. Courts Taking the Position That Bankruptcy Judgments Bar Non-Core Claims

The Second Circuit addressed the question in *Sure-Snap Corporation v. State Street Bank and Trust Company*.[77] Sure-Snap entered into a loan agreement with Bradford and State Street Bank & Trust Company. Later, Sure-Snap filed for bankruptcy. The bankruptcy court entered an order confirming a reorganization plan.[78]

Subsequently, Sure-Snap brought lender liability claims in federal district court against Bradford and State Street Bank. The district court held that principles of res judicata barred Sure-Snap's lender liability claims based on the earlier bankruptcy order.[79] Finding Sure-Snap's contention—that the lender liability claims did not constitute core proceedings—had no bearing on their preclusion, the Second Circuit affirmed.[80] The court reasoned that while 28 U.S.C. § 157(b) and § 1334(b) set out the general jurisdictional parameters conferred on bankruptcy courts, they do not specify where the actions should be brought.[81]

The Sixth Circuit considered the issue in *Sanders Confectionery Products, Inc. v. Heller Financial, Inc.*[82] In *Sanders*, FSI filed for bankruptcy. The bankruptcy court issued an order confirming a bankruptcy plan of reorganization.[83] Subsequently, SCPI, Sanders, and Kreissl asserted lender liability claims in federal district court.[84] The district court dismissed all of the claims as barred on res judicata grounds, because of the order issued in the FSI bankruptcy.[85]

On appeal, SCPI, Sanders, and Kreissl argued that their lender liability claims were non-core proceedings, and therefore, the bankruptcy judgment could not have been res judicata as to those claims. Rejecting the reasoning of the *Howell* and *Barnett* courts, the Sixth Circuit held that in certain circumstances decisions in bankruptcy cases can act as a bar to non-core proceedings.[86] The court reasoned that although the bankruptcy court would not have subject matter jurisdiction over a non-core proceeding, the action would still be within the district court's jurisdiction. The court said that while

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77. 948 F.2d 869 (2d Cir. 1991).
78. *Id.* at 870.
79. *Id.* at 872.
80. *Id.* at 873.
81. *Id.*
82. 973 F.2d 474 (6th Cir. 1992), *cert. denied*, 506 U.S. 1079 (1993).
83. *Id.* at 480.
84. *Id.*
85. *Id.*
86. *Id.* at 482.

the bankruptcy court could not make a final decision in a non-core proceeding, absent the consent of the parties, it could hear the matter and submit proposed findings of fact and conclusions of law to the district court. Through its bankruptcy jurisdiction, the district court could decide the claim. Given this, the court concluded that a bankruptcy court judgment could operate to bar both core and non-core proceedings.[87]

The *Sure-Snap Corporation* and *Sanders* courts' reasoning cannot withstand scrutiny. First, the courts ignore the general res judicata principle that provides that, when the jurisdiction of the first proceeding is limited, an exception to the general rule against claim splitting is justified.[88] The courts also fail to take into account fundamental Article III concerns.[89]

V. RESOLUTION OF THE SPLIT IN THE CIRCUITS

This part of the article seeks to provide a comprehensive rationale to resolve the split in the circuits. In particular, the article argues that bankruptcy judgments should not bar non-core claims. To allow such judgments to bar such claims would be contrary to general principles of res judicata and threaten to undermine fundamental Article III values or create judicial inefficiencies in an effort to preserve such values.

A. General Principles of Res Judicata

In order to resolve the split in the circuits, it is important to understand the basic principles of res judicata. In general, federal law determines the preclusive effect of federal judgments.[90] Thus, federal rules of res judicata

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87. *Id.* at 483.

88. *See infra* notes 119-139 and accompanying text.

89. *See infra* notes 170-208 and accompanying text.

90. "It is clear that where the federal court decided a federal question, federal res judicata rules govern." PAUL M. BATOR ET AL., HART & WECHSLER'S THE FEDERAL COURTS AND THE FEDERAL SYSTEM 1604 (3d ed. 1988) (citing Deposit Bank v. Frankfort, 191 U.S. 499 (1903) and Stoll v. Gottlieb, 305 U.S. 165 (1938)). It is less clear, however, what law governs the preclusion effect of federal diversity judgments. *See* BATOR, *supra* this note, at 1604. Most courts and commentators, however, take the position that federal law should determine the preclusive effect of all federal judgments. *See* Kern v. Hettinger, 303 F.2d 333, 340 (2d Cir. 1962) ("[o]ne of the strongest policies a court can have is that of determining the scope of its own judgments.... It would be destructive of the basic principles of the Federal Rules of Civil Procedure to say that the effect of a judgment of a federal court was governed by the law of the state where the court sits simply because the source of federal jurisdiction is diversity."); *See generally* Ronan E. Degnan, *Federalized Res Judicata*, 85 YALE L.J. 741 (1976).

govern bankruptcy court judgments.[91] In addition, the federal law of res judicata is almost entirely judge-made.[92]

Res judicata can be separated into two basic ideas: claim preclusion and issue preclusion.[93] These terms refer to two ways in which judgments may preclude a future lawsuit.[94] As the Supreme Court has explained, the doctrine of claim preclusion provides that when a final judgment has been entered by a court of competent jurisdiction on the merits of a case, it concludes or extinguishes the entire claim or cause of action in controversy.[95] This bar precludes the parties or their privies from relitigating issues that were or could have been raised in that action.[96] Where the second action, however, is based upon a different claim or cause of action, the prior judgment only operates to preclude the relitigation of specific issues that were actually litigated in the earlier action.[97] Thus, in that situation, the prior judgment does not preclude litigation of matters that might have been but actually were not litigated and determined in the earlier action.[98] This latter type of preclusion is called "issue preclusion."[99]

Central to the doctrine of claim preclusion is the notion of a claim.[100] Courts do not agree on a single definition of a claim.[101] The federal courts, however, generally have adopted the modern transactional approach expressed in the Restatement (Second) of Judgments. This approach defines a claim broadly and provides that the claims extinguished by a first judgment "includes all rights of the plaintiff to remedies against the defendant with respect to all or any part of the transaction, or series of connected transactions, out of which the action arose."[102]

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91. *See* Barnett v. Stern, 909 F.2d 973, 977 (7th Cir. 1990).

92. BATOR, *supra* note 90, at 1598.

93. *See* JACK H. FRIEDENTHAL ET AL., CIVIL PROCEDURE 610-11 (2d ed. 1993).

94. *See id.* at 610.

95. *See* Nevada v. United States, 463 U.S. 110, 129 (1983); Cromwell v. County of Sac, 94 U.S. 351, 352-53 (1876).

96. *See* Allen v. McCurry, 449 U.S. 90, 94 (1980); *Nevada*, 463 U.S. at 352-53.

97. *See Cromwell*, 94 U.S. at 352-353.

98. *See* FLEMING JAMES, JR. ET AL., CIVIL PROCEDURE 607 (4th ed. 1992).

99. *See id.* at 607-08.

100. *See* FRIEDENTHAL ET AL., *supra* note 93, at 662.

101. *See* FRIEDENTHAL ET AL., *supra* note 93, at 623.

102. RESTATEMENT (SECOND) OF JUDGMENTS § 24(1) (1982). *See* Gene R. Shreve, *Preclusion and Federal Choice of Law*, 64 TEX. L. REV. 1209, 1212 (1986) ("In more recent times, however, many lower federal courts have adopted the expansive definition of a claim contained in the Restatement (Second) of Judgments, and the Supreme Court has indicated that it may do the same"); Nevada v. United States, 463 U.S. 110, 131 n.12 (1983) (praising the Second Restatement's approach to the definition of a claim); Central States v. Plymouth Concrete, Inc., 803 F. Supp. 169,

171 (N.D. Ill. 1992) ("The Seventh Circuit has adopted the transactional approach of the Restatement (Second) of Judgments in determining whether the cause of action in the second suit is identical to that set forth in the first."). In determining which factual groupings constitute a transaction, courts are to take a pragmatic approach, "giving weight to such considerations as (1) whether the facts are related in time, space, origin or motivation, (2) whether they form a convenient trial unit, and (3) whether their treatment as a unit conforms to parties' expectations or business understanding or usage." *See* RESTATEMENT (SECOND) OF JUDGMENTS § 24(2) (1982). *See also* Northern Natural Gas Co. v. Grounds, 931 F.2d 678, 683 (10th Cir. 1991) ("The Restatement of Judgments defines 'transaction or series of transactions' pragmatically, by looking at 'whether the facts are related in time, space, origin or motivation, whether they form a convenient trend unit. . . .'"); *see generally* Harnett v. Billman, 800 F.2d 1308 (4th Cir. 1986).

The doctrine of claim preclusion promotes a number of policies. First, the doctrine promotes the state's interest in bringing an end to litigation. *See* JAMES ET AL., *supra* note 98, at 581.

Second, it protects parties against repetitive, vexatious litigation. *See* FRIEDENTHAL ET AL., *supra* note 93, at 617. Thus, the most important purpose of res judicata is to provide repose for both the parties and the public. *See* FRIEDENTHAL ET AL., *supra* note 93, at 618. Third, principles of preclusion conserve scarce judicial resources by preventing relitigation of the same dispute. *See* FRIEDENTHAL ET AL., *supra* note 93, at 617. This is significant in light of the fact that commentators have expressed concern that federal court dockets are overcrowded. *See* Paul D. Carrington, *Crowded Dockets and the Courts of Appeals: the Threat to the Function of Review and the National Law*, 82 HARV. L. REV. 542 (1969); BATOR, *supra* note 90, at 43 (workload of federal courts "was approaching crisis proportions"). *But see* Edward W. Cleary, *Res Judicata Reexamined*, 57 YALE L.J. 339, 348-49 (1948) (arguing that promoting judicial efficiency is an unconvincing justification for claim preclusion). Fourth, the doctrine promotes reliance on judicial decisions and the stability of judgments. Stability of judgments is important so that the moral force of judgments is not undermined. *See* FRIEDENTHAL ET AL., *supra* note 93, at 617-18. *See* JAMES ET AL., *supra* note 98, at 581.

The Supreme Court has recently emphasized the importance of res judicata. In *Federated Department Stores, Inc. v. Moitie*, 452 U.S. 394 (1981), the Court observed that "[the] doctrine of res judicata serves vital public interests beyond any individual judge's ad hoc determination of the equities in a particular case," and that it is 'not a mere matter of practice or procedure inherited from a more technical time than ours.'" *Id.* at 401. According to the Court, res judicata "is a rule of fundamental and substantial justice, 'of public policy and of private peace,' which should be cordially regarded and enforced by the courts." *Id.* (quoting Hart Steel Co. v. Railroad Supply Co., 244 U.S. 294, 299 (1917)).

B. Should Non-Core Proceedings Have Been Brought In the Bankruptcy Court?

In determining whether claim preclusion is appropriate, one must define the breadth of the claim in the first law suit.[103] The process of defining the claim is aimed at defining the matters that might and *should* have been advanced in the first litigation.[104] As the Supreme Court has explained, "[c]laim preclusion refers to the effect of a judgment in foreclosing litigation of a matter that has never been litigated, because of a determination that it *should* have been advanced in an earlier suit."[105] Thus, a threshold issue is whether non-core proceedings should have been brought in the bankruptcy court.

1. Are Non-Core Claims Permissive?

Non-core claims are not claims that should have been brought in the bankruptcy court because the language of the 1984 Act indicates that those claims should be viewed as permissive or non-compulsory claims. In order for claim preclusion to bar non-core claims, in effect, non-core claims must be viewed as compulsory claims—i.e., litigants must assert them if they are not to lose those claims. That interpretation, however, is inconsistent with the permissive language of 28 U.S.C. § 157. Section 157(c)(1) provides that a bankruptcy judge "may" hear non-core proceedings.[106] Given this permissive language, non-core claims should not be viewed as claims that *must* be asserted in the bankruptcy court on pain of being barred by res judicata.

An analogous situation is presented in the context of cross-claims. Rule 13(g) of the Federal Rules of Civil Procedure provides that co-parties "may" assert cross-claims against one another that arise out of the transaction that is the subject matter of the original action.[107] Focusing on the permissive

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103. CHARLES A. WRIGHT ET AL., FEDERAL PRACTICE AND PROCEDURE § 4406, at 45 (1981).

104. *Id.*

105. Migra v. Warren City Sch. Dist. Bd. of Educ., 465 U.S. 75, 77 n.1 (1984) (emphasis added).

106. *See* 28 U.S.C. § 157(c)(1) (1994) ("A bankruptcy judge may hear a proceeding that is not a core proceeding but that is otherwise related to a case under [T]itle 11.").

107. *See* FED. R. CIV. P. 13(g) ("A pleading *may* state as a cross-claim any claim by one party against a co-party arising out of the transaction or occurrence that is the subject matter either of the original action or of a counterclaim therein. . . .") (emphasis added).

language in Rule 13(g)—*i.e.*, the term "may"—courts have concluded that cross-claims are not compulsory and litigants are not barred from bringing the claim in a subsequent action, even if that claim arose out of the same transaction as the original action.[108] In the same way, the permissive language in 28 U.S.C. § 157(c)(1) should be read to mean that non-core claims are permissive and should not be barred by res judicata even if they arise out of the same transaction as the litigation before the bankruptcy court.

2. Are the Non-Core Proceedings Part of the Same "Transaction"?

In the alternative, non-core claims are not claims that should have been brought in the bankruptcy court because core and non-core claims should not be viewed for purposes of res judicata as arising out of the same transaction. According to the modern approach, what factual groupings constitute a transaction is to be determined pragmatically—one is to consider whether the facts are related in time and space, form a convenient trial unit, and whether their treatment as a unit conforms to the parties' expectations.[109] Consideration of these factors supports finding that non-core and core claims do not form part of the same transaction. First, there may be no substantial factual overlap between core and non-core claims. Bankruptcy courts often adjudicate claims that do not derive from a common nucleus of operative fact.[110] Indeed, bankruptcy courts often decide claims that occurred months or years apart.[111] The underlying events giving rise to the claims may be totally unrelated.[112] Moreover, the parties to the claims may not be the same.[113] For these reasons, some commentators have concluded that bankruptcy jurisdiction can not be justified as a form of ancillary jurisdiction since bankruptcy jurisdiction would fail the test established in *United Mine*

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108. *See* American Sur. Co. v. Fazel, 20 F.R.D. 110, 111 (S.D. Iowa 1956) ("The cross-claim in paragraph (g) is not compulsory, and the way is left open for a litigant subsequently to make claim against a co-defendant . . . ."); FRIEDENTHAL ET AL., *supra* note 93, at 358 ("Unlike transactionally related counterclaims in some jurisdictions, cross-claims are totally permissive and may be asserted in the action at the party's option or brought in a subsequent independent action."). *See also* Gallagher v. Frye, 631 F.2d 127, 130 (9th Cir. 1980) ("This circuit has refused to apply res judicata to bar a second suit on a claim related to an earlier claim when the second claim could, but was not required, to have been joined in the first action.").

109. *See* RESTATEMENT (SECOND) OF JUDGMENTS § 24 (1982).

110. *See* John T. Cross, *Congressional Power to Extend Federal Jurisdiction to Disputes Outside Article III: A Critical Analysis from the Perspective of Bankruptcy*, 87 NW. U. L. REV. 1188, 1240 (1993).

111. *See id.*

112. *See id.*

113. *See id.*

Workers v. Gibbs[114] which provides that federal and nonfederal claims that derive from a common nucleus of operative fact may be litigated as a single case in federal court.[115] Second, it would not be convenient to try the claims together. If litigants were forced to advance non-core claims in the bankruptcy court, then in order to preserve their right to have those claims meaningfully reviewed by an Article III court the non-core claims would have to be considered *de novo* by the district court.[116] This would be an extremely inefficient result. Similarly, since bankruptcy courts cannot finally determine such non-core claims absent a party's consent, litigants would not expect that such non-core claims would be treated as a trial unit with core claims. For these reasons, non-core and core claims should not be considered to have arisen from the same transaction.[117] Non-core claims arise out of a different transaction from the core claims, and therefore, they constitute different claims for purposes of claim preclusion. This is consistent with the Restatement's position that "limitations on [the] authority of the tribunal should carry corresponding limitations on the scope of 'claim' for purposes of the rule of claim preclusion."[118] Therefore, bankruptcy court judgments should not bar non-core claims.

C. Limitations of First Proceedings

The bankruptcy court is a court of limited jurisdiction. It has no jurisdiction to decide non-core claims with finality, absent consent by the parties.[119] This fact is significant. Limitations on the jurisdiction of a first court may justify a relaxation of the general requirement that all parts of a single claim be advanced.[120] Indeed, a basic principle of res judicata states that the doctrine of claim preclusion does not apply where the jurisdiction of

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114. 383 U.S. 715, 725 (1966).

115. *See* Cross, *supra* note 110, at 1241.

116. *See infra* notes 170-209 and accompanying text.

117. *See* STEPHEN C. YEAZELL ET AL., CIVIL PROCEDURE 897 (3d ed. 1992) (where there are reasons not to try all claims in a single suit, "it casts some doubt on whether the . . . claims should be treated as one for [claim] preclusion purposes").

118. RESTATEMENT (SECOND) OF JUDGMENTS § 83 cmt. g, at 276 (1982). *See also* Texas Employers' Ins. Ass'n v. Jackson, 862 F.2d 491, 502 (5th Cir. 1988), *cert. denied*, 490 U.S. 1035 (1989).

119. *See* Howell Hydrocarbons, Inc. v. Adams, 897 F.2d 183, 189 (5th Cir. 1990) (bankruptcy court had no jurisdiction over the non-core claims); Sanders Confectionery Prod., Inc. v. Heller Fin., Inc., 973 F.2d 474, 483 (6th Cir. 1992) (bankruptcy court has no subject matter jurisdiction over non-core claims).

120. *See* WRIGHT ET AL., *supra* note 103, § 4407, at 48-64.

the first court was limited in that it could not give the party complete relief.[121] Accordingly, this section of the article argues that bankruptcy judgments should not bar non-core claims because that would be contrary to this basic principle.

1. The Restatement Approach

Because federal courts have often followed the approach of the Restatement, it is helpful to consider it.[122] Section 24 of the Restatement sets out the general rule of claim preclusion and, in essence, provides that a final judgment extinguishes all claims arising out of the same operative nucleus of fact.[123] Section 26 of the Restatement, however, qualifies this general rule. Section 26(1)(c) provides that the general rule of Section 24 does not apply to extinguish a claim where the plaintiff was unable to rely on a certain theory of the case or obtain complete relief in the first action because of the limitation on the subject matter jurisdiction of the courts or restrictions on their authority to entertain multiple theories.[124] Significantly, the Supreme Court quoted this provision of the Restatement with approval in *Marrese v. American Academy of Orthopaedic Surgeons*.[125]

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121. RESTATEMENT (SECOND) OF JUDGMENTS § 26, at 233-34 (1982).

122. *See supra* note 102 and accompanying text.

123. *See* RESTATEMENT (SECOND) OF JUDGMENTS § 24(1) (1982) ("When a valid and final judgment rendered in an action extinguishes the plaintiff's claim pursuant to the rule of merger or bar, . . . the claim extinguished includes all rights of the plaintiff to remedies against the defendant with respect to all or any part of the transaction, or series of connected transactions, out of which the action arose.").

124. *See* RESTATEMENT (SECOND) OF JUDGMENTS § 26(1)(c) (1982) which provides that the general rule of claim preclusion does not apply where:

> the plaintiff was unable to rely on a certain theory of the case or to seek a certain remedy or form of relief in the first action because of the limitations on the subject matter jurisdiction of the courts or restrictions on their authority to entertain multiple theories or demands for multiple remedies or forms of relief in a single action, and the plaintiff desires in the second action to rely on that theory or to seek that remedy or form of relief.

125. 470 U.S. 373, 382 (1985) (noting that claim preclusion generally does not apply where "the plaintiff was unable to rely on a certain theory of the case or to seek a certain remedy because of the limitations on the subject matter jurisdiction of the courts") (quoting RESTATEMENT (SECOND) OF JUDGMENTS § 26(1)(c) (1982)). The lower federal courts also have followed the Restatement in holding that claim preclusion does not apply where the first court's jurisdiction was limited. *See, e.g.*, Texas Employers Ins. Ass'n v. Jackson, 862 F.2d 491, 502 (5th Cir. 1988) ("Thus, this case fits into a well recognized exception to claim preclusion, as provided in Restatement (Second) of Judgments § 26(1)(c), for instances where the relief sought

Comment g to Section 24 explains that the Section 26 exception to the general rule against claim splitting where the first court is one of limited jurisdiction, is sometimes not available. The exception is not available where the first court has no jurisdiction to give an award for more than a designated amount; however, a court of general jurisdiction was available to the plaintiff in the same system of courts in which the plaintiff could have obtained complete relief.[126] When the plaintiff brings an action in such a court and recovers judgment for the maximum amount which the court can award, the plaintiff is precluded from thereafter maintaining an action to the balance of his claim.[127] The comment justifies this result by emphasizing the plaintiff's voluntary action: "The plaintiff, having voluntarily brought his action in a court which can grant him only limited relief, cannot insist upon maintaining another action on the claim."[128]

Comment c to Section 26 of the Restatement further explains when an exception based on the limited jurisdiction of the first court is available. Comment c states that the general rule of Section 24 is based on the assumption that the jurisdiction in which the first judgment was rendered was one which placed no formal barriers in the way of the litigants presenting to a court in one action the entire claim.[129]

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or theory advanced in the first suit is cognizable only before a court of limited jurisdiction not competent to act on the theory advanced or relief sought in the second suit."); Washam v. J.C. Penney Co., 519 F. Supp. 554, 558-59 (D. Del. 1981) ("The settled principles of *res judicata*, as articulated in the proposed RESTATEMENT (SECOND) OF JUDGMENTS, limit the general rule preventing splitting of claims . . . '[w]hen . . .the plaintiff was unable to rely on a certain theory of the case or to seek a certain remedy or form of relief in the first action because of the limitations on the subject matter jurisdiction of the courts.'") (quoting RESTATEMENT (SECOND) OF JUDGMENTS (Tentative Draft No. 5) § 61.2(1) (1978)); Green v. Illinois Dept. of Transp., 609 F. Supp. 1021, 1025-26 (N.D. Ill. 1985) ("claim preclusion does not apply where limitations on first court's jurisdiction prevented litigation of theory or availability of remedy") (citing RESTATEMENT (SECOND) OF JUDGMENTS § 26(1)(c) (1982)).

126. *See* RESTATEMENT (SECOND) OF JUDGMENTS § 24 cmt. g (1982). *See also* Douglass G. Boshkoff, *Bankruptcy in the Seventh Circuit: 1989-1990*, 24 IND. L. REV. 551, 564 (1991) (recognizing the importance of determining the applicability of the Restatement's Section 26 exception to the general rule against claim splitting where the first court is one of limited jurisdiction in analyzing the res judicata effect of bankruptcy court judgments).

127. *See* RESTATEMENT (SECOND) OF JUDGMENTS § 24 cmt. g (1982).

128. *Id.*

129. *See id.* Section 26 cmt. c reads:

The general rule of Section 24 is largely predicated on the assumption that the jurisdiction in which the first judgment was rendered was one which put no formal barriers in the way of a litigants' presenting to a court in one

Given this, a question arises as to whether formal barriers existed with respect to presenting all of plaintiff's claims initially in the district court—the court of greater jurisdiction—as opposed to the bankruptcy court. Such formal barriers existed; thus, litigants should be entitled to take advantage of the exception to the general rule against claim splitting where the initial action is brought in a court of limited jurisdiction. The district courts have original and exclusive jurisdiction over all bankruptcy cases.[130] Each district court is authorized to refer cases within the district court's 1334(a) & (b) jurisdiction to the bankruptcy judges of the district.[131] Indeed, the district courts in each judicial district have since promulgated local rules providing for automatic referral of all bankruptcy matters to the bankruptcy judges of the district.[132] Once the cases are referred to the bankruptcy court, a district court may withdraw in whole or in part, any case that previously was referred to the bankruptcy court, on motion of any party, for cause shown.[133] Thus, a district court has discretion to refuse to withdraw most cases.[134] Given this, a party has no absolute right to present all claims initially in the court of greater jurisdiction—the district court.[135]

Under these circumstances, parties can not fairly be said to have chosen voluntarily to litigate their claims initially in bankruptcy court as opposed to a court of greater jurisdiction—the district court. Formal barriers exist preventing a bankruptcy litigant's presentation of the entire claim to a court of greater jurisdiction in one action. Thus, parties litigating in bankruptcy courts should be entitled to rely on the general exception to the claim splitting rule expressed in Section 26 of the Restatement governing cases where the "plaintiff was unable to rely on a certain theory of the case . . . in the first

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> *action the entire claim* including any theories of recovery or demands for relief that might have been available to him under applicable law. When such formal barriers in fact existed and were operative against a plaintiff in the first action, it is unfair to preclude him from a second action in which he presents those phases of the claim which he was disabled from presenting in the first

(emphasis added). *See also* Boshkoff, *supra* note 126, at 565.

130. 28 U.S.C. § 1334(a),(b) (1994).

131. 28 U.S.C. § 157(a) (1994).

132. *See* NORTON, *supra* note 47, § 5.02 ("Every federal district court in each of the 106 federal districts opted to issue a general order of reference of all present and future bankruptcy cases.").

133. 28 U.S.C. § 157(d) (1994).

134. *See* 28 U.S.C. § 157(d) (1994).

135. For example, in *In re* Auto, 134 B.R. 188 (1990), the court held that it was not required to withdraw its reference of a RICO claim to bankruptcy court.

action because of the limitation on the subject matter jurisdiction of the courts."[136]

The fact that a litigant could have asserted non-core claims in the bankruptcy court with that court in turn submitting proposed findings of fact and conclusions of law to the district court does not require a contrary conclusion. The doctrine of claim preclusion bars claims that "could have been raised" in a prior action.[137] The ability to assert non-core claims in the bankruptcy court, however, should not be interpreted to mean that such claims "could have been raised" in that tribunal so as to raise the bar of res judicata. In order to meet the doctrinal requirement of "could have been raised," the first forum must have had subject matter jurisdiction over the claim.[138] Since the bankruptcy court does not have subject matter jurisdiction over non-core claims absent a party's consent,[139] such claims "could not have been raised" in the bankruptcy court within the meaning of the doctrine of res judicata.

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136. *In re Auto*, 134 B.R. at 233. The argument that litigants should not be viewed as having voluntarily chosen to litigate in the bankruptcy courts finds support in the analogous situation where the issue is whether a prior state court judgment should be given claim preclusive effect so as to bar the assertion of a claim within the exclusive jurisdiction of the federal courts—e.g., an antitrust claim. Some argue that state court judgments should bar such federal claims where the federal court plaintiff chose the forum in the initial state court action—i.e., they were the plaintiff in the earlier state court action and selected a forum that could give only partial relief. *See, e.g.*, Note, *Res Judicata: Exclusive Federal Jurisdiction and the Effect of Prior State-Court Determinations*, 53 VA. L. REV. 1360, 1365 (1967). On the other hand, according to some commentators, a defendant in the earlier state court action should not be viewed as having chosen that forum even though, if the defendant could have removed the case to federal court, he could be said to have chosen the forum. *See id.* at 1365 n.25. They argue that defendants can not be said to have freely chosen the forum because "a defendant in a state court may be able to remove in only very limited circumstances." *Id.* Even if he can remove, "[r]emoval in such a case may not be the full 'choice' that the plaintiff may have had when he initiated the suit." *Id.* at 1366 n.25. Under these circumstances, claim preclusion should not bar the assertion of a claim within the exclusive jurisdiction of the federal court. *See id.* In the same way, as discussed, a bankruptcy court litigant has not freely chosen the initial bankruptcy court forum and cannot freely remove the case to the court of greater jurisdiction—the district court. Thus, the doctrine of claim preclusion should not bar the non-core claim.

137. *See supra* note 96 and accompanying text.

138. *See* David J. Schulte, Comment, *The Claim Preclusive Effect of State Court Judgments on Federal Antitrust Claims:* Marrese v. American Academy of Orthopaedic Surgeons, 71 IOWA L. REV. 609, 617 (1986).

139. *See* Sanders Confectionery Prod., Inc. v. Heller Fin., Inc., 973 F.2d 474, 483 (6th Cir. 1992) (bankruptcy court would not have subject matter jurisdiction over a non-core related proceeding).

2. The Exclusive Federal Jurisdiction Analogy

An analogous situation is presented where state court adjudication is followed by an action brought in the exclusive jurisdiction of the federal court. For example, antitrust and securities actions fall within the exclusive jurisdiction of the federal courts.[140] In these cases, an important issue is whether cases brought in exclusive federal jurisdiction should be immune from the preclusive effects of state court judgments.[141] Because the rules that courts have developed in this analogous context are instructive as to what rule should be adopted in the bankruptcy court context, an analysis of these cases is required. As discussed below, these analogous cases support the proposition that bankruptcy court judgments should not bar non-core claims.

a. The Marrese Case

The Supreme Court recently considered this issue in *Marrese v. American Academy of Orthopaedic Surgeons*.[142] It is worth considering the opinion in some detail. In *Marrese*, two board-certified orthopaedic surgeons applied for membership in the American Academy of Orthopaedic Surgeons (the Academy). The Academy denied their membership applications. The surgeons filed separate suits in Illinois state courts, alleging violations of Illinois common law. Neither surgeon alleged a violation of state antitrust law or filed a federal antitrust suit. The Illinois courts ruled against both surgeons.

Subsequently, the surgeons filed a federal antitrust suit in federal district court, based on the same events underlying their state court actions. The Academy filed a motion to dismiss, arguing that, based on the earlier state court judgments, the doctrine of claim preclusion barred the federal antitrust suit. The court reasoned that state courts lack jurisdiction over federal antitrust claims, and therefore, a state court judgment could not have a claim preclusive effect in a subsequent federal antitrust suit.[143] The Seventh

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140. *See* 15 U.S.C. §§ 15, 26 (1994) (antitrust); 15 U.S.C. § 78(a) (1994) (securities).

141. *See, e.g.*, Note, *Res Judicata: Exclusive Federal Jurisdiction and the Effect of Prior State-Court Determinations*, *supra* note 136, at 1360; Note, *The Res Judicata and Collateral Estoppel Effect of Prior State Suits on Actions Under SEC Rule 10b-5*, 69 YALE L.J. 606 (1960); Note, *The Effect of Prior Nonfederal Proceedings on Exclusive Federal Jurisdiction over Section 10(b) of the Securities Exchange Act of 1934*, 46 N.Y.U. L. REV. 936 (1971).

142. 470 U.S. 373 (1985). For an analysis of the Supreme Court's decision in *Marrese v. American Academy of Orthopaedic Surgeons*, *see* Shreve, *supra* note 102, at 1222.

143. *Marrese*, 470 U.S. at 376.

Circuit reversed, holding that claim preclusion barred the federal antitrust suit.[144]

The Supreme Court reversed.[145] At issue was whether a state court judgment could have preclusive effect on a federal antitrust claim that could not have been raised in the state court action because federal antitrust claims are within the exclusive jurisdiction of the federal courts. While not directly deciding whether preclusion should apply in this case, the Supreme Court found that the Seventh Circuit erred by suggesting that a federal court should determine the preclusive effect of a state court judgment without regard to the law of the state in which the judgment was rendered.[146] The Court held that the preclusive effect of a state court judgment in a subsequent federal lawsuit generally is determined by the full faith and credit statute. The statute provides that state judicial proceedings "shall have the same full faith and credit in every state within the United States."[147] The Court stated that Section 1738 directs a federal court to the preclusion law of the state in which the judgment was rendered in order to determine the preclusive effect of a state judgment.[148] The Court, however, left open the possibility that there might be express or implied exceptions to § 1738,[149] and that the Due Process Clause might require a different result than that provided by the state preclusion law.[150]

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144. *Id.* at 377.

145. *Id.* at 378.

146. *Id.* at 380.

147. 28 U.S.C. § 1738 (1994). *See also* Shreve, *supra* note 102, at 1223 (The *Marrese* Court stated "that section 1738 requires a federal court considering the preclusive effect of a state judgment to begin its inquiry by examining state preclusion law. The circuit court erred in disregarding Illinois state law.").

148. *Marrese*, 470 U.S. at 380.

149. *Id.* at 381. *See also* Shreve, *supra* note 102, at 1224 ("Congress did not have to enact the original full faith and credit statute, and . . . it is free either to repeal it or to lighten its obligations by amending it to create exceptions.").

150. *Marrese*, 470 U.S. at 380. Applying these principles, the Court noted that with respect to matters that were not decided in the state proceedings, claim preclusion generally does not apply where "[t]he plaintiff was unable to rely on a certain theory of the case or to seek a certain remedy because of the limitations on the subject matter jurisdiction of the courts." *Id.* at 382 (quoting RESTATEMENT (SECOND) OF JUDGMENTS § 26(1)(c) (1982)). The Court stated that if the relevant state preclusion law includes this requirement of jurisdictional competency, a state judgment will not have claim preclusive effect on a cause of action within the exclusive jurisdiction of the federal courts. *Id.* at 382. The Court observed that the issue of whether there is an exception to section 1738 arises only if state law indicates that litigation of a particular claim should be barred in the later federal action. *Id.* at 383. The Court considered Chief Justice Burger's suggestion in a separate opinion that a federal rule

Marrese is an important opinion. It is, however, distinguishable from the bankruptcy situation. In the bankruptcy context, there is no problem of comity and deference to state law principles of preclusion. The preclusive effect of bankruptcy judgments is a function of federal law.[151] *Marrese*, then, does not directly address what the federal rule should be in this instance.[152] In considering what the federal rule should be in the bankruptcy context, it is worth examining what federal res judicata rules were formulated prior to *Marrese* where a state court judgment is followed by an action brought in the exclusive jurisdiction of the federal courts.

b. The Federal Law Prior to Marrese

In this connection, a leading case is the Second Circuit's decision in *Lyons v. Westinghouse Electric Corporation*.[153] Westinghouse sued Lyons in state court, alleging breach of contract. Lyons pleaded an affirmative defense based on federal antitrust laws. After a trial, the state court ruled against Lyons.[154]

Subsequently, Lyons sued Westinghouse in the federal district court, alleging federal antitrust claims, based on the same facts as the state court proceeding. On appeal, the issue was whether the doctrine of claim preclusion

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should be crafted reflecting the general preclusion principle that the judgment of a court of limited jurisdiction concludes the claim where the plaintiff might have commenced his action in a court of greater jurisdiction that was competent to give full relief. *See id.* at 383 n.3. The Court also acknowledged that the Seventh Circuit's decision approximated such a rule because it encouraged plaintiffs to file suit initially in federal district court and to attempt to bring any state law claims as pendent claims to their federal antitrust claims. The Court observed that "[i]f we had a single system of courts and our *only* concerns were efficiency and finality, it might be desirable to fashion claim preclusion rules that would require a plaintiff to bring suit initially in the forum of most general jurisdiction . . ." *Id.* at 385. The Court, however, rejected that approach because it ignored important concerns of comity reflected in section 1738 which generally allow states to determine the preclusive effect of their own courts' judgments. *Id.*

151. *See supra* note 91 and accompanying text.

152. *See also* Boshkoff, *supra* note 126, at 566 (recognizing that *Marrese* does not provide an answer to the question of the res judicata effect of bankruptcy court judgments).

153. 222 F.2d 184 (2d Cir. 1955). *See* Note, *Res Judicata: Exclusive Federal Jurisdiction and the Effect of Prior State-Court Determinations*, *supra* note 136, at 1364 ("A discussion of the cases in which the state-court defendant is a plaintiff in federal court or an exclusively federal claim must focus initially on *Lyons v. Westinghouse Electric Corp.*").

154. *Lyons*, 222 F.2d at 185.

barred assertion of the federal antitrust claims based on the earlier state court judgment, even though federal courts had exclusive jurisdiction to hear federal antitrust claims. Judge Learned Hand, writing for the Second Circuit, held that the grant to the district courts of exclusive jurisdiction over antitrust actions "should be taken to imply an immunity of their decisions from any prejudgment elsewhere; at least on occasions, like those at bar, where the putative estoppel includes the whole nexus of facts that makes up the wrong."[155] The court reasoned that one of the purposes of exclusive jurisdiction was to promote the uniform administration of the federal antitrust laws.[156] The court concluded that it could best promote such uniformity "by an untrammeled jurisdiction of the federal courts."[157] According to the Second Circuit, the "delay and expense of a double trial of the same issue" did not outweigh the policy of promoting a uniform federal antitrust law as expressed in the exclusive federal jurisdiction statute.[158]

In *Lyons*, the plaintiff in the federal action was the defendant in the prior state court litigation. Thus, some commentators argued that the *Lyons* decision which held that claim preclusion should not bar the federal antitrust claim, could be partially explained on the ground that the defendant in the state action did not choose a forum that could only give partial relief.[159]

The Second Circuit, however, later made clear that claim preclusion would not bar the federal antitrust claim even where the federal plaintiff had also been the plaintiff in state court. In *International Railways of Central America v. United Fruit Company*,[160] stockholders of International Railways of Central America sued United Fruit in state court alleging certain state law claims arising out of United Fruit's acquisition of International Railways. The stockholders lost in the state court.[161]

Later, International Railways filed a suit in federal court alleging antitrust violations based on the same facts underlying the state court suit. Relying heavily on the fact that the plaintiff had chosen the earlier state court which

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155. *Id.* at 189.

156. *See id.*

157. *Id. See also* Note, *Res Judicata: Exclusive Federal Jurisdiction and the Effect of Prior State-Court Determinations*, *supra* note 136, at 1365 (The *Lyons* court's conclusion "promotes uniform application of the antitrust laws by leaving federal jurisdiction 'untrammeled.'").

158. *Lyons*, 222 F.2d at 190.

159. *See, e.g.*, Note, *Res Judicata: Exclusive Federal Jurisdiction and the Effect of Prior State-Court Determinations*, *supra* note 136, at 1365 ("Another, though less obvious, justification for the [*Lyons*] court's opinion is that Lyons, as defendant in the state action, had not had the choice of forum.").

160. 373 F.2d 408 (2d Cir.), *cert. denied*, 387 U.S. 921 (1967).

161. *Id.* at 409.

could give him only partial relief, the district court held that claim preclusion barred the antitrust claims.[162] The Second Circuit reversed, holding that even where the plaintiff had selected the initial state court forum, the prior state court judgment should not bar a claim within the exclusive jurisdiction of the federal courts.[163]

Lyons and *United Fruit* stood for the proposition, prior to *Marrese*, that state court judgments should not bar claims within the exclusive jurisdiction of the federal courts. According to those courts, the reason for such a rule is to promote the uniformity of federal law.

On the other hand, the basic argument in favor of allowing a state court judgment to bar the assertion of a claim within the exclusive federal jurisdiction "is that a claimant who could have taken both state and federal theories to federal court should be precluded by the choice to advance only a state theory in the state court."[164] This rule promotes judicial efficiency and the protection of the defendant.[165] Although some courts[166] and commentators[167] took such a position, the weight of authority rejected the view that a state court judgment should bar the assertion of a claim within the exclusive jurisdiction of the federal courts.[168]

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162. International Ry. of Central America v. United Fruit Co., 254 F. Supp. 233, 236-37 (S.D.N.Y. 1966).

163. 373 F.2d at 418. *See also* Note, *Res Judicata: Exclusive Federal Jurisdiction and the Effect of Prior State-Court Determinations*, *supra* note 136, at 1380 (The *United Fruit* case "not only ignores, but also condemns, any distinction between a case where the federal plaintiff has earlier exercised the choice of forum and where he has not.").

164. WRIGHT ET AL., *supra* note 103, § 4470.

165. *See* WRIGHT ET AL., *supra* note 103, § 4470.

166. *E.g.*, Nash County Bd. of Educ. v. Biltmore Co., 640 F.2d 484 (4th Cir. 1981).

167. *E.g.*, Note, *The Res Judicata and Collateral Estoppel Effect of Prior State Suits on Actions Under SEC Rule 10b-5*, *supra* note 141, at 606.

168. *See, e.g.*, WRIGHT ET AL., *supra* note 103, at 688 ("On balance it seems better to reject claim preclusion"); RESTATEMENT (SECOND) OF JUDGMENTS § 26, cmt. c and illus. 2 (1982); *id.* § 26, Reporter's Note to cmt. c ("when the plaintiff, after having lost a state action, seeks relief with respect to the same transaction under a federal statute enforceable only in federal court, it may be argued that he should be held barred especially if he could have instituted his original suit in federal court where both federal and state grounds could have been considered, and more especially if the applicable state law was very similar to the federal. It appears sounder, however, not to preclude the federal action by the doctrine of bar."); Cream Top Creamery v. Dean Milk Co., 383 F.2d 358 (6th Cir. 1967); Seagoing Uniform Corp. v. Texaco, Inc., 705 F. Supp. 918, 921 (S.D.N.Y. 1989) ("If because of jurisdictional restrictions a plaintiff is unable to assert his claim in its entirety in a prior proceeding, the general rule

Given the reasoning in these analogous cases, the argument against claim preclusion in the bankruptcy context seems at least as strong as in the exclusive federal jurisdiction context. Article III values are central to our constitutional scheme of government.[169] Indeed, Article III is crucial to preserving the fundamental ideal of the rule of law in American society.[170] The policies of Article III, then, seem at least as important as the policies promoted by exclusive federal jurisdiction—*e.g.*, uniformity of federal law. Thus, if claim preclusion should not be allowed in order to protect exclusive federal jurisdiction, then claim preclusion should not be allowed to undermine Article III jurisdiction. Thus, just as the grant of exclusive federal jurisdiction to the federal district courts should be taken to mean that their decisions are immune from prejudgment, the Article III grant of jurisdiction to the federal district courts should be taken to mean that their decisions regarding non-core claims are immune from prejudgment by the bankruptcy courts, where the litigants have not consented to such bankruptcy court jurisdiction. Thus, bankruptcy court judgments should not bar non-core claims.

D. Principles of Preclusion, the Preservation of Article III Values and the Promotion of Judicial Efficiency

If principles of res judicata are applied to bankruptcy court judgments, Article III values may be undermined or judicial economy may be undermined in an effort to preserve such values. Parties would be required to raise their non-core claims in the bankruptcy courts on pain of having the doctrine of claim preclusion bar those claims. Bankruptcy courts may hear such non-core proceedings, but they may not enter a final order or judgment, absent the party's consent.[171] In such a situation bankruptcy courts may only follow a recommended disposition procedure.[172] Thus, they may hear such claims and propose findings of fact and conclusions of law to the district court.[173]

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against claim splitting will not be applicable against him."); Wellington Computer Graphics, Inc. v. Modell, 315 F. Supp. 24, 26 (S.D.N.Y. 1970) ("Since the New Jersey Court lacks subject matter jurisdiction over plaintiff's claim under Section 10(b) and Rule 10(b)(5), a final judgment there could not have res judicata effect here."); Kaham v. Rosensteil, 285 F. Supp. 61, 63 (D. Del. 1968).

169. *See supra* notes 12-20 and accompanying text.

170. *See supra* notes 12-20 and accompanying text.

171. 28 U.S.C. § 157(c)(1) (1994).

172. *See* 28 U.S.C. § 157(c)(1) (1994).

173. *See* 28 U.S.C. § 157(c)(1) (1994).

1. The Problem of De Facto Adjudication, Meaningful Review and Judicial Economy

Such potentially dispositive bankruptcy recommendations raise potential Article III problems or problems of judicial efficiency. *Schor* has made clear that litigants have a personal Article III right to a fair and independent tribunal.[174] That right is threatened by potentially dispositive bankruptcy recommendations inasmuch as they raise the specter of de facto bankruptcy court adjudication of non-core proceedings.[175] There are a number of analogous cases dealing with the delegation of duties to magistrates that are instructive on this point.[176] For example, in *Wingo v. Wedding*[177] the Supreme Court held that both the Federal Habeas Corpus statute[178] and the 1968 Magistrates Act[179] restricted habeas corpus evidentiary hearings to district judges.[180] Magistrates, non-Article III judges, could not hear such proceedings and then make recommendations to the district court judge.[181] In part, the Court reached this conclusion because the recommended disposition procedure would inevitably result in the risk of de facto magistrate adjudication since the habeas petitions turned largely on factual determinations that are highly dependent on evaluations of witness credibility.[182] The Court concluded that even judicial review of recorded testimony may be unable to guarantee that such habeas petitions would always receive judicial, rather than magistrate determination.[183]

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174. *See* Commodity Futures Trading Comm'n v. Schor, 478 U.S. 833, 848 (1986) ("Article III, § 1 serves . . . to safeguard litigants' 'right to have claims decided before judges who are free from potential domination by other branches of government.'").

175. *Cf.* Reinier H. Kraakman, *Article III Restraints and the Expanding Civil Jurisdiction of Federal Magistrates: A Dissenting View*, 88 YALE L.J. 1023, 1041-1047 (1979) (arguing that magistrates' recommended disposition of proceedings presents constitutional problems because of the risk of de facto magistrate adjudication).

176. Magistrates are non-Article III judges in that they lack the Article III protections. *See* 28 U.S.C. § 631(e) (1994). For example, magistrates are appointed for terms of eight years. *See* 28 U.S.C. § 631(e) (1994). In certain proceedings, magistrates are authorized to conduct hearings and propose findings of fact and conclusions of law to the district court. *See* 28 U.S.C. § 636(b)(1)(B) (1994).

177. 418 U.S. 461 (1974).

178. 28 U.S.C. § 2241 (1976).

179. 28 U.S.C. § 636(b) (1970).

180. *Wingo*, 418 U.S. at 472; *See* Kraakman, *supra* note 175, at 1041.

181. *Wingo*, 418 U.S. at 472.

182. *Id.* at 468, 474; *see* Kraakman, *supra* note 175, at 1043.

183. *Wingo*, 418 U.S. at 465-66; *see* Kraakman, *supra* note 175, at 1043.

Subsequently, in *United States v. Raddatz*,[184] the Supreme Court suggested that delegation of Article III powers to a magistrate is permissible only if the ultimate determinations on the merits of delegated matters are made by the district judge.[185] In *Raddatz*, the district court referred a pretrial motion to suppress evidence to a magistrate. The magistrate recommended that the motion to suppress be denied. In response, the defendant argued that the Federal Magistrates Act and Article III required the district court to rehear the testimony on which the magistrate's findings and recommendations were based in order to make an independent evaluation of credibility.

In addressing the defendant's Article III argument, the Court emphasized the difference between pretrial and trial proceedings, stating that "the interests at stake in a suppression hearing are of lesser magnitude than those in the criminal trial itself."[186] The Court also noted that a "defendant who has not prevailed at the suppression hearing remains free to present evidence and argue to—and may persuade—the jury that the confession was not reliable and therefore should be disregarded."[187] Under these circumstances, the Court found that Article III did not require the district judge to rehear the evidence on which the magistrate based his findings. The Court stated that "[a]lthough the [Federal Magistrates Act] permits the district court to give the magistrates proposed findings of fact and recommendations such weight as their merit commands and the sound discretion of the judge warrants, that delegation does not violate Article III *so long as the ultimate decision is made by the district court.*"[188] Thus, *Raddatz* identified that the availability of meaningful judicial review was a necessary predicate to the constitutionality of any delegation of Article III duties to a magistrate.[189]

In *Gomez v. United States*,[190] the Supreme Court dealt with the delegation of part of a trial—as opposed to a pretrial proceeding—to a magistrate—*i.e.*, the selection of a jury.[191] The Court reaffirmed that

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184. 447 U.S. 667 (1980).

185. *Id.* at 683.

186. *Id.* at 679. *See also* United States v. Ford, 824 F.2d 1430, 1434-35 (5th Cir. 1987), *cert. denied*, 484 U.S. 1034 (1988) (Raddatz emphasized the difference between pretrial and trial proceedings and suggested that where proceedings are sufficiently preliminary to a trial, they may escape constitutional concerns.).

187. *Raddatz*, 447 U.S. at 678.

188. *Id.* at 683 (emphasis added).

189. *Id. See also Ford*, 824 F.2d at 1436 (stating that *Raddatz* requires appellate review of matters delegated by Article III judges to be "real and not illusory").

190. 490 U.S. 858 (1989).

191. *Id.* The Court emphasized that "the trial commences at least from the time when the work of empaneling the jury begins." *Id.* at 872. *See also Ford*, 824 F.2d at 1435 (holding that the selection of the jury is an essential component of the trial

appellate review of delegated matters by an Article III judge must be real and not illusory in order to satisfy the requirements of Article III.[192] The *Gomez* court considered whether the Federal Magistrates Act granted district courts authority to select a jury in a felony trial without the defendant's consent. The Federal Magistrates Act grants district courts authority to assign magistrates certain described functions as well as "such additional duties as are not inconsistent with the Constitution and laws of the United States."[193] Although the Court expressly reserved the question as to whether delegation of jury selection to a magistrate would be constitutional,[194] the court concluded that "additional duties" did not include the selection of a jury without the defendant's consent because it indicated that such delegation would raise the substantial constitutional question as to whether a defendant has a personal right to have an Article III judge preside at every critical stage of a felony trial.[195] In particular, the Court was concerned that such a personal right might be undermined because even if the Magistrates Act allowed the district court to oversee jury selection, the court "harbor[ed] serious doubts that a district judge could review this function meaningfully."[196] The Court suggested that meaningful review was impossible because "no transcript can recapture the atmosphere of the voir dire" and that to detect prejudices a court must scrutinize "not only spoken words but also gestures and attitudes of all participants to ensure the jury's impartiality."[197] To avoid these potential constitutional difficulties, the

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itself).

192. *Gomez*, 490 U.S. at 874. *See* Note, *The Federal Magistrates Act: A New Article III Analysis for a New Breed of Judicial Officer*, 33 WM. & MARY L. REV. 253, 284-85 (1992). The *Gomez* holding suggests that appellate review must be real and not illusory in order to satisfy the requirements of Article III.").

193. 28 U.S.C. § 636(b)(3) (1980).

194. *See Gomez*, 490 U.S. at 872 n.25.

195. *See* Peretz v. United States, 501 U.S. 923, 932 (1991) (observing that the holding in *Gomez* was motivated by the concern that a defendant has a constitutional right to demand that an Article III judge preside at every critical stage of a felony trial).

196. *Gomez*, 490 U.S. at 874.

197. *Id.* at 874-75. *See* Note, *The Federal Magistrates Act*, *supra* note 192, at 269 ("The [*Gomez*] Court rejected the government's argument that the availability of a district judge to review the magistrate's decisions sufficiently safeguarded the defendant's rights; because of the special nature of the *voir dire* proceeding—in which a venireman's reactions and gestures are often as important as his responses to questions—review of the record by a judge was particularly inadequate."). The court observed that even if the district court had inherent power to conduct the voir dire a second time, the time consumed by the review "would negate time initially saved by the delegation." *Gomez*, 490 U.S. at 875 n.29.

Court concluded that Congress did not intend the "additional duties" clause to include the selection of a jury without the defendant's consent.[198]

The reasoning of *Gomez* seems applicable in the bankruptcy court context since the bankruptcy cases would in substance involve the delegation of the trial of non-core claims to bankruptcy judges as opposed to pretrial matters.[199] In essence, bankruptcy judges would have to conduct a trial of the non-core claims and their recommendations for dispositions of non-core claims could also turn on factual determinations that are highly dependent on evaluations of witness demeanor or credibility. In such circumstances, it is questionable whether there could be meaningful review.[200] Given this, there is a risk of de facto bankruptcy adjudication of such claims. As Judith Resnik

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198. *Gomez*, 490 U.S. at 875. The Court followed its policy "to avoid an interpretation of a federal statute that engenders constitutional issues if a reasonable alternative interpretation poses no constitutional questions." *Id.* at 864. *But cf. Peretz*, 501 U.S. 923. In *Peretz*, the Supreme Court held that if the defendant consents, a magistrate may conduct *voir dire* and supervise the jury selection of a felony trial without violation of the Article III requirements. *Id.* at 935-36. The court explained that although the Constitution may require the presence of an Article III judge at the selection of a jury in a felony case, this right is personal in nature and may be waived by the defendant). *Id.* Thus, the Court "distinguished *Gomez* from *Peretz* on the basis of consent." Note, Peretz v. United States: *Magistrates Perform Felony Voir Dire*, 70 N.C. L. REV. 1334, 1339 (1992).

The bankruptcy court adjudication of non-core claims, however, is more analogous to the *Gomez* analytical framework. Litigants in a bankruptcy proceeding who have not consented to the bankruptcy court's final adjudication of their non-core claims cannot be reasonably viewed as waiving their constitutional right to have their non-core claims meaningfully reviewed by an Article III judge.

199. *Cf.* Note, *The Federal Magistrates Act*, *supra* note 192, at 288. "This [*Gomez*] analysis [extends beyond voir dire and] applies with equal force to the practice of allowing magistrates to conduct civil jury and nonjury trials." Note, *The Federal Magistrates Act*, *supra* note 192, at 288. Thus, the reasoning of *Gomez* extends to civil cases. *See* Note, *The Federal Magistrates Act*, *supra* note 192, at 284 n.192.

200. The classic case of *Dyer v. MacDougall*, 201 F.2d 265 (2d Cir. 1952) is instructive on this point. There, the Court of Appeals for the Second Circuit recognized that a witness's demeanor—*i.e.*, her carriage, behavior, bearing, manner and appearance—is part of the evidence. Despite this, the Court of Appeals held that demeanor evidence alone could not count as meeting a plaintiff's burden of proof. *Id.* at 269. Judge Learned Hand, writing for the court, explained that the result of holding otherwise would be that a trial judge's disposition of a motion for a directed verdict based on such demeanor evidence could not be effectively reviewed on appeal. There could be no effective review because the demeanor evidence would have disappeared. Thus, the trial judge would become the final arbiter in all cases where the evidence of witnesses present in court might be determinative. *Id.*

has argued, given workload demands the incentives to simply adopt bankruptcy judges' suggestions will be enormous.[201] Thus, she concludes that in some cases the name on the opinion will be that of the Article III judge but the real authority will be the non-Article III actor.[202] Accordingly, the risks of de facto bankruptcy court adjudication of such claims would be present if litigants were forced to present their non-core claims to the bankruptcy judge where they had not consented to final bankruptcy court adjudication of the matter. Even assuming that a district judge could meaningfully review the bankruptcy court judge's actions by re-examining witnesses, such duplicative effort would defeat the very efficiency arguments that are made in favor of allowing bankruptcy judgments to bar non-core claims.[203] This latter point is supported by analogous cases dealing with the question of whether bankruptcy judges have the power to conduct jury trials.[204] A number of courts took the position that it would be impractical for bankruptcy judges to conduct jury trials of non-core claims.[205] Because the bankruptcy court is unable to enter a final judgment without the consent of the parties, any jury verdict would be subject to *de novo* review upon appeal to the district court.[206] This review would include the holding of a new jury trial.[207] Thus, courts concluded it would be impractical and inefficient for a bankruptcy court to hold a jury trial in a non-core proceeding where the parties have not given their consent to the bankruptcy court's exercise of jurisdiction.[208] Accordingly, to avoid these potential constitutional and practical difficulties, courts should hold that bankruptcy judgments do not operate to bar non-core claims.[209]

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201. *See* Judith Resnik, *The Mythic Meaning of Article III Courts*, 56 U. COLO. L. REV. 581, 605 (1985).

202. *See id.* at 606.

203. *Cf. Gomez*, 490 U.S. at 875 n.29 ("Even assuming that a district judge could review the magistrate's actions meaningfully by . . . re-examining jurors, the time consumed by such review would negate time initially saved by the delegations.").

204. *See* S. Elizabeth Gibson, *Jury Trials in Bankruptcy: Obeying the Commands of Article III and the Seventh Amendment*, 72 MINN. L. REV. 967, 1031 (1988).

205. *See id.* at 1031.

206. *See* Reda, Inc. v. Harris Trust & Sav. Bank (*In re* Reda. Inc.), 60 B.R. 178, 182 (Bankr. N.D. Ill. 1986).

207. *Id.*

208. *Id. See also* Gibson, *supra* note 204, at 1031 n. 304 (collecting cases).

209. *Cf.* Kraakman, *supra* note 175, at 1044 (arguing that magistrate hearings could cause decisionmaking authority to "slip from judicial hands . . .").

2. The Problem of Unconstitutional Conditions

There may be other constitutional difficulties. In particular, one must consider whether application of claim preclusion to bankruptcy judgments to bar non-core claims would violate the unconstitutional conditions doctrine. The doctrine of unconstitutional conditions holds that "government may not condition the receipt of benefits upon the nonassertion of constitutional rights."[210] Two cases suffice to illustrate the doctrine. First, in *Speiser v. Randall*,[211] two veterans of World War II claimed a veteran's property tax exemption provided by the California Constitution. California law required applicants for the exemption to subscribe to an oath stating that the applicant did not advocate the overthrow of the United States or the State of California. Each refused to subscribe to the oath. The California authorities refused to allow the exemptions, and the California Supreme Court held that such action did not violate the procedural safeguards required by the Due Process clause of the United States Constitution.[212] The United States Supreme Court reversed, holding that the applicants could not be required to give up their constitutional right to free speech as a condition for obtaining a tax exemption.[213]

Similarly, in *Sherbert v. Verner*,[214] an employer discharged a member of the Seventh-day Adventist Church because she would not work on Saturday, the Sabbath Day of her church. The South Carolina Employment Security Commission refused to give her unemployment compensation because

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210. LAURENCE H. TRIBE, AMERICAN CONSTITUTIONAL LAW § 10-8, at 681 (2d ed. 1988). *See also* Richard A. Epstein, *Unconstitutional Conditions, State Power, and the Limits of Consent*, 102 HARV. L. REV. 4 (1988). Epstein argues that divisions in opinion on unconstitutional conditions rest upon deep structural problems associated with both constitutional theory and political governances. He states that the doctrine of unconstitutional conditions means that "even if a state has absolute discretion to grant or deny a privilege or benefit, it cannot grant the privilege subject to conditions that improperly 'coerce,' 'pressure,' or 'induce' the waiver of constitutional rights." *Id.* at 6-7. *See also* Kathleen M. Sullivan, *Unconstitutional Conditions*, 102 HARV. L. REV. 1413 (1989). Professor Sullivan explains the value and function of the doctrine of unconstitutional conditions. She defines unconstitutional condition as when the "government offers a benefit on condition that the recipient perform or forego an activity that a preferred constitutional right normally protects from government interference." *Id.* at 1421-22. *See also* Roberto L. Corrada, *Justifying a Search for a Unifying Theory of Unconstitutional Conditions*, 72 DENV. U. L. REV. 1011 (1995).

211. 357 U.S. 513 (1958).

212. *Id.* at 515.

213. *Id.* at 529.

214. 374 U.S. 398 (1963).

her refusal to work Saturday disqualified her.[215] Ultimately, the South Carolina Supreme Court affirmed the Commission's decision, rejecting the contention that the relevant South Carolina law abridged her constitutional right to the free exercise of religion.[216] The United States Supreme Court reversed, holding that conditions on public benefits cannot be sustained if they operate to inhibit, deter, or penalize the free exercise of constitutional rights.[217]

Although the doctrine of unconstitutional conditions has been "somewhat eroded" in recent years,[218] and although *Speiser* and *Sherbert* dealt with the first amendment right of free expression, the doctrine should apply to the Article III right to the protection of judicial independence.[219] As Professor Redish has explained, "[c]onstitutional logic should not differ when the relevant constitutional restraint is the Article III protection of judicial independence, rather than the first amendment right of free expression."[220] Accordingly, if Article III values are to be protected, at some point, "the conditioning of governmental benefits on the waiver of a right to an article III court" violates the unconstitutional conditions doctrine.[221]

Under these circumstances, one must consider whether applying claim preclusion to bankruptcy judgments would violate the unconstitutional conditions doctrine. If claim preclusion were applied to bankruptcy court judgments so as to bar non-core claims, the litigant would be forced to present such claims to the bankruptcy court. As discussed, this could result in the loss of Article III protections through de facto adjudication.[222] Arguably, this means that litigants would have to give up their Article III rights as a condition to receiving the benefit of having their non-core claims heard.

As a result, applying claim preclusion to bankruptcy court judgments to bar non-core claims may violate the unconstitutional conditions doctrine. Indeed, this situation seems closely analogous to the Supreme Court's decision in *Terral v. Burke Construction Company*.[223] Applying the unconstitutional conditions doctrine, *Terral* held that states may not condition entry of foreign corporations on the surrender of their constitutional right to invoke the

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215. *Id.* at 401.

216. *Id.*

217. *Id.* at 405-06.

218. *See* TRIBE, *supra* note 210, at 681.

219. *See* REDISH, *supra* note 17, at 70 (applying unconstitutional conditions doctrine to Article III's right to judicial independence); Fallon, *supra* note 5, at 991 n.414.

220. REDISH, *supra* note 17, at 70.

221. Fallon, *supra* note 5, at 992 n.414.

222. *See supra* notes 170-209 and accompanying text.

223. 257 U.S. 529 (1922).

jurisdiction of the federal courts.[224] In the same way, litigants cannot be coerced to give up their constitutional right to an Article III tribunal in order to obtain the benefit of having non-core claims heard.

3. The Preservation of Article III Values

Under these circumstances, the question is whether the doctrine of res judicata should give way in order to preserve Article III values. There is authority to support a positive answer to this question. Principles of preclusion should give way where their application would undermine important constitutional rights. The Supreme Court's recent decision in *Lytle v. Household Manufacturing, Inc.*[225] is instructive on this point. Petitioner Lytle brought equitable and legal claims in the same action. The district court erroneously dismissed the legal claims. The district court then conducted a bench trial on the equitable claims and ruled against Lytle.

The Supreme Court held that issue preclusion would not bar relitigation of the legal claims in order to preserve Lytle's Seventh Amendment right to a jury trial on legal issues. The court explained: "Although our holding requires a new trial in this case, we view such litigation as essential to vindicating Lytle's Seventh Amendment rights."[226] The court expressly held that "concern[s] about judicial economy . . . remains an insufficient basis for departing from our longstanding commitment to preserving a litigant's right to a jury trial."[227]

Lytle, then, makes clear that concern about judicial economy must give way in favor of preserving constitutional rights. The *Marrese* case provides additional support for this proposition. There, the Supreme Court rejected the suggestion that a federal rule should be formulated that would allow a state court judgment to bar a claim arising within the exclusive jurisdiction of the federal court. Although the Court acknowledged that such a rule might promote judicial efficiency and finality, such concerns had to give way in favor of other important concerns of our system of federalism.[228] In the

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224. *See id.* at 532 ("The principle established by the more recent decisions of this court is that a state may not, in imposing conditions upon the privilege of a foreign corporation's doing business in the state, exact from it a waiver of the exercise of its constitutional right to resort to the federal courts . . .").

225. 494 U.S. 545 (1990).

226. *Id.* at 553.

227. *Id.* at 553-54.

228. *See* Marrese v. American Academy of Orthopaedic Surgeons, 470 U.S. 373, 385 (1985) ("If we had a single system of courts and our only concerns were efficiency and finality, it might be desirable to fashion claim preclusion rules that would require a plaintiff to bring suit initially in the forum of most general

same way, federal courts should not construct a rule which would allow bankruptcy judgments to bar non-core claims even if such a rule would promote judicial efficiency. Such concerns of efficiency should give way in favor of preserving Article III values.

VI. CONCLUSION

Courts of appeals are divided over the question of whether a bankruptcy court's judgment bars further litigation of any claim that arises out of the transaction at issue in the bankruptcy proceeding, or whether the doctrine of claim preclusion applies only if such subsequent action would have constituted a core—as opposed to a non-core but related—proceeding in the bankruptcy case. This article has sought to resolve that conflict present in the circuits. The argument holds that bankruptcy court judgments should not bar the assertion of non-core claims. The article has argued that to allow such judgments to bar non-core claims would be contrary to established principles of res judicata and would threaten to undermine fundamental Article III values or generate judicial inefficiencies in an effort to preserve such values.

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jurisdiction . . . . More importantly, we have parallel systems of state and federal courts, and the concerns of comity reflected in § 1738 generally allow States to determine the preclusive scope of their own courts' judgments.").