

## Supreme Court Provides Further Guidance on Bankruptcy Court Jurisdiction over Avoidance Actions

On June 9, 2014, in *Exec. Benefits Ins. Agency v. Arkison*, No. 12-1200, 2014 WL 2560461 (U.S. June 9, 2014) (the “Opinion”), the Supreme Court of the United States held unanimously that (1) if a bankruptcy court is presented with a claim that is designated for final adjudication as a “core proceeding” by 28 U.S.C. § 157(b)(1)<sup>1</sup> but Constitutionally outside the scope of the bankruptcy court’s jurisdiction to render a final judgment following *Stern v. Marshall*, 131 S.Ct. 2594 (2011) (“Stern”), a bankruptcy court may properly rely on its powers over non-core proceedings under 28 U.S.C. § 157(c)(1)<sup>2</sup> to submit proposed findings of fact and conclusions of law to the district court for *de novo* review. The Opinion provides jurisdictional and procedural guidance for bankruptcy courts and litigants, and is significant because the Supreme Court provides an important clarification concerning *Stern*’s scope and meaning.

### Factual Background and Procedural History

Nicolas Paleveda and his wife owned and operated two companies, Aegis Retirement Income Services, Inc. (“ARIS”) and Bellingham Insurance Agency, Inc. (“BIA”). *Id.* at \*3. BIA was insolvent and had ceased operations by January 31, 2006. *Id.* Paleveda used BIA funds to incorporate Executive Benefits Insurance Agency (“EBIA”), and through a series of subsequent transactions, transferred BIA’s assets to EBIA and ARIS, thereby depleting BIA’s estate. *Id.* Following BIA’s June 2006 Chapter 7 bankruptcy filing in the United States Bankruptcy Court for the Western District of Washington, the trustee appointed in BIA’s bankruptcy case commenced fraudulent conveyance actions in the Bankruptcy Court to recover the assets transferred from BIA’s estate to ARIS and EBIA.

The Bankruptcy Court granted summary judgment to the trustee on the fraudulent conveyance claims. *Arkison v. Exec. Benefits Ins. Agency (In re Bellingham Ins. Agency, Inc.)*, Adv. Proc. No. 08-1132, No. 06-11721 (Bankr. W.D. Wash. May 27, 2010). EBIA appealed to the United States District Court for the Western District of Washington, which reviewed the

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<sup>1</sup> 28 U.S.C. § 157(b) provides in relevant part: “(b)(1) Bankruptcy judges may hear and determine all cases under title 11 and all core proceedings arising under title 11, or arising in a case under title 11, referred under subsection (a) of this section, and may enter appropriate orders and judgments, subject to review under section 158 of this title. . . (b)(2) . . . [nonexhaustive list of core proceedings].”

<sup>2</sup> 28 U.S.C. § 157(c)(1) provides: “A bankruptcy judge may hear a proceeding that is not a core proceeding but that is otherwise related to a case under title 11. In such proceeding, the bankruptcy judge shall submit proposed findings of fact and conclusions of law to the district court, and any final order or judgment shall be entered by the district judge after considering the bankruptcy judge’s proposed findings and conclusions and after reviewing *de novo* those matters to which any party has timely and specifically objected.”

Bankruptcy Court's decision *de novo* and affirmed the grant of summary judgment. *Arkison v. Exec. Benefits Ins. Agency (In re Bellingham Ins. Agency, Inc.)*, Case No. 10-929 MJP (W.D. Wash. Jan. 21, 2011). EBIA further appealed to the United States Court of Appeals for the Ninth Circuit. While the appeal was pending, the Supreme Court decided *Stern*, holding that while 28 U.S.C. § 157(b)(1) provides that bankruptcy courts may enter a final judgment in certain enumerated "core proceedings," Article III of the Constitution prevents a Bankruptcy Court from finally adjudicating claims involving a matter of private rights rather than public rights (such claim a "Stern Claim") absent consent of the parties.

Relying on *Stern*, EBIA brought a motion to vacate the Bankruptcy Court's judgment for lack of subject matter jurisdiction, arguing that the fraudulent transfer action brought against EBIA (who was not a creditor of the bankruptcy estate) was a private right that could not be finally adjudicated by the Bankruptcy Court, notwithstanding that 28 U.S.C. § 157(b)(2)(H) gives a bankruptcy court the right to render final judgments in "proceedings to determine, avoid, or recover fraudulent conveyances." The Ninth Circuit held that in light of *Stern* and *Granfinanciera, S.A. v. Nordberg*, 492 U.S. 33 (1989) (holding that a fraudulent conveyance action brought under the Bankruptcy Code was not a public right), Article III of the Constitution does not permit fraudulent conveyance claims against non-creditors to be finally adjudicated by the bankruptcy court unless the parties consent. *Exec. Benefits Ins. Agency v. Arkison*, 702 F.3d 553, 572 (9th Cir. 2012). The court further concluded that given EBIA's failure to raise a jurisdictional objection before the Bankruptcy Court or the District Court, the parties had impliedly consented and the Bankruptcy Court's decision should stand. *Arkison*, 702 F.3d at 568. EBIA then appealed to the Supreme Court.

### **The Decision**

The Supreme Court affirmed the Ninth Circuit's holding. The Supreme Court chose not to analyze whether the fraudulent conveyance action constituted a Stern Claim, given the parties did not dispute the Ninth Circuit's conclusion that it did. Opinion at \*7. Instead, the Supreme Court focused its analysis on and emphatically rejected EBIA's contention that a bankruptcy court does not have jurisdiction over Stern Claims including solely in order to propose findings of fact and conclusions of law to a district court.

EBIA argued that the Bankruptcy Court lacked jurisdiction over the fraudulent conveyance action because it fell into a "statutory gap" where, as a Stern Claim, the bankruptcy court cannot adjudicate the claims notwithstanding that § 157(b) includes such claims as "core" proceedings that may be finally adjudicated by a bankruptcy court. The bankruptcy court similarly could not render proposed findings of fact or conclusions of law because such actions did not constitute related or non-core proceedings covered by §157(c), in light of their designation as core proceedings under § 157(b). *Id.* at \*7.

The Supreme Court rejected EBIA's argument, relying primarily on the jurisdictional statute's severability provisions to conclude that when a claim is classified as a Stern Claim, it

means only that a bankruptcy court cannot finally adjudicate the claim as a “core proceeding” under § 157(b), and has no effect on a bankruptcy court’s jurisdiction pursuant to any other portion of the statute. *Id.* The Court concluded that a fraudulent conveyance claim is “related to a case under title 11,” and therefore under § 157(c) a bankruptcy court may properly make proposed findings of fact and conclusions of law in the non-core proceeding, subject to *de novo* review by a district court. *Id.* at \*7-8.

The Supreme Court similarly rejected EBIA’s argument that it was denied its Constitutional right to a full review of the claims by an Article III court, holding that any procedural Constitutional defect was cured by the District Court’s consideration of the claims under a *de novo* review basis: “EBIA thus received the same review from the District Court that it would have received if the Bankruptcy Court had treated the fraudulent conveyance claims as non-core proceedings under § 157(c)(1). . . the District Court’s *de novo* review and entry of its own valid final judgment cured any error.” *Id.* at \*9.

### **Significance of the Opinion**

While the Supreme Court addressed the narrow question of bankruptcy courts’ ability to determine fraudulent conveyance claims, the Opinion is significant in providing much needed clarification on *Stern*’s scope and impact on bankruptcy courts’ jurisdiction in such cases, and assuaged any fears that *Stern* would lead to the total divestiture of bankruptcy court jurisdiction over *Stern* Claims due to a “statutory gap.” Notably, the Supreme Court reserved its consideration of whether Article III permits a bankruptcy court, with the consent of the parties, to enter final judgment on a *Stern* Claim. Opinion at \*4 n.4.

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