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EXPERT ANALYSIS

Supreme Court Upholds Bankruptcy Courts' Limited Procedural Power

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The U.S. Supreme Court, on June 9, unanimously held that certain "core" proceedings — fraudulent-transfer suits — can be litigated in bankruptcy court, but that the court's proposed findings and conclusions face a *de novo* review by the district court.[1]

Affirming the 9th U.S. Circuit Court of Appeals' fraudulent-transfer judgment against the insider defendant "in light of the procedural posture of this case,"[2] the Supreme Court avoided deciding whether a defendant could consent to bankruptcy jurisdiction. This is an issue that had caused a split among the circuits.[3]

The Supreme Court essentially accepted the 9th Circuit's alternative holding in *In re Bellingham Insurance Agency* "that the bankruptcy court's state law fraudulent-transfer judgment could … be treated as proposed findings of fact and conclusions of law, subject to *de novo* review by the district court."[4] As the Supreme Court said, the "procedural posture" of *Bellingham* mooted the jurisdiction issue:

> At bottom, [the defendant] argues that it was entitled to have an Article III court review *de novo* and enter judgment on the fraudulent [-transfer] claims asserted by the trustee. In effect, [the defendant] received exactly that. The District Court conducted *de novo* review of the [Bankruptcy Court's] summary judgment [ruling], concluding in a written opinion that there were no disputed issues of material fact and that the trustee was entitled to judgment as a matter of law. In accordance with its statutory authority over matters related to the bankruptcy, see [28 U.S.C.] § 1334(b), the District Court then separately entered judgment in favor of the trustee. [The defendant] thus received the same review from the District Court that it would have received if the Bankruptcy Court had treated the fraudulent [-transfer] claims as non-core proceedings under [28 U.S.C.] § 157(c)(1). In short, … the District Court's *de novo* review and entry of its own valid final judgment cured any error [by the Bankruptcy Court].[5]

FACTS

The defendant in *Bellingham* never filed a claim in the Bankruptcy Court, but the corporate debtor's Chapter 7 trustee sued Bellingham for having received a fraudulent transfer under applicable state law. "[T]he complaint alleged that [the debtor's insiders] used various methods to fraudulently convey [the debtor's] assets to [another affiliate]."[6] The trustee moved for summary judgment against the affiliate in the Bankruptcy Court, which granted summary judgment for the trustee on all claims. The affiliate then appealed to the U.S. District Court for the Western District of Washington, which conducted a *de novo* review, affirmed the Bankruptcy Court's decision and entered judgment for the plaintiff trustee.

The defendant further appealed to the 9th Circuit. After the defendant filed its opening brief, the Supreme Court handed down its decision in *Stern v. Marshall*, 131 S. Ct. 2594 (2011). The court held that non-Article III bankruptcy courts "lack … constitutional authority to enter final judgment on a state law … claim [by the estate] that is not resolved in … [the] process of ruling on …] [the] creditor's claim." Thus, "Article III of the Constitution did not permit a bankruptcy court to enter a final judgment on a counterclaim for tortious interference."[7]

The defendant in *Bellingham* moved to dismiss its appeal in the 9th Circuit. Relying on *Stern*, the defendant argued Article III did not give Congress the right "to vest authority in a bankruptcy court to finally decide the trustee's [state law fraudulent-transfer] claims."[8] The 9th Circuit relied on the defendant's implied consent to the Bankruptcy Court's jurisdiction, however, saying the defendant had failed to raise the issue in the lower courts.[9]

For fraudulent-transfer suits, the bankruptcy judge should only propose fact findings and conclusions of law for the district court's de novo *review.*

Alternatively, the 9th Circuit held that the Bankruptcy Court's judgment "could instead be treated as proposed findings of fact and conclusions of law," which had actually been reviewed, *de novo*, by the District Court.[10] Other circuits (the 5th Circuit and the 6th Circuit) disagreed with the 9th Circuit on the consent issue, causing the split the Supreme Court granted *certiorari* to address. Unfortunately for scholars, the court found a neat way to avoid the difficult jurisdictional consent issue with a fact-intensive holding based on the District Court's *de novo* review of the Bankruptcy Court's ruling.

FRAUDULENT-TRANSFER LITIGATION DEEMED NON-CORE

Congress provided in 28 U.S.C. § 157(b)(2)(H) that fraudulent-transfer proceedings were "core," enabling the bankruptcy judge to "hear and determine" these claims and "enter appropriate orders and judgments" under 28 U.S.C § 157(b)(1). Courts have construed *Stern*, however, to apply to fraudulent-transfer litigation in the bankruptcy courts, creating constitutional issues.[11]

Indeed, the Supreme Court acknowledged that the fraudulent-transfer claims in *Bellingham* were "not … core" because, after *Stern*, "Article III [of the Constitution] does not permit these claims to be treated as 'core.'"[12] Nevertheless, because these claims were "related to" the bankruptcy case, the Bankruptcy Court had jurisdiction under 28 U.S.C. § 1334(b) ("civil proceedings related to cases under Title 11") to hear this matter but not enter a judgment. Thus, despite the statutory "core" label, for fraudulent-transfer suits, the bankruptcy judge should only propose fact findings and conclusions of law for the district court's *de novo* review.

NO STATUTORY GAP

The *Stern* decision never decided "how bankruptcy or district courts should proceed when a '*Stern* claim' is identified."[13] The Supreme Court said, "when, under *Stern*'s reasoning, the Constitution does not permit a bankruptcy court to enter final judgment," the Judiciary Code (Title 28) still "permits a bankruptcy court to issue proposed findings … to be reviewed by the district court."[14]

The court thus rejected the 9th Circuit's view in *Bellingham* and elsewhere that *Stern* claims had created "a statutory 'gap.'"[15] It found "a severability provision" in 28 U.S.C. § 151 "that accounts for decisions, like *Stern*, that invalidate certain applications of the statute."[16] Thus, if "the claim satisfies the criteria of [28 U.S.C.] § 157(c)(1) ['related to' the bankruptcy case], the bankruptcy court simply treats the claims as non-core."[17] The bankruptcy court then "hear[s] the proceeding and submit[s] proposed findings … to the district court for *de novo* review and entry of judgment."[18]

COMMENTS

Bellingham merely ratifies what many courts had already been doing in the wake of *Stern* over the past three years. By order dated Jan. 30, 2012, the U.S. District Court for the Southern District of New York amended its standing "order of reference" of cases to bankruptcy judges as follows:

> If a bankruptcy judge or district judge determines that entry of a final order or judgment by a bankruptcy judge would not be consistent with Article III of the United States Constitution in a particular proceeding … and [it is] determined to be a core matter; the bankruptcy judge shall, unless otherwise ordered by the district court, hear the

proceeding and submit proposed findings of fact and conclusions of law to the district court.[19]

Delaware has a similar order. *Bellingham* will enable savvy courts and practitioners in all future cases to avoid the jurisdiction-by-consent issue.

A trustee may bring a fraudulent-transfer claim in the bankruptcy court, but any party to the suit, or the court itself, can always insist on *de novo* review by the district court. In short, the Supreme Court not only avoided a thorny jurisdictional issue in *Bellingham*, but also blessed a procedure for other cases. WJ

NOTES

1 *Executive Benefits Ins. Agency v. Arkison (In re Bellingham Ins. Agency)*, 134 S. Ct. 2165 (June 9, 2014).

2 *Id.* at 2175.

3 *See, e.g., In re Bellingham Ins. Agency*, 702 F.3d 553 (9th Cir. 2012) (holding that a bankruptcy judge could decide fraudulent-transfer claim when parties consent); *Waldman v. Stone*, 698 F.3d 910, 921 (6th Cir. 2012) (holding that a bankruptcy court could *not* enter final judgment on a state law fraud suit by a debtor even when the defendant had consented); *In re Frazin*, 732 F.3d 313 (5th Cir. 2013) (same); *In re BP RE LP*, 735 F.3d 279 (5th Cir. 2013) (same).

4 *Executive Benefits,* 134 S. Ct. at 2170, citing *In re Bellingham,* 702 F.3d at 565-66.

5 *Id*. at 2175.

6 *Id.* at 2169.

7 *Id.*.

8 *Id.*

9 *In re Bellingham*,702 F.3d at 566, 568.

10 *Executive Benefits,* 134 S. Ct. at 2170, citing *In re Bellingham*, 702 F.3d at 565-66.

11 *See, e.g., In re Lyondell Chem. Co.*, 467 B.R. 712 (S.D.N.Y. 2012) (bankruptcy court cannot, after *Stern*, enter final judgment on fraudulent-transfer claim); *Adelphia Recovery Trust v. FLP Group,*, 2012 WL 264180 (S.D.N.Y. 2012) (same); *In re Heller Ehrman LLP*, 464 B.R. 348 (N.D. Cal. 2011) (same).

12 *Executive Benefits,* 134 S. Ct. at 2174.

13 *Id.* at 2168.

14 *Id.*

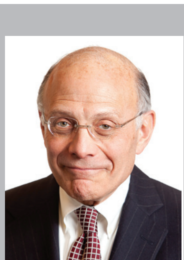
15 *Id.* at 2172. *See, e.g.*, *In re Ortiz*, 665 F.3d 906, 915 (7th Cir. 2011) (bankruptcy courts cannot order proposed findings of fact and conclusions of law in any core proceeding).

16 *Id.*, citing 98 Stat. 344, note following 28 U.S.C. § 151.

17 *Id.*

18 *Id.*

19 Amended Standing Order of Reference Re: Title 11, M10–468, 12 Misc 00032 (S.D.N.Y. Jan. 31, 2012) (Preska, C.J.).



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