CLIENT UPDATE

THE SUPREME COURT CONFIRMS THAT BANKRUPTCY COURTS CAN ISSUE PROPOSED FINDINGS OF FACT AND CONCLUSIONS OF LAW IN *STERN*-TYPE DISPUTES

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On Monday, the Supreme Court confirmed[1] that bankruptcy courts may hear "*Stern*-type" matters (such as tortious interference counterclaims) that relate to bankruptcy proceedings, so long as a district court reviews the bankruptcy court's proposed findings and renders the final decision. Other questions left in the wake of *Stern v. Marshall*,[2] however, remain unanswered and will continue to occupy the attention of parties to bankruptcy matters and courts alike.

BACKGROUND: IN THE WAKE OF *STERN V. MARSHALL*

In *Stern v. Marshall*, the bankruptcy estate of Anna Nicole Smith filed a counterclaim to recover damages for tortious interference from the estate of her deceased stepson. The bankruptcy court entered judgment in favor of Smith's estate, but the Supreme Court reversed. The Supreme Court held that the bankruptcy court, as a non-Article III court, could not enter a final judgment on a counterclaim for tortious interference, even though the counterclaim qualified as "core" under the statutory definitions in 28 U.S.C. § 157. In effect, the Supreme Court decided in *Stern* that Section 157 went too far in identifying matters that could be finally resolved in the bankruptcy

[1] *Executive Benefits Insurance Agency v. Arkison, Chapter 7 Trustee of Estate of Bellingham Insurance Agency, Inc.* ("*Executive Benefits*"), 573 U.S. ___ (June 9, 2014). Justice Thomas delivered the opinion for a unanimous Court. The decision is available at http://www.supremecourt.gov/opinions/13pdf/12-1200_2035.pdf.

[2] 131 S. Ct. 2594 (June 23, 2011).

court as opposed to an Article III court, and that Congress had granted powers that the Constitution did not allow bankruptcy courts to exercise.

Some courts held that matters designated as "core" in Section 157, but that concerned constitutionally private rights and could not be finally adjudicated by the bankruptcy courts under *Stern* (referred to herein as "*Stern*-type matters"), represented a gap in the statutory scheme. Section 157 authorizes bankruptcy courts to issue proposed findings of fact and conclusions of law with respect to "non-core" matters, but because of the definitions in the statute, this authority did not expressly cover *Stern*-type matters (which, under the statute, had been designated as "core" matters). From this perspective, it was unclear whether bankruptcy courts could issue proposed findings of fact and conclusions of law with respect to *Stern*-type matters.

EXECUTIVE BENEFITS: THE NINTH CIRCUIT SPLITS WITH THE SIXTH AND SEVENTH CIRCUITS

The trustee in the chapter 7 liquidation of Bellingham Insurance Agency filed a fraudulent conveyance claim to recover assets that had been transferred to another company. The trustee prevailed in the bankruptcy court, with the district court affirming on appeal. While a further appeal to the Ninth Circuit was pending, the Supreme Court issued its ruling in *Stern*. The beneficiary of the transfer then moved to dismiss the bankruptcy court's ruling on the trustee's fraudulent conveyance claim for lack of jurisdiction. No party disputed that the claim, based in part on state fraudulent conveyance law, was a *Stern*-type matter.

The Ninth Circuit affirmed the district court's decision and rejected the dismissal arguments, holding that, even though Article III does not permit a bankruptcy court to enter final judgment on a fraudulent conveyance claim against a non-creditor, both parties had impliedly consented to the bankruptcy court's jurisdiction. The Ninth Circuit also reasoned that the bankruptcy court's judgment could be construed as proposed findings of fact and conclusions of law, subject to *de novo* review by the district court: in essence, that this *Stern*-type matter could be, and was, handled in the same manner as a non-core matter.[3]

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[3] *In re Bellingham Insurance Agency*, 702 F.3d 553 (9th Cir. 2012).

The Ninth Circuit's decision contrasted with decisions by the Sixth and Seventh Circuits, which held that bankruptcy courts could not issue proposed findings of fact and conclusions of law in *Stern*-type matters.[4]

THE SUPREME COURT AFFIRMS THE NINTH CIRCUIT'S DECISION

The Supreme Court granted certiorari. In the decision issued this week, the Supreme Court held that bankruptcy courts may enter proposed findings of fact and conclusions of law in *Stern*-type matters, so long as they are subject to *de novo* review and final determination by the district court. The Court held that *Stern* had invalidated the designation of certain cases as "core," but that the effect of this ruling was that such matters should now be treated as "non-core" and subject to the entry of proposed findings of fact and conclusions of law.

PRACTICAL IMPLICATIONS

Executive Benefits provides some clarification to parties whose disputes are heard in bankruptcy courts. Even if their disputes are *Stern*-type, the bankruptcy court may issue proposed findings of fact and conclusions of law (subject to *de novo* review by the District Court) in any matter in which it cannot issue a final decision.

However, other questions remain open and may be the subject of further splits among the lower courts. The Supreme Court did not explicitly address whether *Stern*-type matters may be finally decided by bankruptcy courts if the parties so consent, despite the fact that many parties asked the Court to resolve that open issue. Nor did the Supreme Court decide whether the fraudulent conveyance claim raised in *Executive Benefits* was the type of claim that must be adjudicated in an Article III court.

In addition, the Supreme Court did not clarify the extent to which bankruptcy courts can exercise control over cases in which a party has made a proper demand for a jury trial. A jury's findings could not constitutionally be treated as "proposed" findings of fact because the Constitution does not permit a *de novo* review of a jury's findings by a judge. A bankruptcy court therefore would be unable to enter "proposed" findings in such a case, even if the bankruptcy court were to hold the jury trial. The extent to which the bankruptcy court may nevertheless supervise pretrial proceedings (as a magistrate judge might do) has not been addressed by the Supreme Court.

[4] *Waldman v. Stone*, 698 F.3d 910 (6th Cir. 2012); *In re Ortiz*, 665 F.3d 906 (7th Cir. 2011).

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Please do not hesitate to contact us with any questions.

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