No. 12-1200

IN THE

Supreme Court of the United States

EXECUTIVE BENEFITS INSURANCE AGENCY

Petitioner,

v.

PETER H. ARKISON, TRUSTEE, SOLELY IN HIS CAPACITY AS 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 OF THE NATIONAL ASSOCIATION OF BANKRUPTCY TRUSTEES AS *AMICUS CURIAE* IN SUPPORT OF THE RESPONDENT

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QUESTION PRESENTED*

Whether a bankruptcy judge may preside over and recommend proposed rulings to the district court in proceedings held to be outside of the bankruptcy court's constitutional authority to decide.

* This *amicus* brief does not address the issue of whether a defendant in a federal fraudulent conveyance action may consent to adjudication by a bankruptcy judge, and if so, whether this consent may be waived by implication. The Respondent's and *Amici Curiae* Professors' briefs fully address this issue.

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INTEREST OF THE *AMICUS CURIAE* [1]

The National Association of Bankruptcy Trustees ("NABT") submits its brief in support of the Respondent, and respectfully urges the Court to conclude that bankruptcy courts may continue to preside over and propose findings of fact and conclusions of law, subject to *de novo* review in the district court, in proceedings involving matters denominated as core under 28 U.S.C. § 157(b)(2), but where the bankruptcy court lacks the constitutional authority to enter a final judgment order.

NABT is a non-profit professional association formed in 1982 to address the needs of chapter 7 bankruptcy trustees throughout the country, and to promote the effectiveness of the bankruptcy system as a whole. There are approximately 1,100 chapter 7 bankruptcy trustees currently receiving new cases, and the vast majority of them are NABT members. In forty-eight states and the federal territories, the United States Trustee has the responsibility of appointing chapter 7 panel trustees pursuant to 28 U.S.C. § 586(a)(1). The United States Trustee appoints a bankruptcy trustee in every chapter 7 case. The trustee has primary responsibility for all aspects of chapter 7 case administration.

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1 No counsel for a party authored this brief in whole or part, and no counsel or party made a monetary contribution to fund the preparation or submission of this brief. No person other than the *amicus curiae*, its members, and its counsel made any monetary contribution to its preparation and submission. The parties have consented to this filing.

Chapter 7 trustees, as the fiduciaries responsible for the administration of all chapter 7 bankruptcy cases, are charged with preserving and promoting the system's integrity by, among other things, efficiently administering their bankruptcy cases. This includes prosecuting fraudulent transfer actions under both 11 U.S.C. §§ 544 and 548. *See also* 11 U.S.C. §§ 704(a)(1), 704(a)(5).

This appeal addresses the issue of whether a bankruptcy court may submit proposed findings of fact, conclusions of law and a recommendation to the district court for *de novo* review and entry of a final order in any matter that is denominated as core under 28 U.S.C. § 157(b)(2) but where the bankruptcy court lacks the constitutional authority to enter a final judgment order.

The NABT's position is that neither this Court's recent opinion in *Stern v. Marshall*, 131 S. Ct. 2594 (2011) nor 28 U.S.C. §157 prohibits a bankruptcy court from hearing private causes of action and submitting proposed findings of fact, conclusions of law and recommendations for *de novo* review and entry of a final order by a district court. Thus, this Court's decision on this issue is of critical importance to the NABT because it will affect the ability of trustees to efficiently and cost-effectively administer chapter 7 cases in accordance with their fiduciary mandates under the Bankruptcy Code.

SUMMARY OF THE ARGUMENT

The Court held in *Stern v. Marshall*, that "in one isolated" respect Congress exceeded the limitations of Article III of the Constitution when it established the current framework under which the bankruptcy courts decide matters. 131 S. Ct. at 2620. Under 28 U.S.C. § 157, district courts are authorized to refer "any or all" bankruptcy cases and proceedings under Title 11, and related proceedings to the bankruptcy courts under that provision; bankruptcy courts are authorized to enter final judgments in core matters and to propose findings of fact and conclusions of law to the district court for *de novo* review in matters that are not core. Section 157(b)(2) sets forth a nonexhaustive list of the matters that Congress deemed core. *Stern* held that Section 157(b)(2)(C), which authorized bankruptcy courts to enter final judgments on state law counterclaims filed by the bankruptcy estate against a creditor who had filed a claim against the estate, was unconstitutional unless the counterclaim would be resolved in the process of ruling on the creditor's claim. 131 S. Ct. at 2620. The Court described its holding as "narrow" and predicted that its ruling would not "meaningfully change[ ] the division of labor" under Section 157 between the bankruptcy courts and the district court. *Id.* at 2620.

Petitioner contends that *Stern's* "narrow" holding created a gaping statutory hole in 28 U.S.C. § 157, leaving the bankruptcy courts without any statutory authority to address matters that are denominated

as core but which are outside of the bankruptcy court's constitutional authority to decide by final order. (Pet.Br. at 46-57.) The NABT urges this Court to reject Petitioner's argument.

This Court explained that the remedy for the constitutional violation in *Stern* was "the removal of counterclaims such as Vickie's from core bankruptcy jurisdiction. . . ." 131 S. Ct. at 2620. By "remov[ing]" the counterclaim from the bankruptcy court's core authority, the Court did not create an abyss or "Dead Zone" within Section 157 where the bankruptcy court can take no action; rather, it necessarily moved those state law counterclaims into the non-core category of proceedings, making Section 157(c)(1) and the authority of a bankruptcy judge to submit proposed findings of fact and conclusions of law to the district court for de novo review and entry of judgment applicable.

Affirming the bankruptcy court's power to issue proposed findings of fact and conclusions of law in all private causes of action including fraudulent transfer actions will ensure the continued extraordinary expertise of the bankruptcy courts in handling avoidance actions, which have represented a major component of bankruptcy courts' dockets for well over a hundred years.

ARGUMENT

I. Bankruptcy Courts May Enter Proposed Findings Of Fact And Conclusions Of Law In "Core" Matters Involving Private Rights.

In *Northern Pipeline Constr. Co. v. Marathon Pipe Line Co.*, 458 U.S. 50 (1982), the Court held that "'Congress may not vest in a non-Article III court the power to adjudicate, render final judgment, and issue binding orders in a traditional contract action arising under state law, without consent of the litigants, and subject only to ordinary appellate review.'" *Stern v. Marshall*, 131 S. Ct. 2594, 2615 (2012) (quoting *Thomas v. Union Carbide Agricultural Products Co.*, 473 U.S. 568, 584 (1985).) In response to *Northern Pipeline*, Congress enacted 28 U.S.C. §§ 1334 and 157. Section 1334 vests subject matter jurisdiction in the district courts over bankruptcy cases and adversary proceedings filed in those bankruptcy cases. Section 157 authorizes the district courts to refer bankruptcy cases and adversary proceedings to the bankruptcy courts and sets forth the authority of the bankruptcy courts to hear and determine those matters that the district courts refer to them. *See Stern*, 131 S. Ct. at 2605 (explaining the interplay between 28 U.S.C. § 1334 and § 157).

Section 157 provides that the bankruptcy courts' authority to act in referred matters depends on whether the matter is classified as "core" or not. Bankruptcy courts may enter final judgment orders in "core" matters. 28 U.S.C. § 157(b). If a matter is

not core, a bankruptcy court "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." 28 U.S.C. § 157(c)(1).

Petitioner contends that *Stern* created a statutory gap leaving the bankruptcy court without any authority to address matters that are constitutionally outside of the bankruptcy court's core authority to decide. (Pet.Br. at 46-57.) Proponents of this "Dead Zone" theory argue that there is a new genre of proceedings: those that Congress listed as core in Section 157 (b)(2), but which are outside of the bankruptcy court's constitutional authority to decide by final judgment order. The "Dead Zone" theory advances the view that for these core but unconstitutional matters, the bankruptcy courts can take no action and that such proceedings must now all be heard exclusively in the district courts.

This Court explained in *Stern* that "[w]e do not think the removal of counterclaims such as Vickie's from core bankruptcy jurisdiction meaningfully changes the division of labor in the current statute; we agree with the United States that the question presented here is a 'narrow' one." 131 S. Ct. at 2620 (citing to the United States as *Amicus Curiae* at page 23). The United States had argued, "[t]he narrow

constitutional question presented is whether Congress, consistent with Article III, could authorize the bankruptcy judge to enter final judgment on petitioner's counterclaim (subject to appellate review as provided in 28 U.S.C. § 158) *rather than simply submitting proposed findings and conclusions to the district court*." United States as *Amicus Curiae* at 23 (Sup. Ct. Dkt. 10-179) (Nov. 19, 2010) (emphasis added).

The Court's statement about the limited impact of its holding on the bankruptcy courts' workload, coupled with its citation to the United States' *amicus* brief suggests that the Court intended that bankruptcy courts would continue to have the authority to preside over a "counterclaim such as Vickie's"—just not authority to enter final orders. Indeed, in *Stern* the Court explained that it was "*remov[ing]* . . . counterclaims such as Vickie's from core bankruptcy jurisdiction. 131 S. Ct. at 2620 (emphasis added). Because Section 157 creates only two categories of claims—all proceedings are either core or non-core—when the Court removed Vickie's counterclaim from the bankruptcy court's core adjudicative authority, it necessarily moved that claim into the non-core category, making Section 157(c)(1) and the authority to recommend a judgment applicable.

This reading of *Stern* is consistent with well-established principles of statutory construction. First, under the severability doctrine, if part of a statute is held unconstitutional, the offending

provision is excised from the statute, leaving the remaining provisions intact. *See, e.g.*, *Free Enterprise Fund v. Public Co. Accounting Oversight Bd.*, 130 S. Ct. 3138, 3161 (2010); *Alaska Airlines, Inc. v. Brock*, 480 U.S. 678, 684 (1987); *United States v. Kelly*, 314 F.3d 908, 912-13 (7th Cir. 2003). Congress intended this doctrine to apply to Section 157. *See* Pub. L. 98-353, Sec. 119 (July 10, 1984). Applying this doctrine, proceedings which are delineated as "core" but which involve private rights of actions should be excised from the list of core matters delineated in Section 157(b) and deemed non-core. Thus, if a matter is core, a bankruptcy court is constitutionally permitted to enter a final order and if the bankruptcy court is not so constitutionally permitted, then the matter is deemed non-core and the bankruptcy court may recommend a ruling to the district court.

Second, it is long established that a statute should not be interpreted in a way that would defeat the purpose of the statute, if any other reasonable construction may be given to it. *See The Emily & the Caroline,* 22 U.S. 381, 388 (1824). In *Hills v. Gautreaux*, 425 U.S. 284, 293-94 (1976), the Court held that "[o]nce a constitutional violation is found, a federal court is required to tailor the 'scope of the remedy' to fit 'the nature and extent of the constitutional violation.'" Here, if Congress erred in delineating certain matters as "core", the appropriate remedy is to deem those matters non-core for purposes of Section 157.

Third, the grant of greater authority includes a grant of lesser authority. *See, e.g.*, *Posadas de Puerto Rico Assocs. v. Tourism Co. of Puerto Rico*, 478 U.S. 328, 345-46 (1986); *Smith v. Wis. Dept. of Agriculture, Trade & Consumer Protection*, 23 F.3d 1134, 1144 (7th Cir. 1994). The power to hear and determine a matter includes the more "modest power to submit findings of fact and recommendations of law to the district courts." *Agency, Inc. v. Arkinson, (In re Bellingham Ins.)*, 702 F.3d 553, 565 (9th Cir. 2012). That more modest power remains, even when, following *Stern*, the bankruptcy court can no longer enter a final judgment. 702 F.3d at 565-66.

Reading *Stern* to limit Section 157(b)(2)'s list of core matters to include only those over which the bankruptcy court may constitutionally enter final judgment is also consistent with pre-*Stern* case law. According to this case law, this list was limited by *Northern Pipeline Constr. Co. v. Marathon Pipe Line Co.*, 458 U.S. 50 (1982)—the Court's decision that prompted Congress to create the core and non-core distinction in the first instance. Before *Stern,* when the exercise of core authority exceeded *Northern Pipeline's* limits, the lower courts previously treated the matters as non-core, thereby allowing the bankruptcy courts to recommend rulings. *See, e.g., Barnett v. Stern*, 909 F.2d 973, 979-80 (7th Cir. 1990); *see also In re Allegheny Health, Educ. & Research Found.*, 383 F.3d 169, 175 (3d Cir. 2004); *In re Seven Fields Dev. Corp.*, 505 F.3d 237, 257 (3d Cir. 2007); *Teton Exploration Drilling, Inc. v. Bokum Res. Corp.*, 818 F.2d 1521, 1524-25 (10th Cir. 1987).

Petitioner advances the exact opposite result, thereby causing a "meaningful[] change[] [in] the division of labor" between the bankruptcy and district courts, contrary to what the Supreme Court intended in *Stern*. 131 S. Ct. at 2620.

II. The Ability Of Bankruptcy Courts To Enter Proposed Findings Of Fact And Conclusions Of Law In Matters Where The Court May Not Constitutionally Enter A Final Judgment Fulfills An Important Function Of The Federal System.

The adjudication by bankruptcy courts of fraudulent transfer claims brought under 11 U.S.C. §§ 544(b) and 548 and other avoidance actions is vital to the ability of chapter 7 trustees to effectively and efficiently perform their duties under the Bankruptcy Code. The duties of chapter 7 trustees are generally defined in 11 U.S.C. § 704. Chapter 7 trustees also are required to follow the guidelines established by the Executive Office for United States Trustees in its handbook (the "UST Handbook").[2] The UST Handbook governs a wide variety of practices and procedures pertaining to chapter 7 cases.

Currently, approximately 1100 chapter 7 trustees administer a total of over one million cases a

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[2] *See* Handbook for Chapter 7 Trustees, http://www.justice.gov/ust/eo/private_trustee/library/chapter07/docs/ch7hb2012/Handbook_for_Chapter_7_Trustees.pdf. ("UST Handbook").

year.[3] Under Section 704, as elaborated upon in the UST Handbook, trustees are duty-bound to close a bankruptcy estate as expeditiously as is compatible with the best interests of the estate. *See* 11 U.S.C. § 704(a)(1). As set forth in the UST Handbook, "[d]elays in case closure diminish returns to creditors, undermine the creditors' and public's confidence in the bankruptcy system, increase the trustee's exposure to liabilities, raise the costs of administration, and, in cases involving non-dischargeable tax liabilities, expose the debtor to increased penalties and interest." UST Handbook at 6-1, 8-42. "Delays also give rise to public criticism of the bankruptcy process." *Id.* at 8-42.

The district courts' reference of title 11 matters to bankruptcy courts promotes judicial economy and the trustees' efficient administration of chapter 7 bankruptcy estates. But as this Court recognized in *Northern Pipeline*, the reference cannot be without limitation. 458 U.S. at 73-74. In response to *Northern Pipeline*, Congress created a clear distinction in the Bankruptcy Code: in matters that are not core, bankruptcy courts may only enter proposed findings of fact and conclusions of law; in matters that are core, bankruptcy courts may enter final findings of fact and conclusions of law. The outcome advanced by Petitioner, which would create a third category—core, but unconstitutional—will defeat the purposes of Congress by impeding the

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[3] *See* National Association of Bankruptcy Trustees, Bankruptcy FAQ, *available at* http://www.nabt.com/faq.cfm#Q4.

efficient administration of bankruptcy estates, engendering wasteful litigation and producing anomalous results.

First, if this Court were to adopt Petitioner's Dead Zone argument that bankruptcy courts may not issue proposed findings of fact and conclusions of law in fraudulent transfer actions, requiring trustees to litigate those proceedings in the district courts, the likely result will be significant delays. Moving fraudulent transfer and other avoidance actions to the already busy district courts would place further burdens upon the courts and trustees—already challenged with additional administrative responsibilities under the Bankruptcy Abuse and Consumer Protection Act.[4] The result would be diminished and delayed returns to creditors and exposure of the bankruptcy estate and debtors to increased costs. Such an outcome undermines the Congressional intent behind the enactment of 28 U.S.C. § 157.

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[4] Under BAPCPA, trustees are responsible for giving notices to child support claimants. 11 U.S.C. § 704(a)(10), (c) (2006). If the debtor had an employee benefits plan, the trustee now assumes the responsibilities of the plan administrator under the Employee Retirement Income Security Act of 1974, 29 U.S.C. § 1002. *See* 11 U.S.C. § 704(a)(11). In health care cases, trustees are responsible for maintaining and disposing of patient medical records, and must use reasonable and best efforts to transfer patients to other appropriate health care facilities. *See* 11 U.S.C. § 704(a)(12), § 351.

Second, for over 100 years bankruptcy courts have developed an expertise in handling insolvency matters and avoidance litigation. In addition, the bankruptcy courts are administrating the bankruptcy case generally, and as a result have an intimate familiarity with the underlying facts of their cases. Affirming the bankruptcy court's power to issue a report and recommendation will ensure the continued expertise of the bankruptcy courts in handling fraudulent transfer claims, which have represented an important component of bankruptcy courts' litigation dockets for well over a century. Adopting the position of the Petitioner will leave these matters in the hands of the district courts which do not have the same familiarity of the facts arising from the underlying bankruptcy case.

Third, pursuant to the outcome advanced by the Petitioner, countless core matters involving private rights that have been heard and/or ruled upon by bankruptcy courts would need to be retried before district courts, and any proceedings thus far rendered void ab initio. The Court of Appeals for the Seventh Circuit in *Wellness International Network, Ltd. v. Sharif*, 727 F.3d 751, 777 (7th Cir. 2013) held that for matters that are designated as core by Section 157(b), but for which the bankruptcy court lacks constitutional authority to enter final judgment, "the only statutorily authorized remedy would be for the district court to withdraw the reference." The Seventh Circuit premised its conclusion, in part, on its observation that "[n]o statutory provision authorizes a bankruptcy court to

propose findings of fact and conclusions of law in a core proceeding." *Id.* at 776.[5] As a result, the court determined that if the matter is core, the parties essentially will have to start over after many years of fruitless litigation.

The case of *Bank of America, N.A. v. Veluchamy,* Case No. 12-9054 (N.D.Ill.) illustrates the potential wasteful results if the approach of *Wellness* is upheld. In *Veluchamy,* the bankruptcy court had expended considerable resources in adjudicating pretrial motions, resolving evidentiary disputes and presiding over a trial, and the parties had completed post-trial briefing. On the eve of a ruling from the bankruptcy court, and despite the magistrate judge's report and recommendation that the bankruptcy court issue proposed findings of fact and conclusions of law, the district court granted the plaintiff's motion to withdraw the reference, based on the *Wellness* decision, and removed the adversary proceeding from the bankruptcy court. If the

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[5] A subsequent Seventh Circuit Court of Appeals decision, *Peterson v. Somers Dublin Ltd.*, 729 F.3d 741 (7th Cir. 2013), characterized *Wellness* as pertaining only to the issue of whether parties could forfeit a *Stern* objection, rather than whether parties may waive a *Stern* objection or consent to a final adjudication by a bankruptcy court. Nor did the *Wellness* decision consider prior Seventh Circuit decisions establishing "that consent on the record authorizes decision by an untenured magistrate judge." 729 F.3d at 747. As such, the *Peterson* court concluded that "the effect of an express and mutual waiver [is] open in this circuit" (*id.*) after *Wellness*.

Veluchamy district court follows the instructions contained in the *Wellness* opinion, the litigants may also have to start from scratch, multiplying the costs of litigation and creating substantial delay. *See Bank of America v. Veluchamy,* Case No. 12 CV 9054 (N.D. Ill.) October 21, 2013 Order at Docket No. 43. If the large number of avoidance actions currently pending had to start over in the district courts, the time delay, the wasted litigation expenses, and the actions that trustees would be forced to abandon because of lack of funds to start over, would be enormous.

Fourth, the "Dead Zone" theory produces anomalous results. Take for example: if a trustee sues Party A for tort, it is a non-core matter and the bankruptcy court is permitted to submit proposed findings of fact and conclusions of law to the district court pursuant to 28 U.S.C. 157(c)(1). Pursuant to the outcome advanced by the Petitioner, however, if Party A files a proof of claim in the bankruptcy case first, then the trustee's claim becomes a counterclaim, and only the district court can hear and adjudicate such tort claim.

Accordingly, the NABT urges this Court to decline the invitation to read *Stern* as eliminating the ability of bankruptcy judges to submit proposed findings of fact and conclusions of law for *de novo* review by a district court in "core" proceedings under 28 U.S.C. 157(b) involving private rights.

CONCLUSION

For the foregoing reasons, *amicus curiae* National Association of Bankruptcy Trustee requests that the judgment of the court of appeals be affirmed.

Respectfully submitted,

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