Client Alert

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Stern Revisited: Big Questions Remain Unresolved

By James M. Peck and Meryl L. Rothchild

In its recent decision, *Executive Benefits Insurance Agency v. Arkison (In re Bellingham Insurance Agency, Inc.)*,[1] the Supreme Court reiterated and expanded on the reasoning in *Stern v. Marshall*[2] and made clear that a bankruptcy court may issue reports and recommendations in fraudulent conveyance litigation that by statute is classified as core but that is beyond the adjudicative power of an Article I court. By weighing in authoritatively in the robust ongoing debate about the proper way to apply *Stern* in practice, the long-awaited pronouncement of the Supreme Court is a helpful step in the direction of greater order and predictability, but the decision is not a giant step. To the disappointment of observers eager for greater clarity, the Court has determined that it does not need to decide whether parties may consent to the entry of final judgments by the bankruptcy court in fraudulent conveyance proceedings.

Under the reasoning of *Stern* as augmented by *Bellingham*, such claims can only be finally resolved by the district court, an Article III tribunal. Given the side-stepping of the consent issue in *Bellingham*, it remains to be seen whether the law will develop to enable parties to consent to the entry of final judgments by bankruptcy courts in core matters that are governed by *Stern*. This uncertainty is unfortunate. From a systemic perspective, it would be more efficient for the courts that are most directly responsible for the administration and application of the United States Bankruptcy Code to have the unquestioned ability to grant final relief in fraudulent conveyance litigation, disputes that so obviously are within the expertise of these courts.

In its *Bellingham* opinion, the Supreme Court provided guidance to trial courts and practitioners faced with *Stern* claims that fall into a statutory "gap." These are claims denominated as "core" that by their nature cannot be decided by an Article I court. This anomaly is an aspect of bifurcated bankruptcy jurisdiction. As the Court stated:

> Put simply: If a matter is core, the statute empowers the bankruptcy judge to enter final judgment on the claim, subject to appellate review by the district court. If a matter is non-core, and the parties have not consented to final adjudication by the bankruptcy court, the bankruptcy judge must propose findings of fact and conclusions of law. Then, the district court must review the proceeding *de novo* and enter final judgment.

See Bellingham Opinion, at 7.

Justice Thomas, writing for a unanimous Court, then specified how the bankruptcy court should proceed when presented with a *Stern* claim and made clear that bankruptcy courts were not "powerless to act," as the statutory scheme permits *Stern* claims to proceed as non-core claims within the meaning of section 157(c). *See id.* at 9.

[1] *Executive Benefits Ins. Agency v. Arkison*, No. 12-1200, 573 U.S. __ (June 9, 2014).

[2] *Stern v. Marshall*, No. 10-179, 131 S. Ct. 2594 (June 23, 2011).

The Court went on to explain that while *Stern* claims cannot be treated as "core" under section 157(b) of the Bankruptcy Code, bankruptcy courts may still adjudicate such claims pursuant to section 157(c) and submit proposed findings of fact and conclusions of law to the district court for *de novo* review. These procedures are appropriate by virtue of the severability provision in the Bankruptcy Amendments and Federal Judgeship Act of 1984,[3] which permits bankruptcy courts to proceed with *Stern* claims as they would non-core claims and "closes the so-called [statutory] 'gap' created by *Stern* claims." *See id.* at 9-10. The Supreme Court also left no doubt that fraudulent conveyance claims are, in fact, *Stern* claims.[4] *See id.* at 11.

The *Bellingham* Court narrowly addressed the issue presented in this appeal and found that *de novo* review by the district court was sufficient to cure any potential constitutional infirmity in the record. Inasmuch as the appeal of Executive Benefits Insurance Agency, Inc. received *de novo* review—the same standard that would have applied had the bankruptcy court treated the claims as "non-core" under section 157(c)(1)—the Supreme Court found no reason to address the issue of express or implied consent to adjudication by an Article I court.

The *Bellingham* decision confirms that bankruptcy courts can issue reports and recommendations in core matters that must be decided by an Article III judge but fails to provide meaningful guidance on whether consent is sufficient to overcome the constitutional issues associated with *Stern* claims. It would have been desirable for the bankruptcy system, and also for the magistrate system, if the Supreme Court had chosen to deal with the consent (and waiver) issues that had been considered by the Ninth Circuit.

In leaving these important questions for another day, bankruptcy courts and parties to litigations with *Stern* claims do not know whether consent is sufficient to override any potential constitutional issues. It is foreseeable that district courts will be called upon to bear some added burdens until the consent issue is resolved. These burdens may take the form of having to review more cases *de novo* rather than under an abuse of discretion standard or having to decide motions to withdraw the reference filed by defendants in an effort to avoid the prospect of multiple *de novo* trials.

The *Bellingham* decision does not disrupt the bankruptcy system, but it does not do much to fix it either. Our system is not procedurally cumbersome because of Supreme Court decisions but because of the policy choices made by Congress in delegating an Article III workload to Article I tribunals. Pending a clarifying future case that reaches the Supreme Court, the system will continue to function without major distress but burdened with uncertainty as to the judicial power of the bankruptcy courts. That uncertainty may cause greater delay and expense in administering cases that arise under the Bankruptcy Code.

[3] *See* 28 U.S.C. § 151 *et seq.* This Act provides federal courts with original jurisdiction in bankruptcy cases and the power to refer to bankruptcy judges both core and non-core proceedings.

[4] The *Stern* case indicated that a debtor's state law counterclaim against a claimant could be finally adjudicated by a bankruptcy court to the extent that adjudication is tied to the core functions of resolving claims against the debtor. *Bellingham* states, without qualification, that all fraudulent conveyance claims are *Stern* claims, and in that respect expresses a more sweeping treatment of *Stern* claims.

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Contact:

James M. Peck
(212) 468-8094
jpeck@mofo.com

Meryl L. Rothchild
(212) 336-4168
mrothchild@mofo.com

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