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No. 12-1200

IN THE

Supreme Court of the United States

EXECUTIVE BENEFITS INSURANCE AGENCY,

Petitioner,

v.

PETER H. ARKISON, CHAPTER 7 TRUSTEE OF THE ESTATE OF BELLINGHAM INSURANCE AGENCY, INC.

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF *AMICUS CURIAE* OF THE BUSINESS LAW SECTION OF THE FLORIDA BAR IN SUPPORT OF NEITHER PARTY

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TABLE OF CONTENTS

Page

TABLE OF CONTENTS. i

TABLE OF CITED AUTHORITIES iii

I. *AMICUS CURIAE*. 1

II. SUMMARY OF ARGUMENT. 2

III. ARGUMENT 4

A. THE STATUTE IS PRESUMED TO BE CONSTITUTIONAL 6

B. NEITHER *STERN* NOR *GRANFINANCIERA* CONSIDERED THE CONSTITUTIONALITY OF 28 U.S.C. § 157(b)(2)(H) 8

1. The *Stern* Ruling Was Isolated And Narrow. 8

2. *Granfinanciera* Does Not Preclude A Finding That Bankruptcy Courts May Enter Judgments In Fraudulent Transfer Actions Brought By A Bankruptcy Trustee 10

Table of Contents

Page

C. UPON FULL CONSIDERATION, THE SUPREME COURT IS LIKELY TO UPHOLD THE AUTHORITY OF BANKRUPTCY COURTS TO FINALLY ADJUDICATE FRAUDULENT TRANSFER CLAIMS .12

1. Bankruptcy Fraudulent Transfer Actions Are Grounded In Federal Bankruptcy Law 14

2. Bankruptcy Fraudulent Transfer Actions Fall Within The Broad *In Rem* Jurisdiction Recognized By The Supreme Court 16

D. TREATMENT OF FRAUDULENT TRANSFER ACTIONS AS NON-CORE IS INCONSISTENT WITH *STERN'S* NARROW RULING. 20

E. CONSENT IS SUFFICIENT TO CONFER AUTHORITY IN NON-CORE MATTERS. 21

TABLE OF CITED AUTHORITIES

Page

CASES

Begier v. I.R.S.,
496 U.S. 53 (1990) 17

Central Va. Comm. Coll. v. Katz,
546 U.S. 356 (2006) . . . . *passim*

City Fire Equip. Co. v. Ansul Fire Prot. Wormald U.S., Inc.,
125 B.R. 645 (N.D. Ala. 1989) .12

Cohens v. Virginia,
19 U.S. 264 (1821) 6, 7

Exxon Shipping Co. v. Baker,
554 U.S. 471 (2008) 22

Feuerbacher v. Moser,
No. 4:11–CV–272, 2012 WL 1070138
(E.D. Tex. Mar. 29, 2012) 22

Glinka v. Abraham & Rose Co.,
1994 WL 905714 (D. Vt. June 2, 1994) 12

Granfinanciera v. Nordberg,
492 U.S. 33 (1989) . . . . *passim*

In re Apex Long Term Acute Care—Katy, L.P.,
465 B.R. 452 (Bankr. S.D. Tex. 2011) 11, 16

Page

In re BankUnited Fin. Corp.,
462 B.R. 885 (Bankr. S.D. Fla. 2011) 9

In re Blixseth,
No. 10–0088, 2011 WL 3274042
(Bankr. D. Mont. Aug. 1, 2011). 22

In re Bujak,
No. 11-6038-JDP, 2011 WL 5326038
(Bankr. D. Idaho Nov. 3, 2011) 9

In re Custom Contractors, LLC,
462 B.R. 901 (Bankr. S.D. Fla. 2011) 9, 12

In re DPH Holdings Corp.,
448 Fed. App'x 134, 2011 WL 5924410
(2d Cir. Nov. 29, 2011) 13

In re Feiler,
218 F.3d 948 (9th Cir. 2000) 19

In re Fietz,
852 F.2d 455 (9th Cir. 1988) 21

In re Heller Ehrman LLP,
No. 10-3203DM, 2011 WL 4542512
(Bankr. N.D. Cal. Sept. 28, 2011) 9

In re International Auction and Appraisal Servcs., LLC,
493 B.R. 460 (Bankr. M.D. Pa. 2013) 22

Page

In re MortgageAmerica Corp.,
714 F.2d 1266 (5th Cir. 1983) 19

In re Peacock,
455 B.R. 810 (Bankr. M.D. Fla. 2011) 9

In re Pearson Indus., Inc.,
178 B.R. 753 (Bankr. C.D. Ill. 1995) 19

In re Refco, Inc.,
461 B.R. 181 (Bankr. S.D.N.Y. 2011) 9, 12, 15, 16

In re Safety Harbor Resort & Spa,
456 B.R. 703 (Bankr. M.D. Fla. 2011) 9, 12

In re Salander O'Reilly Galleries,
453 B.R. 106 (Bankr. S.D.N.Y. 2011) 9

In re Wilderness Crossings, LLC,
No. 11–80417, 2011 WL 5417098
(Bankr. W.D. Mich. Nov. 8, 2011) 9

Katchen v. Landy,
382 U.S. 323 (1966) 13-14

Langenkamp v. Culp,
498 U.S. 42 (1990) 5, 14

Moore v. Bay,
284 U.S. 4 (1931) 4, 17

Page

Northern Pipeline Constr. Co. v. Marathon Pipe Line Co., 458 U.S. 50 (1982) 14, 19

Pacor, Inc. v. Higgins, 743 F.2d 984 (3d Cir. 1984) 21

Reitmeyer v. Meinen (In re Meinen), 232 B.R. 827 (Bankr. W.D. Pa. 1999) 12

Roell v. Withrow, 123 S. Ct. 1696 (2003) 23

Schlossberg v. Comptroller of the Treasury (In re Creative Goldsmiths), 119 F.3d 1140 (4th Cir. 1997), *cert. denied*, 523 U.S. 1075 (1998) 7

Sacred Heart Hosp. v. Dept. of Pub. Welfare (In re Sacred Heart Hospital), 133 F.3d 237 (3d Cir. 1998) 7

Seminole Tribe of Fla. v. Florida, 517 U.S. 44 (1996) 7

Stein v. Miller, 158 B.R. 876 (S.D. Fla. 1993) 12

Stern v. Marshall, 131 S. Ct. 2594 (2011) . . . . *passim*

Page

U.S. v. Morrison,
529 U.S. 598 (2000) 6

U.S. v. Whiting Pools, Inc.,
462 U.S. 198 (1983) 17

Union Bank v. Wolas,
502 U.S. 151 (1991) 5

Van Huffel v. Harkelrode,
284 U.S. 225 (1931) 17

STATUTES

Article III to the U.S. Constitution. 8, 11, 16

Seventh Amendment to the U.S. Constitution. . 5, 10, 11, 16

Eleventh Amendment to the U.S. Constitution 7

11 U.S.C. § 101 4

11 U.S.C. § 502(d). 10, 13, 14, 15

11 U.S.C. § 541 . . . . .4, 5

11 U.S.C. § 541(a) 19

11 U.S.C. § 544 . . . . .4, 15, 16

Page

11 U.S.C. § 544(a)(1). 15

11 U.S.C. § 546(e). 15

11 U.S.C. § 547 . . . . .15, 16

11 U.S.C. § 548. . . . . .15, 16, 19

11 U.S.C. § 548(a)(1). 19

11 U.S.C. § 548(a)(1)(B) 11

11 U.S.C. § 548(a)(2) 11

11 U.S.C. § 549 15

11 U.S.C. § 550 . . . . .4, 15, 16, 19

11 U.S.C. § 550(a). 16

11 U.S.C. § 551 15

28 U.S.C. § 157(b)(1) 12

28 U.S.C. § 157(b)(2) 13

28 U.S.C. § 157(b)(2)(A). 13

28 U.S.C. § 157(b)(2)(B). 13

Page

28 U.S.C. § 157(b)(2)(C) 8, 10

28 U.S.C. § 157(b)(2)(f) 2

28 U.S.C. § 157(b)(2)(h) . . . . *passim*

28 U.S.C. § 157(b)(2)(O) 13

28 U.S.C. § 157(c)(1) 3, 4, 20, 21

28 U.S.C. § 157(c)(2) 3, 4, 21, 22

28 U.S.C. § 586(3) 4

28 U.S.C. § 636 23

28 U.S.C. § 636(c) 4, 23

28 U.S.C. § 1334(b) 21

UFCA § 9(1) 4, 15

UFTA § 7(a)(1) 4, 15

28 C.F.R. § 58.3. 4

Supreme Court Rule 37(3) 1

I. *AMICUS CURIAE*

This brief is submitted by the Business Law Section of The Florida Bar (the "Section"), pursuant to the consent to the filing of *amicus curaie* briefs, in support of either party or neither party, filed with the Court on August 27, 2013 in accordance with Supreme Court Rule 37(3)[1]. The Section consists of more than 5,000 members and the impetus for this brief arose from the Section's Bankruptcy/UCC Committee. Although a prior version of this brief was reviewed by the Executive Committee of the Board of Governors of The Florida Bar on January 11, 2012 consistent with applicable standing board policies, it is tendered solely by the Section and supported by the separate resources of this voluntary organization - not in the name of The Florida Bar, and without implicating the mandatory membership fees paid by any Florida Bar licensee.

This brief does not support a particular party. The Section will not address any factual or legal issue raised by this appeal, except the issues of whether (1) a fraudulent transfer action filed by a bankruptcy trustee may be finally adjudicated by a bankruptcy court, and (2) bankruptcy courts can issue final judgments in non-core matters "related to" bankruptcy cases when the parties consent. For almost thirty years, Florida bankruptcy courts

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1. Attorneys authoring the brief on behalf of the Section inlcude Paul Steven Singerman and Roberta A Colton. No counsel for a party authored this brief in whole or in part, and no such counsel or party made a monetary contribution intended to fund the preparation or submission of this brief. No person other than the *amicus*, or its counsel, made a monetary contribution intended to fund its preparation or submission. As previously stated, the parties have filed blanket waivers with the Court consenting to the submission of all *amicus* briefs.

have finally adjudicated countless fraudulent transfer actions. Because this appeal purports to challenge the jurisdictional underpinnings of those judgments, the Section determined that an *amicus* brief is appropriate.

For many reasons, numerous "Ponzi" and similar fraud cases seem to be ultimately resolved in Florida bankruptcy courts. One such case alone can give rise to hundreds of fraudulent transfer adversary proceedings. Removing those proceedings from bankruptcy courts and transferring them instead to state court or the federal district court (or worse, trying them once in bankruptcy court and then again in federal district court) would have a significant impact on the administration of justice in states such as Florida, where federal and state courts are already struggling with overly crowded dockets. Doing so would also impact the quality of justice for bankruptcy estates that have limited resources, thus impairing the ability of creditors to recover losses.

The Section acknowledges that concern for efficient judicial administration and timely justice alone cannot trump constitutional requirements, but it does caution prudence and restraint in considering the constitutionality of an important and longstanding practice.

II. SUMMARY OF ARGUMENT

Until *Stern v. Marshall*, 131 S. Ct. 2594 (2011), no case law from the Court questioned the long-standing practice of bankruptcy courts entering final orders in fraudulent conveyance actions. Indeed, federal courts worked on the assumption that avoidance actions, designated as "core" proceedings, 28 U.S.C. § 157(b)(2)(f) (preference actions) and (h) (fraudulent transfer actions), could be

adjudicated in the form of final orders by bankruptcy courts. Although *Stern* held that a bankruptcy court could not enter a final judgment on a state law counterclaim that was not necessarily resolved as part of the claims allowance/disallowance process, the Court made clear that this holding was "narrow" and "isolated," and did not "meaningfully change" the division of labor between district and bankruptcy court judges. Given the Court's repeated statements that the holding in *Stern* was narrow, most courts have given that holding a narrow construction. Neither *Stern* nor *Granfinanciera v. Nordberg*, 492 U.S. 33 (1989), or any other decision from this Court held, explicitly or implicitly, that bankruptcy courts lacked the constitutional authority to enter final judgments in fraudulent transfer actions. As such, the statute at issue here, 28 U.S.C. § 157(b)(2)(h), should be presumed constitutional. For these reasons, as explained in more detail in the Argument section of this Brief, the Section submits that a fraudulent transfer action prosecuted by a trustee in bankruptcy can be adjudicated in the form of a final order by an Article I bankruptcy court without exceeding that court's authority under the United States Constitution.

The Section further submits that, even where bankruptcy courts cannot constitutionally adjudicate a "core" fraudulent transfer action under *Stern*, such courts can submit proposed findings of fact and conclusions of law for *de novo* review by district courts as they do in non-core matters. This result has been reached by the vast majority of lower courts that have addressed the issue. Yet, in non-core matters that are "related to" bankruptcy cases, the parties' consent allows the bankruptcy court to enter a final order as specifically contemplated by 28 U.S.C. § 157(c)(1) and (2). And nothing in *Stern* addressed,

let alone found, that entry of a final decision in a non-core matter brought by a trustee pursuant to § 157(c)(1) or (2) would violate the Constitution. A contrary determination would call into question long-standing statutes that provide for similar procedures, *i.e.*, 28 U.S.C. § 636(c).

III. ARGUMENT

In a chapter 7 case, such as *Bellingham Insurance Agency, Inc.*, a trustee is appointed to marshal the assets of the estate and to pay the claims of creditors. The trustee is supervised by the Office of the United States Trustee and must provide a bond in favor of the United States.[2] The Bankruptcy Code[3] authorizes the trustee to commence an adversary proceeding to avoid transfers of property that is rightfully property of the bankruptcy estate.[4] Once avoided, a bankruptcy fraudulent transfer (whether property or money) may then be recovered for the benefit of all creditors.[5]

Outside of bankruptcy, a fraudulent transfer claim under state law is generally limited to the amount of a single creditor's claim.[6] In enacting the Bankruptcy Code,

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2. *See generally* 28 U.S.C. § 586(3) and 28 C.F.R. § 58.3.

3. 11 U.S.C. §§ 101 *et seq.*

4. 11 U.S.C. §§ 541, 544.

5. 11 U.S.C. § 550; *see also Moore v. Bay,* 284 U.S. 4 (1931).

6. 43 states and the District of Columbia have adopted the Uniform Fraudulent Transfer Act (the "UFTA") and 2 (New York and Maryland) as well as the U.S. Virgin Islands have adopted the Uniform Fraudulent Conveyance Act (the "UFCA"). Both statutes limit recoveries to the extent of the single creditor's claim. UFTA § 7(a)(1); UFCA § 9(1).

it was the express intent of Congress to end the race to the courthouse and to promote the equal treatment of creditors. *See generally Union Bank v. Wolas,* 502 U.S. 151, 160-61 (1991).

The recovery of fraudulent transfers for the benefit of all creditors is a fundamental aspect of the bankruptcy scheme enacted by Congress. A bankruptcy estate is defined as "all legal or equitable interests of the debtor," and includes the recovery of fraudulently transferred property. 11 U.S.C. § 541. The Judicial Code of the United States clearly provides that a fraudulent transfer action, as well as an action for recovery of the property, lies within the "core" jurisdiction of the United States Bankruptcy Courts. 28 U.S.C. § 157(b)(2)(H). For years, bankruptcy courts have tried and entered final judgments in fraudulent transfer actions.

In 1989, the Court ruled in *Granfinanciera v. Nordberg,* 492 U.S. 33 (1989), that a defendant in a fraudulent transfer action seeking a money judgment, as opposed to the return of a tangible object or land, has a right to a jury trial under the Seventh Amendment of the Constitution. That right was quickly limited by the Court to actions where the defendant had not filed a claim in the bankruptcy case. *See Langenkamp v. Culp,* 498 U.S. 42 (1990) (by filing a claim, a preference defendant waives the jury trial right).

Since *Granfinanciera* was decided in 1989, the "core" jurisdiction of a bankruptcy court to adjudicate a fraudulent transfer action was not seriously questioned until the Court's 2011 decision of *Stern v. Marshall,* 131 S. Ct. 2594 (2011). In *Stern,* the Court ruled that a bankruptcy court could not enter judgment on a state

law counterclaim that was not necessarily resolved as part of the bankruptcy claims resolution process. The Court plainly stated that its ruling was "narrow" and "isolated." *Id.* at 2620. Nevertheless, litigants anxious to frustrate the efforts of bankruptcy trustees and avoid or delay the return of fraudulently transferred assets have seized on dicta in *Stern* and *Granfinanciera* to conclude that statutory law recognizing a bankruptcy court's "core" jurisdiction to adjudicate such actions is unconstitutional. This conclusion is unfounded. It is an overreaction to dicta in two narrowly decided cases, and it ignores a substantial body of case law that supports the constitutional underpinnings of 28 U.S.C. § 157(b)(2)(H).

A. THE STATUTE IS PRESUMED TO BE CONSTITUTIONAL

In considering the constitutionality of any statute, restraint and deference should be exercised.

> Due respect for the decisions of a coordinate branch of Government demands that we invalidate a congressional enactment only upon a plain showing that Congress has exceeded its constitutional bounds. With this presumption of constitutionality in mind, we turn to the question ...

U.S. v. Morrison, 529 U.S. 598, 607 (2000) (citations omitted). In view of this standard, dicta should not be the basis for striking down a law duly enacted by Congress. For the reasons stated by Chief Justice Marshall in *Cohens v. Virginia,* 19 U.S. 264 (1821), the Court is not bound to follow its own dicta:

> It is a maxim not to be disregarded, that general expressions, in every opinion, are to be taken in connection with the case in which those expressions are used. If they go beyond the case, they may be respected, but ought not to control the judgment in a subsequent suit when the very point is presented for decision.

Id. at 399. The danger of elevating dicta is well illustrated by the aftermath of the Court's case of *Seminole Tribe of Fla. v. Florida,* 517 U.S. 44 (1996), which applied Eleventh Amendment sovereign immunity to the Indian Commerce Clause.

After *Seminole Tribe,* lower courts simply assumed, based on the Court's seemingly clear dicta that the same Eleventh Amendment analysis would apply to the Bankruptcy Clause.[7] It was not until the 2006 case of *Central Va. Comm. Coll. v. Katz,* 546 U.S. 356 (2006), that the Court directly addressed the issue. With the benefit of full briefing and consideration of the issues presented, the Court concluded the assumption that *Seminole Tribe* applied to bankruptcy cases was incorrect. The Court said that although statements in *Seminole Tribe* "reflect an assumption that the case's holding would apply to the [Bankruptcy] Clause, careful study and reflection convince this Court that that assumption was erroneous." *Id.* at 363.

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7. *See, e.g., Schlossberg v. Comptroller of the Treasury (In re Creative Goldsmiths),* 119 F.3d 1140 (4th Cir. 1997), *cert. denied,* 523 U.S. 1075 (1998); *Sacred Heart Hosp. v. Dept. of Pub. Welfare (In re Sacred Heart Hospital),* 133 F.3d 237 (3d Cir. 1998).

B. NEITHER *STERN* NOR *GRANFINANCIERA* CONSIDERED THE CONSTITUTIONALITY OF 28 U.S.C. § 157(b)(2)(H)

1. The *Stern* Ruling Was Isolated And Narrow

Stern held that a bankruptcy court "lacked the constitutional authority to enter final judgment on a state law counterclaim that is not resolved in the process of ruling on a creditor's proof of claim." 131 S. Ct. at 2620. The Court reasoned that the bankruptcy court had the statutory authority to consider Vickie Lynn Marshall's (a/k/a Anna Nicole Smith) counterclaim, but that the statute itself (28 U.S.C. § 157(b)(2)(C)) was unconstitutional, as applied to her state law counterclaim. *Id.* at 2597. Because the counterclaim could not be resolved in the process of ruling on E. Pierce Marshall's proof of claim for defamation, it had to be tried by an Article III court. *Id.* at 2611. The decision was 5-4.

Writing for the Court, Chief Justice Roberts stressed the narrowness of the holding and minimized its practical impact in his final comments:

> Article III of the Constitution provides that the judicial power of the United States may be vested only in courts whose judges enjoy the protections set forth in that Article. We conclude today that Congress, *in one isolated respect,* exceeded that limitation in the Bankruptcy Act of 1984. The Bankruptcy Court below lacked the constitutional authority to enter a final judgment on a state counterclaim that is not resolved in the process of ruling on a creditor's proof of claim.

Id. at 2620 (emphasis original). The Court emphasized that "the question presented here is a 'narrow' one" and "our decision today does not change all that much" in bankruptcy law. *Id.* Accepting this guidance, many courts have narrowly construed the *Stern* holding.[8]

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8. *See, e.g., In re Safety Harbor Resort & Spa,* 456 B.R. 703, 705 (Bankr. M.D. Fla. 2011) ("The Supreme Court merely held that Congress exceeded its authority under the Constitution in one isolated instance ... the Supreme Court's holding in *Stern* was very narrow"); *In re Peacock,* 455 B.R. 810, 812 (Bankr. M.D. Fla. 2011); *In re BankUnited Fin. Corp,* 462 B.R. 885, 892 (Bankr. S.D. Fla. 2011) ("As a bankruptcy court, I will not [make decisions] based on extrapolations of what the Chief Justice took great pains to emphasize is the narrow holding of *Stern.*"*); In re Refco, Inc.,* 461 B.R. 181, 191(Bankr. S.D.N.Y. 30, 2011); *In re Wilderness Crossings, LLC,* No. 11–80417, 2011 WL 5417098, at *2 (Bankr. W.D. Mich. Nov. 8, 2011) ("Our common law tradition counsels in favor of hewing closely to the holdings of higher authority and although the multifarious rationales in *Stern* are quite broad, the holding is mercifully narrow."); *In re Bujak,* No. 11-6038-JDP, 2011 WL 5326038 at *2 (Bankr. D. Idaho Nov. 3, 2011) ("Despite what the majority actually said in *Stern,* some insist that the decision foretells a jurisdictional Armageddon for the bankruptcy courts. This Court disagrees. It instead chooses to believe the Supreme Court's own assessment of the decision's impact, and discounts those who argue that the sky is falling. While the Supreme Court in the future may explain its decision, and could conceivably expand the reach of *Stern*'s constitutional analysis, . . . this Court need not do so. Instead of attempting to predict the future, this Court should carefully apply *Stern*'s holding in its cases, and refrain from extending that holding to facts different from those in Stern."); *In re Salander O'Reilly Galleries,* 453 B.R. 106, 115-16 (Bankr. S.D.N.Y. 2011) ("*Stern* is replete with language emphasizing that the ruling should be limited to the unique circumstances of that case."); *In re Heller Ehrman LLP,* No. 10-3203DM, 2011 WL 4542512 (Bankr. N.D. Cal. Sept. 28, 2011); *In re Custom Contractors, LLC,* 462 B.R. 901, (Bankr. S.D. Fla. 2011).

Notably, *Stern* did not involve a fraudulent transfer action at all. Indeed, the Court in *Stern* did not rule that 28 U.S.C. § 157(b)(2)(C) was unconstitutional with respect to all counterclaims. Counterclaims that can be decided as part of the claims allowance process remain subject to the core jurisdiction of a bankruptcy court. Because a claimant who has received a fraudulent transfer is prohibited from having any claim in a bankruptcy case until it is returned, 11 U.S.C. § 502(d), the determination of a fraudulent transfer action may be critical to the claims resolution process. In this regard, *Stern* actually supports the exercise of core bankruptcy court jurisdiction in the case of a preference or fraudulent transfer counterclaim.

2. *Granfinanciera* Does Not Preclude A Finding That Bankruptcy Courts May Enter Judgments In Fraudulent Transfer Actions Brought By A Bankruptcy Trustee

In *Granfinanciera,* the Court held that a party who has not asserted a claim in bankruptcy has the right to a jury trial when sued by a bankruptcy trustee to recover a fraudulent transfer of money. 492 U.S. at 36. The Court analyzed the Seventh Amendment, focusing on the historical nature of the cause of action and the nature of the remedy sought. In holding that the right to a trial by jury survived enactment of the Bankruptcy Code, the Court did not determine whether the bankruptcy court could itself conduct the required jury trial. *Id.* at 50, 64-65. The Court simply held that Congress could not strip a litigant of its jury trial right by assigning the cause of action to a court of equity for adjudication.

Granfinanciera referenced the public rights exception to the requirement of adjudication by an Article III tribunal, and stated that actions "to recover a fraudulent conveyance under 11 U.S.C. § 548(a)(2)[9] seem to us more accurately characterized as a private rather than a public right..." 492 U.S. at 55. Ultimately, however, the majority opinion stated that "[t]he sole issue before us is whether the Seventh Amendment confers on petitioners a right to a jury trial in the face of Congress' decision to allow a non-Article III tribunal to adjudicate the claims against them." *Id.* at 50. Further, at least in the context of a bankruptcy preference claim, one court has already ruled that *Granfinanciera's* "public rights" dicta was implicitly overruled by the Supreme Court's more recent decision of *Central Va. Comm. College v. Katz,* 546 U.S. 356 (2006). *See In re Apex Long Term Acute Care—Katy, L.P.,* 465 B.R. 452 (Bankr. S.D. Tex. 2011).

Notably, *Granfinanciera* did not hold that bankruptcy courts lack jurisdiction or authority to enter final judgments in fraudulent transfer actions. The fact that, in certain limited cases, a defendant may be entitled to a jury trial in no way impacts the jurisdictional basis of the claim. Indeed, many cases have properly drawn the distinction between "the right to a jury trial, at issue in *Granfinanciera,* and the power of a bankruptcy court to issue a final order notwithstanding its Article I status," deciding that the jury trial issue in *Granfinanciera* "did not restrict the bankruptcy courts' power to decide

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9. At the time *Granfinanciera* was decided, § 548(a)(2) provided for the avoidance of constructively fraudulent transfers, now provided for in Section 548(a)(1)(B). Accordingly, the Court's statement does not appear to apply to actual fraud claims.

motions to dismiss and summary judgment motions on fraudulent transfer claims on a final basis."[10] As a practical matter, courts and litigants simply continued to operate under the premise that the bankruptcy courts had the constitutional as well as the statutory power to issue final judgments in fraudulent transfer proceedings.[11] In the twenty years between *Granfinanciera* and *Stern,* no court challenged a bankruptcy court's authority to enter final judgments in fraudulent conveyance actions.[12]

C. UPON FULL CONSIDERATION, THE SUPREME COURT IS LIKELY TO UPHOLD THE AUTHORITY OF BANKRUPTCY COURTS TO FINALLY ADJUDICATE FRAUDULENT TRANSFER CLAIMS

Section 157(b)(1) of title 28 empowers bankruptcy judges, by referral from the district court, to hear and determine all cases under title 11, and all core proceedings arising under title 11 or arising in or related to a case under title 11. By their nature, proceedings can be

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10. *In re Refco,* 461 B.R. at 190. *See, e.g., Glinka v. Abraham & Rose Co.,* 1994 WL 905714, at *20-24 (D. Vt. June 2, 1994); *Stein v. Miller,* 158 B.R. 876, 880 (S.D. Fla. 1993); *City Fire Equip. Co. v. Ansul Fire Prot. Wormald U.S., Inc.,* 125 B.R. 645, 649 (N.D. Ala. 1989) (en banc); *Reitmeyer v. Meinen (In re Meinen),* 232 B.R. 827, 833 (Bankr. W.D. Pa. 1999). Cases in which a jury trial is requested are generally pre-tried by the bankruptcy court and the jury trial subsequently conducted by the district court.

11. *See In re Refco,* 461 B.R. 181 (Bankr. S.D.N.Y. 2011).

12. *See In re Safety Harbor Resort & Spa,* 456 B.R. 703 (Bankr. M.D. Fla. 2011); *In re Custom Contractors,* 462 B.R. at 907-08.

core if either "(1) the type of proceeding is unique to or uniquely affected by the bankruptcy proceedings or (2) the proceedings directly affect a core bankruptcy function." *In re DPH Holdings Corp.,* 448 Fed. App'x 134, 136, 2011 WL 5924410, at *1 (2d Cir. Nov. 29, 2011) (internal quotations omitted). Section 157(b)(2) provides a non-exhaustive list of core proceedings, including: "matters concerning the administration of the estate," proceedings seeking the "allowance or disallowance of claims against the estate," and "other proceedings affecting the liquidation of the assets of the estate or the adjustment of the debtor-creditor . . . relationship." 28 U.S.C. § 157(b)(2)(A), (B), (O). Section 157(b)(2)(H) adds "proceedings to determine, avoid, or recover fraudulent conveyances" as core proceedings.

Whether a proceeding is core is irrelevant for determining jurisdiction. *Stern,* 131 S. Ct. at 2607 ("That allocation [of core and non-core] does not implicate questions of subject matter jurisdiction"). As long as a proceeding is one or the other, the bankruptcy court has subject-matter jurisdiction. *Stern* addresses the authority of bankruptcy judges over proceedings referred to them by the district court, not bankruptcy subject matter jurisdiction. *Stern* does not question a bankruptcy court's authority to determine state law claims that "stem[] from the bankruptcy itself or would necessarily be resolved in the claims allowance process." *Id.* at 2618.

When a fraudulent transfer defendant has filed a proof of claim, the bankruptcy court's core jurisdiction seems obvious. Unlike the counterclaim in *Stern,* a fraudulent transfer counterclaim is intrinsically tied to the claims resolution process. *See* 11 U.S.C. § 502(d); *see also Katchen*

v. Landy, 382 U.S. 323 (1966); *Langenkamp v. Culp,* 498 U.S. 42 (1990). A fraudulent transfer counterclaim must be adjudicated before the primary claim is allowed against the estate. 11 U.S.C. § 502(d). Accordingly, *Stern* itself supports core jurisdiction where a counterclaim, such as a fraudulent transfer, must be resolved in the claims resolution process.

The more difficult case is when, before filing bankruptcy, the debtor simply gives away his money or property to a friend or relative who makes no claim against the bankruptcy estate. In such a case, the defendant has not submitted to the jurisdiction of the bankruptcy court by filing a proof of claim. Nevertheless, the nature of a fraudulent transfer claim - to recover property improperly transferred - historically and constitutionally supports the conclusion that bankruptcy courts have "core" jurisdiction over such claims. Moreover, such authority is essential to the fundamental bankruptcy functions of gathering property of the estate and distributing it equally among creditors.

1. Bankruptcy Fraudulent Transfer Actions Are Grounded In Federal Bankruptcy Law

The prosecution of avoidance actions such as fraudulent transfers has been "a core aspect of the administration of bankrupt estates since the 18th century. . ." *Katz,* 546 U.S. at 369-70. Unlike the state law tortious interference claim in *Stern,* or even the state law contract action that was the subject of *Northern Pipeline Constr. Co. v. Marathon Pipe Line Co.,* 458 U.S. 50 (1982), fraudulent transfer claims flow from a federal statutory scheme and are "completely dependent upon adjudication of a claim created by federal

law." *In re Refco,* 461 B.R. at 187. Federal law provides the right upon which the remedy for a bankruptcy fraudulent transfer is based. Within the chapter of Title 11 entitled "The Estate," Congress provides for the avoidance of preferences (§ 547), fraudulent transfers (§§ 548 and 544), and unauthorized post-bankruptcy transfers (§ 549). Section 548 is a standalone statute governing fraudulent transfers. Section 544 effectively incorporates state law avoidance powers by granting a bankruptcy trustee the power to avoid transfers that are voidable by a judgment lien creditor. 11 U.S.C. § 544(a)(1). All bankruptcy avoiding powers exist "within a unique statutory framework such as the safe harbor of 11 U.S.C. § 546(e), the recovery and preservation provisions of 11 U.S.C. §§ 550 and 551, and the 'pay or face claim disallowance' rule of 11 U.S.C. § 502(d)." *Id.*

A fraudulent transfer action under §§ 544 or 548, <u>initiated for the benefit of all creditors</u> of the bankruptcy estate, does not exist independent of a bankruptcy case. Outside of bankruptcy, an individual creditor may race to the courthouse to recover transfers, but only to the extent of its own claim. UFTA § 7(a)(1); UFCA § 9(1). Not only is the nature of the remedy different in bankruptcy, but, in fact, the "race to the courthouse" is precisely the conduct that Congress sought to prevent in enacting the Bankruptcy Code. Further, adjudication of a bankruptcy fraudulent transfer claim is a "particularized area of the law" because of the significance of the litigation to the overall case and creditor recoveries, as well as bankruptcy courts' fluency in the Bankruptcy Code's fraudulent transfer statutory scheme. *In re Refco,* 461 B.R. at 187. This is particularly true in cases in which most of the debtor's property has been transferred to third parties

prepetition, "such as the many *Ponzi-* scheme driven cases of recent years, requiring a coordinated response overseen by one judge on behalf of a host of creditor-victims." *Id.* at 188. Also, in Section 550 of the Bankruptcy Code, Congress adopted a unified mechanism for recovery of the property avoided under §§ 548, 544 or even § 547, which has resulted in a complex body of case law, including considerations regarding "initial" versus "mediate" transferees, "good faith," conduits, and allocations for improvements to property. 11 U.S.C. § 550.

2. Bankruptcy Fraudulent Transfer Actions Fall Within The Broad *In Rem* Jurisdiction Recognized By The Supreme Court

Notwithstanding extensive and conflicting dicta, the Court has not directly considered whether avoidance actions, such as preferences and fraudulent transfers, all of which are recovered under 11 U.S.C. § 550, fall within the bankruptcy court's *in rem* jurisdiction. In *Katz,* the Court stated that "it is not necessary to decide whether actions to recover preferential transfers pursuant to § 550(a) are themselves properly characterized as *in rem.*" 546 U.S. at 372. In *Granfinanciera,* the Court concluded that a constructive fraudulent transfer action for money is a legal action for Seventh Amendment purposes but not directly for Article III purposes. As a result, the Court has not had the occasion to fully consider the body of case law, as a whole, which delineates the expansive *in rem* jurisdiction of bankruptcy courts, including the issuance of ancillary *(in personam)* orders necessary to effectuate that jurisdiction. *See In re Apex,* 465 B.R. at 464-65 ("Even if the estate seeks a turnover order under § 550(a), a bankruptcy court may issue such an order 'ancillary to

and in furtherance of the court's *in rem* jurisdiction.'") (citing *Katz).*

Avoidance claims are a core aspect of bankruptcy because of the bankruptcy court's "principally *in rem* jurisdiction." *Katz,* 546 U.S. at 369-70. Indeed, the Court has historically recognized the expansive *in rem* jurisdiction of bankruptcy courts. Justice Holmes concluded in 1931 that "[t]he trustee in bankruptcy gets the title to all property which has been transferred by the bankrupt in fraud of creditors or which prior to the petition he could by any means have transferred, or which might have been levied upon and sold under judicial process against him." *Moore v. Bay,* 284 U.S. 4 (1931). Shortly thereafter, the Court, through Justice Brandeis, reaffirmed expansive *in rem* jurisdiction in bankruptcy courts with the power and duty to collect, reduce to money through sale, and distribute the *res* of bankruptcy estates. *Van Huffel v. Harkelrode,* 284 U.S. 225 (1931).

In the 1983 case of *U.S. v. Whiting Pools, Inc.,* 462 U.S. 198 (1983), the Court held that a bankruptcy estate includes property of the debtor seized by a creditor prior to the filing of the bankruptcy case. In the 1990 decision of *Begier v. I.R.S.,* 496 U.S. 53 (1990), the Court further reasoned that "property of the debtor" includes property that would have been part of the estate but for the transfer prior to the commencement of the case, and that the purpose of the avoidance provision is to preserve property includable within the bankruptcy estate.

In *Katz,* the Court held that sovereign immunity does not bar a bankruptcy trustee's avoidance action against a state agency. 546 U.S. at 369-70. Focusing on the *in rem*

jurisdiction of a bankruptcy court, three critical *in rem* functions were identified: "[1] the exercise of exclusive jurisdiction over all of the debtor's property, [2] the equitable distribution of that property among the debtor's creditors, and [3] the ultimate discharge that gives the debtor a 'fresh start' by releasing him, her, or it from further liability for old debts." *Id.* at 363-64.

As noted in *Katz,* "courts adjudicating disputes concerning bankrupts' estates historically have had the power to issue ancillary orders enforcing their *in rem* adjudications." *Katz,* 546 U.S. at 370. The Court goes on to describe such orders ancillary to this *in rem* jurisdiction as orders directing turnover of preferential transfers, and other orders which facilitate the recovery of transferred property. *Id.* at 372-73. Although the Court stops short of finding the avoidance action against the state agency within the *in rem* jurisdiction of the bankruptcy court, it makes the following observations:

> In some cases, though, the trustee, in order to marshal the entirety of the debtor's estate, will need to recover the subject of the transfer pursuant to § 550(a). A court order mandating turnover of the property, although ancillary to and in furtherance of the court's *in rem* jurisdiction, might itself involve *in personam* process.
>
> ...it is not necessary to decide whether actions to recover preferential transfers pursuant to § 550(a) are themselves properly characterized as *in rem*. Whatever the appropriate appellation, those who crafted the Bankruptcy Clause

> would have understood it to give Congress the power to authorize courts to avoid preferential transfers and to recover the transferred property. Petitioners do not dispute that that authority has been a core aspect of the administration of bankruptcy estates since at least the 18th century.

Id. at 371-72.

A bankruptcy estate is defined to include all of a debtor's legal and equitable interests "wherever located and by whomever held." 11 U.S.C. § 541(a). In the same chapter of the Code, § 548 effectively expands the *res* of a bankruptcy estate to include property fraudulently transferred within 2 years of the petition. 11 U.S.C. § 548(a)(1). If the property is not returnable in kind, then "if the court so orders," the trustee may obtain a money judgment. 11 U.S.C. § 550.

An avoided transfer is treated "as though the Debtor had never transferred it." *In re MortgageAmerica Corp.*, 714 F.2d 1266, 1275 (5th Cir. 1983). In other words, "[o]nce avoided, the transaction is a nullity and is treated as if it never happened." *In re Feiler*, 218 F.3d 948, 953 (9th Cir. 2000). Further, "the transfer is retroactively ineffective and the transferee legally acquired nothing through it." *In re Pearson Indus., Inc.*, 178 B.R. 753, 759 (Bankr. C.D. Ill. 1995). In this respect, a fraudulent transfer claim in bankruptcy is akin to an action for constructive trust under state law, which arguably gives rise to an equitable interest existing at the commencement of the case. The state law claims for damages in *Stern* and *Northern Pipeline* do not share this characteristic, nor do they give

rise to any equitable property interests. Moreover, unlike a fraudulent transfer or preference, a state law breach of contract claim has no historical basis in bankruptcy.

D. TREATMENT OF FRAUDULENT TRANSFER ACTIONS AS NON-CORE IS INCONSISTENT WITH *STERN'S* NARROW RULING

Since *Stern,* a number of district courts have denied motions to withdraw the reference for final judgment, ordering that the fraudulent transfer action continue in the bankruptcy court for all purposes including trial. Out of caution due to the potential implications of *Stern,* however, those courts have limited the bankruptcy court to entering proposed findings of fact and conclusions of law. This is the statutory procedure followed in non-core cases and requires that the final judgment be entered by the district judge after reviewing *de novo* the bankruptcy court's proposed findings of fact and conclusions of law as to those matters to which any party objected. 28 U.S.C. § 157(c)(1).

Although constitutionally sound, any suggestions that this procedure does not "meaningfully change" the division of labor between bankruptcy judges and district judges, and thus would be consistent with the admonition in *Stern* that its holding was a "narrow" one, is misplaced. To the contrary, the difference in judicial effort to administer hundreds of fraudulent transfer actions in any district would be substantial. Rather than the relatively rare appeal in which a bankruptcy judge's findings of fact are upheld unless clearly erroneous, this new system would mandate *de novo* review in every fraudulent transfer action in which proposed findings of fact and conclusions

of law were submitted and a party objected. Without doubt, this would constitute "meaningful change," directly contrary to *Stern's* conclusion, and may significantly impact the administration of justice in states, like Florida, where judicial resources are already heavily taxed.

E. CONSENT IS SUFFICIENT TO CONFER AUTHORITY IN NON-CORE MATTERS

Regardless of *Stern*, bankruptcy courts are statutorily authorized to hear non-core matters "related to" bankruptcy cases and issue proposed findings of fact and conclusions of law, and if the parties consent, bankruptcy courts can enter final judgments on such non-core matters subject to appellate review. 28 U.S.C. § 157(c)(1) and (2). The Ninth Circuit has adopted the widely-cited *Pacor* test enunciated by the Third Circuit for determining whether a non-core matter is within the scope of a bankruptcy court's "related to" jurisdictional grant provided by 28 U.S.C. § 1334(b). *In re Fietz*, 852 F.2d 455, 457 (9th Cir. 1988). Under this formulation, a matter is "related to" a bankruptcy proceeding when "*the outcome of the proceeding could conceivably have any effect on the estate being administered in bankruptcy.* Thus, the proceeding need not necessarily be against the debtor or against the debtor's property. An action is related to bankruptcy if the outcome could alter the debtor's rights, liabilities, options, or freedom of action (either positively or negatively) and which in any way impacts upon the handling and administration of the bankrupt estate." *Id.* (quoting *Pacor, Inc. v. Higgins,* 743 F.2d 984, 994 (3d Cir. 1984)) (Italics in original) (internal citations omitted).

There is dispute whether, in respect of core matters in which bankruptcy courts per *Stern* are constitutionally prohibited from issuing final judgments, bankruptcy courts can issue proposed findings of fact and conclusions of law for *de novo* review by district courts. However, while some cases hold that proposed findings of fact and conclusions law cannot be issued in that circumstance, *see, e.g., In re Blixseth*, No. 10–0088, 2011 WL 3274042, *12 (Bankr. D. Mont. Aug. 1, 2011) (holding it had no authority to enter proposed findings of fact and conclusions of law on a "core" fraudulent conveyance claim because it "may not constitutionally hear the fraudulent conveyance claim as a core proceeding, and this Court does not have statutory authority to hear it as a non-core proceeding"), "[m]ost district and bankruptcy courts … have held that bankruptcy courts have implied authority to issue findings of fact and conclusions of law in core proceedings." *In re International Auction and Appraisal Servcs., LLC*, 493 B.R. 460, 465-66 (Bankr. M.D. Pa. 2013) (citing cases); *Feuerbacher v. Moser,* No. 4:11–CV–272, 2012WL 1070138, *9 (E.D. Tex. Mar. 29, 2012) (noting that "the vast majority of courts to confront the issue have concluded that bankruptcy courts nonetheless have unquestioned authority to submit proposed findings of fact and conclusions of law.")

If consent is not sufficient to allow bankruptcy courts to issue final judgments in core matters, then 28 U.S.C. § 157(c)(2), which allows bankruptcy courts to enter final judgment in non-core matters, is put into question despite this Court's recognition of the "'value of waiver and forfeiture rules' in 'complex' cases." *Stern,* 131 S. Ct. at 2608 (quoting *Exxon Shipping Co. v. Baker*, 554 U.S. 471, 487-88 n.6 (2008)). This would also bring into question

the Federal Magistrate Statute which allows parties to consent to an Article I judge entering final judgments. *See* 28 U.S.C. § 636(c); *Roell v. Withrow*, 123 S. Ct. 1696 (2003) (a judgment entered by a magistrate judge designated under § 636 based on consent of the parties is to be treated as a final judgment of the district court).

Respectfully submitted this 16th day of September, 2013.

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