Milbank

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CONTACT

Linda Dakin-Grimm
Partner
213-892-4404
ldakin-grimm@milbank.com

Revi-Ruth Enriquez
Associate
213-892-4484
renriquez@milbank.com

Litigation & Arbitration Group Client Alert: Petition for Supreme Court Review Filed in Ninth Circuit's *Bellingham* Case Highlighting Circuit Splits Post-*Stern*

The Supreme Court may revisit two of the many questions left open by its much-discussed decision in *Stern v. Marshall*, 131 S. Ct. 2594 (2011), an opinion famous not only for its subject – the estate of the late actress and model Anna Nicole Smith – but also for redefining the allocation of judicial authority between an Article III federal district court and a bankruptcy court. Appellants have filed a petition for a writ of certiorari seeking review of the Ninth Circuit's decision in *Executive Benefits Insurance Agency v. Arkison* (*In re Bellingham Insurance Agency*), 702 F.3d 553 (9th Cir. Dec. 4, 2012), and asking the nation's highest court to take on two questions about which lower courts have disagreed in the wake of *Stern*:

1. Whether Article III permits the exercise of the federal judicial power by non-Article III bankruptcy courts on the basis of litigant consent, and, if so, whether "implied consent" is sufficient to satisfy Article III; and

2. Whether a bankruptcy judge may submit proposed findings of fact and conclusions of law for review by a district court in a "core" proceeding under 28 U.S.C. § 157(b).

ALLOCATION OF ARTICLE III POWERS AND LITIGANT CONSENT

In *Bellingham*, the bankruptcy trustee brought a complaint for fraudulent transfer against non-creditor Executive Benefits Insurance Agency ("EBIA") in bankruptcy court. Seeking to recover for the estate, the trustee alleged that EBIA was the successor corporation to the debtor and liable for claims against the debtor. 702 F.3d at 557. The bankruptcy court found for the trustee and held that EBIA was the successor corporation to the debtor and the debtor fraudulently transferred funds to EBIA. *Id.* After the district court affirmed the bankruptcy court's decision, EBIA appealed to the Ninth Circuit. *Id.* While the appeal was pending, the Supreme Court issued its de-

cision in *Stern*. *Id.* On the eve of oral argument, EBIA filed a motion before the circuit court to vacate the judgment, arguing the bankruptcy court did not have constitutional authority to enter final judgment on the trustee's claims. *Id.* at 568.

Interpreting the Supreme Court's decision in *Stern*, the Ninth Circuit held that a bankruptcy court, as a "legislative court" created by Congress and not authorized to exercise the judicial power of the United States under Article III of the Constitution, does not have the authority to enter final judgments on fraudulent conveyance claims asserted by non-creditors to a bankruptcy estate. *Id.* at 565. However, the Ninth Circuit also found that a litigant could waive that right to a hearing by an Article III court in favor of a decision by a bankruptcy court. *Id.* at 567. Citing Supreme Court precedent, the Ninth Circuit reasoned that Article III provides both structural and personal protections and "as a personal right, Article III's guarantee of an impartial and independent federal adjudication is subject to waiver." *Id.* at 567 (citing *Commodity Futures Trading Commission v. Schor*, 478 U.S. 833, 848 (1986)). Ultimately, the Ninth Circuit held that EBIA had indeed waived its right to Article III adjudication by failing to raise a constitutional objection to the bankruptcy court's judgment until after briefing before the Ninth Circuit was complete. *Bellingham*, 702 F.3d at 568.

In its petition for certiorari, Appellant EBIA points to the conflict between the Ninth Circuit's *Bellingham* holding and the Sixth Circuit's decision in *Waldman v. Stone*, 698 F.3d 910 (6th Cir. 2012). There, the Sixth Circuit held exactly the opposite: a litigant cannot waive the constitutional requirement that only Article III judges, not bankruptcy judges, could exercise the federal judicial power of the United States. The *Waldman* court found that the requirement that federal judiciary power be exercised only by Article III district courts is a structural principal that a litigant did not have power to waive. 698 F.3d at 917 ("This requirement … is 'an inseparable element of the constitutional system of checks and balances that both defines the power and protects the independence of the Judicial Branch.'" (citing *Stern*, 131 S. Ct. at 2608)).

ADDRESSING THE "GAP" IN BANKRUPTCY COURT'S AUTHORITY

A bankruptcy judge has authority to "hear and determine" and enter final judgments in all cases under title 11 and all "core" proceedings arising under title 11. 28 U.S.C. § 157(b). Section 157(b) also enumerates sixteen non-exclusive examples of "core" proceedings, including counterclaims by the estate against persons filing claims against the estate and fraudulent conveyance claims. In "non-core" proceedings, a bankruptcy court may submit proposed findings of fact and conclusions of law to the district court, which will then enter final judgment. 28 U.S.C. § 157(c).

In *Stern*, the Supreme Court held that while bankruptcy courts have statutory authority to enter final judgments on "core" proceedings, they are constitutionally pro-

hibited from entering a final judgment on certain "core" proceedings — those causes of action that neither derive from nor depend on bankruptcy law derived rights. 131 S. Ct. at 2615. The Court held that a bankruptcy court may only issue final judgments when "the action at issue stems from the bankruptcy itself or would necessarily be resolved in the claims allowance process." *Id.* at 2618. This ruling redefined the scope of a bankruptcy court's constitutional authority and opened an apparent "gap" in its statutory authority. *Bellingham*, 702 F.3d at 565. Bankruptcy courts cannot issue final judgments in certain "core" proceedings under Article III, but Section 157 only gives authority to submit proposed findings of fact and conclusions of law in "non-core" proceedings. Can a bankruptcy court issue proposed findings of fact and conclusions of law in those "core" proceedings it did not have constitutional authority to finally adjudicate?

Analyzing Supreme Court precedent leading up to the *Stern* decision, the Ninth Circuit answered affirmatively and held that bankruptcy judges did have the statutory power under 28 U.S.C. § 157 to submit proposed findings of fact and conclusions of law in bankruptcy related "core" proceedings even when the entry of a final judgment is unconstitutional. *Bellingham*, 702 F.3d at 566. The Ninth Circuit reasoned that the power to "hear and determine" a core proceeding under Section 157(b) "surely encompasses" … "the more modest power to submit findings of fact and recommendations of law to the district courts" under Section 157(c). *Id.* at 565. At least one other circuit disagrees.

In its petition for certiorari, EBIA highlights the split between this holding and that of the Seventh Circuit's in *In re Ortiz*, 665 F.3d 906 (2011). In *Ortiz*, the Seventh Circuit reasoned that a bankruptcy judge's orders could not function as proposed findings of fact or conclusions of law in a core proceeding under 28 U.S.C. § 157(c). *Id.* at 915. The Ninth Circuit acknowledged the *Ortiz* decision but dismissed the Seventh Circuit's analysis as dicta and not thoroughly reasoned. *Bellingham*, 702 F.3d at 566, n.8.

If the Supreme Court grants certiorari on *Bellingham*, it may finally resolve these issues and offer both lower federal courts and bankruptcy courts further guidance on the scope of a bankruptcy judge's authority. Appellants filed their petition for writ of certiorari on April 3, 2013. The response is expected by May 3, 2013.

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NEW YORK
One Chase Manhattan Plaza, New York, NY 10005

Name	Email	Phone
Wayne M. Aaron	waaron@milbank.com	+1-212-530-5284
Thomas A. Arena	tarena@milbank.com	+1-212-530-5828
Sander Bak	sbak@milbank.com	+1-212-530-5125
James N. Benedict *Chair*	jbenedict@milbank.com	+1-212-530-5696
James G. Cavoli	jcavoli@milbank.com	+1-212-530-5172
Christopher E. Chalsen	cchalsen@milbank.com	+1-212-530-5380
Scott Edelman *Firm Chairman*	sedelman@milbank.com	+1-212-530-5149
Christopher J. Gaspar	cgaspar@milbank.com	+1-212-530-5019
David R. Gelfand	dgelfand@milbank.com	+1-212-530-5520
Joseph S. Genova	jgenova@milbank.com	+1-212-530-5532
Douglas W. Henkin	dhenkin@milbank.com	+1-212-530-5393
Michael L. Hirschfeld	mhirschfeld@milbank.com	+1-212-530-5832
Robert C. Hora	rhora@milbank.com	+1-212-530-5170
Lawrence T. Kass	lkass@milbank.com	+1-212-530-5178
Atara Miller	amiller@milbank.com	+1-212-530-5421
Sean M. Murphy	smurphy@milbank.com	+1-212-530-5688
Daniel Perry	dperry@milbank.com	+1-212-530-5083
Stacey J. Rappaport	srappaport@milbank.com	+1-212-530-5347
Richard Sharp	rsharp@milbank.com	+1-212-530-5209
Alan Stone *Practice Group Leader*	astone@milbank.com	+1-212-530-5285
Errol B. Taylor	etaylor@milbank.com	+1-212-530-5545
Fredrick M. Zullow	fzullow@milbank.com	+1-212-530-5533

WASHINGTON, DC
International Square Building, 1850 K Street, NW, Suite 1100, Washington, D.C. 20006

David S. Cohen	dcohen2@milbank.com	+1-202-835-7517
Robert J. Koch	rkoch@milbank.com	+1-202-835-7520
Andrew M. Leblanc	aleblanc@milbank.com	+1-202-835-7574
Michael D. Nolan	mnolan@milbank.com	+1-202-835-7524

LOS ANGELES
601 South Figueroa Street, 30th Floor Los Angeles, CA 90017

Linda Dakin-Grimm	ldakin-grimm@milbank.com	+1-213-892-4404
Robert J. Liubicic	rliubicic@milbank.com	+1-213-892-4525
Jerry L. Marks	jmarks@milbank.com	+1-213-892-4550
Mark Scarsi	mscarsi@milbank.com	+1-213-892-4580

LONDON
10 Gresham Street, London EC2V 7JD, England

Tom Canning	tcanning@milbank.com	44-20-7615-3047
Charles Evans	cevans@milbank.com	44-20-7615-3090
Julian Stait	jstait@milbank.com	44-20-7615-3005