

# BURR ALERT

## Evolving Bankruptcy Jurisdiction - Ninth Circuit Rules that Bankruptcy Courts Cannot Enter Final Judgment on Fraudulent Conveyance Claims

January 2013

Before the Supreme Court's seminal ruling in *Stern v. Marshall*,<sup>1</sup> bankruptcy courts regularly entered final orders in fraudulent conveyance actions and other "core"<sup>2</sup> matters. In *Stern v. Marshall*, the Supreme Court ruled that despite being statutorily defined as "core" under the bankruptcy code, bankruptcy courts do not have the constitutional power to adjudicate counterclaims to proofs of claim because they are based in state law. Following the same course, the Ninth Circuit recently held in *In re Bellingham Insurance Agency, Inc.*,<sup>3</sup> that a non-Article III bankruptcy judge lacks constitutional authority to enter a final judgment on a fraudulent conveyance action against a nonclaimant to a bankruptcy estate.

In *In re Bellingham Insurance Agency, Inc.*, the debtor (Bellingham Insurance Agency) transferred funds to a closely related entity (Executive Benefits Insurance Agency) shortly before filing its chapter 7 petition. The Trustee filed a complaint against Bellingham alleging that the funds were property of the estate and asserting claims under federal and state law. The bankruptcy court granted summary judgment in favor of the Trustee, finding that Executive Benefits was a corporate successor of Bellingham and therefore liable for its debts.

---

<sup>1</sup> 131 S.Ct. 2594 (2011).

<sup>2</sup> Pursuant to 28 U.S.C. § 157(b)(2) "core" matters include, but are not limited to: (A) matters concerning the administration of the estate; (B) allowance or disallowance of claims against the estate or exemptions from property of the estate, and estimation of claims or interests for the purposes of confirming a plan under chapter 11, 12, or 13 of title 11 but not the liquidation or estimation of contingent or unliquidated personal injury tort or wrongful death claims against the estate for purposes of distribution in a case under title 11; (C) counterclaims by the estate against persons filing claims against the estate; (D) orders in respect to obtaining credit; (E) orders to turn over property of the estate; (F) proceedings to determine, avoid, or recover preferences; (G) motions to terminate, annul, or modify the automatic stay; (H) proceedings to determine, avoid, or recover fraudulent conveyances; (I) determinations as to the dischargeability of particular debts; (J) objections to discharges; (K) determinations of the validity, extent, or priority of liens; (L) confirmations of plans; (M) orders approving the use or lease of property, including the use of cash collateral; (N) orders approving the sale of property other than property resulting from claims brought by the estate against persons who have not filed claims against the estate; (O) other proceedings affecting the liquidation of the assets of the estate or the adjustment of the debtor-creditor or the equity security holder relationship, except personal injury tort or wrongful death claims; and (P) recognition of foreign proceedings and other matters under chapter 15 of title 11 matters concerning the administration of the estate, allowance or disallowance of claims, counterclaims by the estate against persons filing claims against the estate, orders in respect to obtaining credit, orders to turn over property of the estate, proceedings to determine, avoid, or recover preferences, motions to terminate or modify the automatic stay, proceedings to determine, avoid, or recover fraudulent conveyances.

<sup>3</sup> --- F.3d. ---, No. 11-35162 (9th Cir. Dec. 4, 2012).

The district court affirmed the bankruptcy court's decision. On appeal, Executive Benefits Insurance Agency argued that the bankruptcy court lacked subject matter jurisdiction because the bankruptcy judge was constitutionally proscribed from entering final judgment on the Trustee's claims.

The Ninth Circuit walked through the evolution of bankruptcy court jurisdiction, examining the Supreme Court's rulings in *Northern Pipeline Construction Co. v. Marathon Pipe Line Co.*,<sup>4</sup> *Granfinanciera, S.A. v. Nordberg*,<sup>5</sup> and *Stern v. Marshall*.<sup>6</sup> Each case involves consideration of Article III of the Constitution which provides that three types of controversies can be removed from Article III courts: matters for territorial courts, matters for military tribunals, and matters involving "public" as opposed to "private" rights.<sup>7</sup> "Private" rights include common law rights such as the right to recover contract damages. "Public" rights, on the other hand, cannot be asserted by individual citizens. Bankruptcy courts are authorized to govern debtor-creditor relations under the "public" rights exception.

Under the facts of *Bellingham*, Executive Benefits Insurance Agency did not assert any claim in the bankruptcy and did not subject itself to the bankruptcy court's jurisdiction. Even though the Trustee's lawsuit may have had some bearing on the underlying bankruptcy, that fact alone was insufficient to confer jurisdiction on the bankruptcy court. The appellate court concluded that fraudulent conveyance claims are not matters of "public" right, therefore any adjudication on such claims necessarily must occur within the confines of an Article III court.

After concluding that no jurisdiction existed for final adjudication of fraudulent conveyance claims, the Ninth Circuit reasoned that since the matters are still core proceedings, bankruptcy courts may hear and determine such matters and make a "Report and Recommendation" to the district court. Only the power to enter a final judgment is abrogated.

Ultimately, the Ninth Circuit held that Executive Benefits Insurance Agency consented to the bankruptcy court's jurisdiction because it failed to raise any jurisdictional objection until the case reached the appellate court. Yet, even this waiver would not enable a bankruptcy court to enter a final judgment. According to the Ninth Circuit, parties cannot empower a bankruptcy court to enter a final order even if by agreement.

The post-*Stern* landscape will continue to evolve as the circuit courts wrestle with striking a balance between the adjudication of "public" rights – like restructuring debtor-creditor relations – and "private" state-created rights.

**For more information, contact:**

[Kasee Sparks Heisterhagen](mailto:ksparks@burr.com) in Mobile at (251) 345-8244 or [ksparks@burr.com](mailto:ksparks@burr.com)

or your Burr & Forman attorney with whom you regularly work.

No representation is made that the quality of services to be performed is greater than the quality of legal services performed by other lawyers.

---

<sup>4</sup> 458 U.S. 50 (1982).

<sup>5</sup> 492 U.S. 33 (1989).

<sup>6</sup> 131 S.Ct. 2594 (2011).

<sup>7</sup> *In re Bellingham*, --- F.3d. ---, \*11, No. 11-35162 (9th Cir. Dec. 4, 2012).