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.

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

REPLY BRIEF OF PETITIONER

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INTRODUCTION

Respondent concedes that the petition presents a clear split between the Sixth and Ninth Circuits on Question One and the Seventh and Ninth Circuits are in disagreement on Question Two. Nor can respondent deny that the issues are of national importance. Indeed, more than a dozen amici responded to the court of appeals' sua sponte invitation for amicus briefs. Prompt resolution of the questions presented is essential to alleviate the disruptive uncertainty that has plagued bankruptcy proceedings since *Stern* v. *Marshall*, 131 S. Ct. 2594 (2011).

The Ninth and Sixth Circuits sharply disagree on whether litigant consent can cure the Bankruptcy Code's unconstitutional grant of Article III authority to bankruptcy judges. That split was outcome determinative in this case, and, until resolved by this Court, it will cast doubt on the validity of countless proceedings before bankruptcy judges premised on litigant consent.

On the second question presented, respondent does not even defend the court of appeals' holding that bankruptcy courts may propose findings of fact and conclusions of law pursuant to 28 U.S.C. 157(b) in core proceedings governed by *Stern*. The text and structure of the statute make clear that Congress did not grant bankruptcy judges that authority, and it is not the role of the courts to fill this perceived statutory gap.

I. THE COURT SHOULD RESOLVE WHETHER, AND IN WHAT CIRCUMSTANCES, CONGRESS'S OTHERWISE UNCONSTITUTIONAL DELEGATION OF AUTHORITY TO NON-ARTICLE III JUDGES CAN BE CURED BY LITIGANT CONSENT

1. As respondent concedes (Br. in Opp. 12), the court of appeals' decision is in direct conflict with the Sixth Circuit's holding in *Waldman* v. *Stone*, 698 F.3d 910 (2012), cert. denied, 133 S. Ct. 1604 (2013). Respondent makes no effort to distinguish *Waldman*; nor could he. *Waldman* expressly held that a party cannot consent to a bankruptcy court exercising Article III power. Respondent disparages *Waldman*'s constitutional analysis as "cursory." Br. in Opp. 12. But it is respondent and the court below who fail to grasp the full import of the holding in *Stern* v. *Marshall*, 131 S. Ct. 2594 (2011), that Congress's attempt to assign Article III authority to bankruptcy judges violates the separation of powers. *Cf. Waldman*, 698 F.3d at 918 (discussing *Stern*, 131 S. Ct. at 2609).

Until this circuit split is resolved, the validity of every judgment in an Article III "core" case entered by a bankruptcy court on the basis of litigant consent will remain in doubt. The uncertainty among litigants whether bankruptcy judgments will be binding in such cases will drastically increase the inefficiency, and costs, of bankruptcy proceedings.

Even if lower courts outside the Sixth Circuit decline to follow *Waldman*, that would not diminish the urgent need for this Court to resolve the existing circuit split. It would hardly be surprising if overworked Article III courts and bankruptcy judges whose authority is under threat would align to resist the transfer of a

significant number of cases from bankruptcy to district courts. *Cf.* Br. in Opp. 15 (citing three bankruptcy courts disagreeing with *Waldman*). But if the structural Article III violation identified in *Stern* cannot be cured by litigant consent, as the Sixth Circuit held, then lower courts' collective attempt to ignore that consequence is only further reason for this Court to exercise review and vindicate fully *Stern*'s holding.

2. The court of appeals' holding—that bankruptcy courts may, with litigant consent, exercise the judicial power of the United States without threating the Constitution's separation of powers—cannot be squared with *Stern* and *Commodity Futures Trading Commission* v. *Schor*, 478 U.S. 833 (1986). *Stern* "emphatically" declared that Congress's grant to non-Article III bankruptcy judges of authority to enter final judgment on private rights of action—"the most prototypical exercise of judicial power," 131 S. Ct. at 2615—poses "a threat to the separation of powers," *id.* at 2620. *Schor* held that "[t]o the extent that this structural principle [of the separation of powers] is implicated in a given case, *the parties cannot by consent cure the constitutional difficulty*." 478 U.S. at 850–851 (emphasis added). Together, those holdings compel the conclusion that litigant consent cannot confer on bankruptcy courts authority to enter final judgment on private rights of action.

Respondent misreads *Stern* as approving waiver of an Article III violation. Br. in Opp. 17. The portion of *Stern* on which respondent relies concerned waiver of a *statutory* right, not consent to infringement of Article III. See 131 S. Ct. 2606–2608. Pierce Marshall had asserted a defamation claim against the bankruptcy estate of Vickie Lynn Marshall. *Id.* at 2601. He neither

possessed nor claimed an Article III right to district court adjudication of that proof of claim. See *N. Pipeline Constr. Co.* v. *Marathon Pipe Line Co.*, 458 U.S. 50, 71 (1982) (plurality opinion) ("restructuring of debtor-creditor relations * * * is at the core of the federal bankruptcy power"). Instead, Pierce argued his defamation claim constituted a "personal injury tort" claim as to which he had a *statutory* right to district court adjudication, pursuant to Section 157(b)(5). The Court's discussion of Pierce's waiver, and its citation within that discussion to Section 157(c)(2), was in the context of holding that this *statutory* right was not jurisdictional and could be waived. See *Stern*, 131 S. Ct. at 2607. That holding is simply irrelevant to whether an Article III violation can be cured by litigant consent.

Respondent is likewise mistaken in suggesting that *Roell* v. *Withrow*, 538 U.S. 580 (2003), supports the court of appeals' Article III analysis. In *Roell*, the sharply divided Court decided only a question of statutory interpretation about the Federal Magistrates Act. *Id.* at 586–587. The Court's passing reference to "the Article III right" being "substantially honored," *id.* at 590, in no way undermines the force and effect of the Court's subsequent, comprehensive discussion of Article III in *Stern*. In any event, as discussed below, see *infra* 5–7, *Roell* is inapposite because (a) unlike the magistrates statute, Congress did not include consent as a limiting feature of bankruptcy judges' authority in core proceedings and (b) petitioner's conduct would not constitute implied consent under *Roell*'s standard.

3. The constitutional question presented in the petition is neither "case-specific," Br. in Opp. 20, nor "time-limited" in importance, *id.* at 26. The Sixth Circuit held that litigants cannot consent to bankruptcy

court adjudication of *Stern*-governed core claims. That issue will arise *whenever* consent is relied upon to permit bankruptcy court adjudication of claims designated as "core" by Congress, but as to which *Stern* held that Article III applies. The issue arises frequently because *Stern* applies beyond state law counterclaims to many causes of action designated "core," including fraudulent conveyance claims, Pet. App. 23a, and certain preferential transfer claims, see *Sec. Investor Protection Corp.* v. *Bernard L. Madoff Inv. Sec. LLC*, 490 B.R. 46, 49–54 (S.D.N.Y. 2013).

4. Ironically, while respondent mischaracterizes the petition as "case-specific," he also contends (Br. in Opp. 5) that certiorari is unwarranted because petitioner's argument calls into question Section 157(c)(2), which authorizes bankruptcy judges to adjudicate non-core claims with litigant consent. If the Court's decision casts doubt on Section 157(c)(2), that is hardly reason to deny the present petition. But whether doubt is cast on Section 157(c)(2) by a decision reversing the court of appeals would depend on this Court's rationale. As the petition makes clear, the Court might distinguish between the constitutional significance of consent when Congress incorporates consent as a limit on the authority of non-Article III judges and when, as here, courts simply invoke consent post-hoc, attempting to salvage an unconstitutional statute.

If litigant consent is relevant to the Article III analysis, it is only insofar as consent is an express limiting feature of the statutory scheme. Unlike the statute at issue in *Schor*, the Federal Magistrates Act at issue in *Roell*, or even the Bankruptcy Code provisions governing non-core proceedings, the statutory scheme applicable to core proceedings does not condition bank-

ruptcy judges' authority on litigant consent. Compare, *Schor*, 478 U.S. at 855 ("decision to invoke [non-Article III] forum is left entirely to the parties"), 28 U.S.C. 636(c)(1) (conditioning magistrates' authority on consent), and 28 U.S.C. 157(c)(2) (conditioning bankruptcy judges' authority in non-core proceedings on consent), with 28 U.S.C. 157(b)(1) (granting bankruptcy judges unqualified authority to "hear and determine" core proceedings). Statutes that expressly limit non-Article III tribunals to adjudicating claims where the parties have consented arguably mitigate the threat to Article III's separation-of-powers function. There is no such limitation in Section 157(b), and it is not the courts' role to rewrite the statutory text. See *Seminole Tribe of Fla.* v. *Florida*, 517 U.S. 44, 76 (1996).

5. Respondent's reliance on *Roell* is doubly misplaced because the facts from which the court of appeals inferred consent here would not satisfy *Roell*. Under *Roell*, consent cannot be inferred when litigants are not "made aware of the need for consent and the right to refuse it." *Roell*, 538 U.S. at 590; see also *id.* at 587 n.5; *Pacemaker Diagnostic Clinic of Am.* v. *Instromedix, Inc.*, 725 F.2d 537, 546 (9th Cir.) (en banc) (Kennedy, J.) (voluntary consent is essential), cert. denied, 469 U.S. 824 (1984).

This case exemplifies why implied litigant consent cannot cure an Article III violation when consent is not incorporated as a limit in the statutory scheme. Because Section 157(b) does not require consent before a bankruptcy court can adjudicate a claim designated as "core," petitioner had no notice of its right to insist that respondent's summary judgment motion be adjudicated in the first instance by an Article III judge. Indeed, at the time petitioner supposedly waived its Article III

right by acquiescing in adjournment of petitioner's motion for a jury trial, binding Ninth Circuit precedent held that petitioner *was not* entitled to final disposition by an Article III judge. See *Duck* v. *Munn (In re Mankin)*, 823 F.2d 1296 (1987), overruled by, Pet. App. 15a.[1]

The most the court of appeals could say in concluding that petitioner had "impliedly consented" to entry of judgment by a non-Article III judge is that petitioner "affirmatively assented to suspend its demands for a jury trial in district court." Pet. App. 29a. But, at most, petitioner agreed to suspend consideration of its assertion of a different constitutional right—its Seventh Amendment right to *trial before a jury*—until it was clear whether there would even be a trial. That is far from demonstrating "aware[ness] of the need for consent" to *pretrial adjudication* by a bankruptcy judge, or "the right to refuse it." *Roell*, 538 U.S. at 590.

6. The district court's purported de novo review was not the basis for the court of appeals' ruling, and is not reason to deny the petition. The court of appeals held that entry of final judgment by a bankruptcy court does not implicate separation-of-powers concerns "because bankruptcy judges are officers of the district court and are appointed by the Courts of Appeals" and

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[1] Although the panel below suggested that the court of appeals' decision in *Stern* foreshadowed *Mankin*'s demise, Pet. App. 32a, respondent acknowledges that the panel decision in *Stern* was not issued until *after* the status report (which petitioner did not join) upon which the panel below based its finding of implied consent, Br. in Opp. 24 n.13; Pet. App. 73a–76a.

such adjudication was therefore permissible with litigant consent. Pet. App. 27a n.1 (brackets and internal quotation marks omitted). That holding is directly contrary to *Stern*'s conclusion that "it does not matter who appointed the bankruptcy judge or authorized the judge to render final judgments in such proceedings. The constitutional bar remains." 131 S. Ct. at 2619. Unless corrected, this erroneous holding will remain the law in the Ninth Circuit.

Moreover, petitioner did *not* receive an *initial determination* by the district court. The bankruptcy judge entered final judgment, and the district court merely exercised appellate review. See Pet. App. 41a, 53a–55a. The district court, for example, placed the burden on petitioner to demonstrate error in the bankruptcy court's reasoning. *Id.* at 47a ("Appellant has failed to show any error in the Bankruptcy Court's grant of summary judgment * * *."). And it applied a "substantial evidence" standard to its review of certain of the bankruptcy court's conclusions. *Id.* at 50a. It was the bankruptcy court, not the district court, that "exercise[d] the essential attributes of judicial power" by entering final judgment against petitioner. *Stern*, 131 S. Ct. at 2618–2619.

Such appellate review is a far cry from the initial determination by an Article III judge to which petitioner was entitled. Indeed, *Stern* rejected the argument that appellate review of bankruptcy court judgments is sufficient to satisfy Article III. See 131 S. Ct. at 2619. Limiting the involvement of an Article III judge to mere appellate review is especially problematic in the bankruptcy context, where there is a well-recognized perception that bankruptcy courts are institutionally predisposed to favor debtors. See, *e.g.*, *M.*

Sobel, Inc. v. *Weinstein (In re Weinstein)*, 237 B.R. 567, 574 (Bankr. E.D.N.Y. 1999).

II. RESPONDENT IGNORES THE TEXTUAL AND STRUCTURAL FLAWS IN THE COURT OF APPEALS' HOLDING THAT BANKRUPTCY JUDGES MAY PROPOSE FINDINGS OF FACT AND CONCLUSIONS OF LAW IN *STERN*-GOVERNED "CORE" PROCEEDINGS

The court of appeals' holding that bankruptcy judges' authority to "hear and determine" so-called "core" proceedings includes authority to propose findings of fact and conclusions of law, subject to de novo district court review, is contrary to the statutory text and structure, and respondent does not defend it. Respondent nevertheless argues that certiorari is unwarranted because most lower courts agree with the result, if not the rationale, that bankruptcy judges should continue to propose findings and conclusions in "core" proceedings where *Stern* precludes them from entering final judgment. Even if the lower courts were in agreement (which they are not), convergence among bankruptcy judges and the district courts—who share institutional interests in maintaining the current division of authority—is hardly reason to deny the petition. To the contrary, it demonstrates that little would be gained from allowing this issue to percolate further.

Respondent's assertion of lower court unanimity is, in any event, incorrect. The Seventh Circuit has clearly stated that "claims [that] qualify as core proceedings" under Section 157(b) "do not fit under § 157(c)(1)" and that bankruptcy judges therefore do not have statutory authority to propose findings and conclusions in core proceedings. *Ortiz* v. *Aurora Health Care, Inc.*, 665

F.3d 906, 915 (2012). Respondent characterizes this as dictum, Br. in Opp. 29 n.17, but the Seventh Circuit plainly believed this discussion of the dichotomy regarding bankruptcy judges' authority in core and non-core proceedings was necessary to its holding, see *Ortiz*, 665 F.3d at 915. And, while respondent declares that "[t]he *Ortiz* case is odd," Br. in Opp. 27 n.16, he cannot escape that the decision below is directly contrary to the view expressed by the Seventh Circuit on precisely the same question.

Notably, although many lower courts have made clear their desire to remedy the statutory gap by allowing bankruptcy judges to propose findings and conclusions in core proceedings governed by *Stern*, those courts cannot agree on a construction of the statute supporting that remedy. Some, like the court of appeals, hold that authority to "hear and determine" core proceedings pursuant Section 157(b)(1) "encompasses" a lesser-included power to propose findings and conclusions. See, *e.g.*, App. 24a. Others have "recharacteriz[ed]" core proceedings subject to *Stern* as non-core proceedings governed by Section 157(c)(1), as respondent proposes. See, *e.g.*, Br. in Opp. i, 28; *Field* v. *Lindell (In re Mortg. Store, Inc.)*, 464 B.R. 421, 427–428 (D. Haw. 2011). And still others have "enacted" standing orders of reference under Section 157(a) purporting to authorize proposed findings and conclusions in core proceedings governed by *Stern*. See, *e.g.*, *In re Standing Order of Reference Re: Title 11*, No. 12-misc-00032) (S.D.N.Y. Jan. 31, 2012). The reason these courts cannot agree on *what* statutory authority permits bankruptcy judges to propose findings and conclusions in core proceedings is that *none* exists. To the contrary,

the statute's text and structure make clear Congress did *not* confer that authority on bankruptcy judges.

It is telling that respondent does not defend the court of appeals' rationale that bankruptcy courts can propose findings and conclusions in core proceedings under Section 157(b)(1)'s grant of authority to "hear and determine" such actions. Pet. App. 24a. Congress uses the phrase "hear and determine" (which also appears in other statutes) to connote finality, not a non-final recommendation. See Pet. 27–30. Moreover, Congress provided for only *appellate* review of orders and judgments entered pursuant to Section 157(b). 28 U.S.C. 157(b)(1), 158(a). Nothing in the statute grants district courts authority to engage in de novo review of, or enter final judgment on, a bankruptcy court's decision in a "core" proceeding that has been referred to it. *Cf.* 28 U.S.C. 157(c)(1) (granting this authority in *non-core* proceedings).

Rather than defend the court of appeals, respondent asserts that bankruptcy courts may "recharacteriz[e]" core proceedings to which *Stern* applies as non-core proceedings and issue propose findings and conclusions under Section 157(c)(1). Br. in Opp. 28. By its plain terms, however, Section 157(c)(1) applies only to a proceeding that is "not a core proceeding." 28 U.S.C. 157(c)(1). As *Stern* made clear, and as the court of appeals recognized, courts must honor Congress's designation of proceedings as core or non-core. 131 S. Ct. at 2604–2605; Pet. App. 24-25a (claims subject to *Stern* "remain in the core").

Even if all of the lower courts (apart from the Seventh Circuit) agreed, their unanimity would not change the fact that it is not the role of the judicial branch to

"rewrite the statutory scheme in order to approximate what [it] think[s] Congress might have wanted had it known that [a provision] was beyond its authority." *Seminole Tribe of Fla.* v. *Florida*, 517 U.S. 44, 76 (1996); *N. Pipeline Constr. Co.* v. *Marathon Pipe Line Co.*, 458 U.S. 50, 87 n.40 (1982). This Court should reverse the lower courts' attempt to do just that.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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