The Supreme Court Keeps Its "Stern" Promise Not To Change Bankruptcy Court Jurisdiction

By Stephen Lerner & Colter Paulson

The bankruptcy bench and bar breathed a sigh of relief when the Supreme Court issued *Executive Benefits Insurance Agency v. Arkison (In re Bellingham Insurance Agency, Inc.)*, No. 12-1200 (June 9, 2014) ("*Bellingham*"). Its prior decision in *Stern v. Marshall*, 131 S. Ct. 2594 (2011), held that bankruptcy courts do not have jurisdiction to enter final judgments on fraudulent conveyance claims against non-creditors. *Stern* held that those disputes were not "core" claims over which the bankruptcy court could exercise jurisdiction because of Article III concerns. In the aftermath of *Stern*, there were questions about whether bankruptcy courts can issue final rulings on fraudulent conveyance claims, leading many courts to issue findings of fact and conclusions of law for district courts to review, just to be safe. But *Stern* created at least an argument that a statutory loophole exists that prevents bankruptcy courts from issuing findings of fact and conclusions of law. It also led to a circuit split on whether Article III permits the consent of the parties to enable a bankruptcy court to enter a final judgment on a "*Stern*" claim. As we explained in the April edition of the CBA Report, the resolution of these questions could significantly affect the jurisdiction of bankruptcy and federal magistrate judges. Anticipating such questions, *Stern* promised an anxious bankruptcy bar that the decision "does not change all that much."

> The Supreme Court kept its promise and explicitly approved of the practice of using findings of fact and conclusions of law to eliminate jurisdictional problems.

The Supreme Court kept its promise and explicitly approved of the practice of using findings of fact and conclusions of law to eliminate jurisdictional problems. The court, however, technically punted on the consent issue which has split the circuit courts. In a unanimous opinion by Justice Thomas, the Court closed the loophole and gave clear and simple advice to bankruptcy courts when dealing with claims that they do not have jurisdiction to handle under *Stern*:

> [W]hen a bankruptcy court is presented with such a claim, the proper course is to issue proposed findings of fact and conclusions of law. The district court will then review the claim *de novo* and enter judgment.

The reasoning in *Bellingham* is simple. The Court first stated that the Congress had originally allowed for entry of final judgments in core matters and for proposed findings of law and fact in non-core matters. *Stern* held that bankruptcy courts could not enter final judgments in certain core matters, and the Court framed *Bellingham* as merely answering what to do with those matters that are no longer core under *Stern*. The sensible result, which the Court reached as a matter of statutory interpretation, was that those claims should be treated as non-core under the statute.

At first glance, *Bellingham* appears to be a narrow decision that does not decide the difficult questions of Article III and litigant consent. But the implications of the decision are clear enough:

First, the practical result is that the Supreme Court decided to preserve the decades-old practice in bankruptcy courts of entering final judgment on some claims and issuing findings of fact and conclusions of law on others. The only difference is that more claims will require findings than before. The Supreme Court did emphasize the importance of *de novo* review and

noted that the district court conducted a *de novo* review and issued a written opinion. But it is likely that district courts will continue to defer to bankruptcy court judges in the areas of their expertise when conducting a *de novo* review.

Second, the Court arguably gave tacit approval to the entry of final judgments of non-core matters after party consent. Footnote four does state that the question of consent is "reserved for another day." However, the Court stated in dicta that *Stern* claims could proceed as non-core under the statutory procedures of 28 U.S.C. §157(c). The opinion also repeatedly discusses the procedures in Section 157(c) that allow bankruptcy court to enter judgments with party consent. While the Court found that deciding the consent issue was not essential to its decision, directing bankruptcy courts to follow Section 157(c)(2) for *Stern* claims will provide fodder for parties to argue that consensual jurisdiction is legitimate The Court arguably sent a message that it is not very persuaded by arguments that structural Article III concerns prevent litigants from consenting to jurisdiction.

The suspense over these lingering questions may not last long. On July 1, the Court granted certiorari to the Seventh Circuit's decision in *Wellness International Network, Ltd. v. Sharif*, 727 F.3d 751 (2014). The grant was limited to two questions on jurisdiction (out of the four proposed). The first regards the bankruptcy court's jurisdiction to decide state law issues brought by a third-party against the debtor—an issue that is, itself, very important to the current practices of bankruptcy courts. But the second is whether Article III permits bankruptcy courts to exercise jurisdiction on the basis of litigant consent. In *Sharif* the Seventh Circuit followed the Sixth Circuit's decision in *Waldman v. Stone*, 698 F.3d 910 (2012), holding that litigants could not consent to final judgment by a bankruptcy court because of non-waivable Article III principles.

In light of *Bellingham*, we believe that *Sharif* will likely be reversed. But even if the Supreme Court only decides the first question in *Sharif*, the writing is on the wall. We expect that most lower courts are likely to take the hints from *Bellingham* and find that consent under Section 157(c) is sufficient to support jurisdiction. In the meantime, however, courts in the Sixth and Seventh Circuits may feel compelled to continue to follow *Waldman* and *Sharif* if they believe that *Bellingham* was not explicit enough on the consent issue to consider the holdings in those cases to be overturned.

In addition, *Bellingham's* implicit approval of consent to support jurisdiction over *Stern* claims may help resolve concerns about whether consent is sufficient to support magistrate judge jurisdiction under 28 U.S.C. 636(c)—which has many parallels to Section 157(c). The Supreme Court went out of its way to avoid disrupting the bankruptcy system in *Bellingham*; it is now much less likely that the Court will dismantle the jurisdiction of magistrate judges.

Third, the Supreme Court tacitly accepted the Ninth Circuit's decision that fraudulent conveyance claims are *Stern* claims. The opinion assumed without deciding that the Ninth Circuit correctly classified the claim as falling under *Stern*, and noted that the parties did not contest this issue. This is an issue essential to the Court's holding, and such comments give a clear signal that the Court is not troubled by the Ninth Circuit's decision. It is very unlikely that the Court will grant certiorari to reverse a decision holding fraudulent conveyance claims fall under *Stern*.

Fourth, any remaining issues, and especially those about consent, can be cured by *de novo* review in the district court. *Bellingham* strongly implies that constitutional concerns are irrelevant if the district court engages in *de novo* review: "At bottom, EBIA argues that it was entitled to have an Article III court review *de novo* and enter judgment on the fraudulent conveyance claims asserted by the trustee. In effect, EBIA received exactly that." The opinion explicitly approved of the practice where a district court treats a bankruptcy court's entry of judgment as a recommendation, conducts *de novo* review, and then enters its own judgment. The Court found that this process "cured any error" by the bankruptcy court. While some have argued that an Article III court must receive testimony in the first instance so it can evaluate credibility, the sweep of *Bellingham's* reasoning rejects such arguments.

In the end, *Bellingham* implied much more than it decided. But the takeaway for bankruptcy lawyers is that if there are any questions about the bankruptcy court's jurisdiction, those concerns can and should be resolved by asking for *de novo* review in the district court.

Lerner is the chair of the Squire Patton Boggs restructuring and insolvency practice group, and has an extensive national and cross-border restructuring practice. Paulson is a member of the Squire Patton Boggs appellate and U.S. Supreme Court practice group. Squire Patton Boggs served as lead counsel to the American College of Bankruptcy on its Supreme Court amicus brief in the Bellingham Insurance case.