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## US Supreme Court Resolves Executive Benefits on Narrow Grounds, Leaving Unresolved Many Important Questions About Bankruptcy Court Authority

JUNE 9, 2014

The US Supreme Court earlier today issued its much anticipated decision in *Executive Benefits Insurance Agency v. Arkison*, No. 12-1200 (June 9, 2014), a follow-on case to the Court's landmark decision in *Stern v. Marshall*, 131 S. Ct. 2594 (2011), regarding the scope of bankruptcy courts' authority under Article III of the Constitution. *Executive Benefits* decides an important statutory question that has divided lower courts in the wake of *Stern*, holding that, when addressing claims like the one at issue in *Stern*, bankruptcy courts may issue findings of fact and conclusions of law for *de novo* review by district courts. But it leaves unresolved a circuit split on the constitutional question of whether, and under what circumstances, parties may consent to bankruptcy courts' entry of final judgment in non-core matters.

**The Legal Background.** The 1978 Bankruptcy Code gave bankruptcy courts expansive jurisdiction, including the authority to enter final judgment on all claims that could affect a bankruptcy estate. In 1982, the Supreme Court held that regime unconstitutional, concluding that it violated Article III to permit bankruptcy courts to enter final judgment on matters of "private right," including state-law causes of action by the estate against non-creditors. *Northern Pipeline Constr. Co. v. Marathon Pipe Line Co.*, 458 U.S. 50 (1982). In 1984, in response to *Marathon*, Congress amended the bankruptcy jurisdiction provisions, dividing claims that may be brought in bankruptcy into "core matters" (which are matters of public right that can be heard and determined by bankruptcy courts) and "non-core" matters (which are matters of private right, as to which bankruptcy courts may essentially exercise the power of a magistrate judge).

In *Stern*, the Supreme Court held that Congress had drawn that line improperly. Specifically, Congress had incorrectly included as statutory "core" matters a number of claims (in *Stern* itself, a state-law tort claim raised by the debtor as a counterclaim to a proof of claim) that are in fact matters of private right. Despite being statutorily designated as "core," such claims cannot be heard and determined in bankruptcy court (at least absent the parties' consent).

**Proceedings Below.** The dispute in *Executive Benefits* arose in the aftermath of *Stern*. The suit at issue was a fraudulent transfer action. Like counterclaims to proofs of claim, fraudulent transfer

actions are statutorily designated as core matters. However, the Supreme Court had previously made clear in *Granfinanciera S.A. v. Nordberg*, 492 U.S. 33 (1989), that fraudulent transfer suits against defendants who have not filed proofs of claim are matters of "private right"-disputes between two private parties originating in the common law. (Although the Supreme Court in *Executive Benefits* did not decide the question, when the case was in the Ninth Circuit, that court had held that fraudulent transfer suits against non-creditors thus may not be finally adjudicated by a bankruptcy court absent the parties' consent. Neither of the parties challenged that ruling in the Supreme Court, which decided the case on the assumption that the fraudulent transfer action was like the claim in *Stern*-a claim that is statutorily designated as core, but one that cannot constitutionally be treated as a core matter.)

In *Executive Benefits*, the bankruptcy court entered summary judgment in favor of the trustee on his fraudulent transfer claim; the district court reviewed the bankruptcy court's judgment *de novo* and affirmed. Before the Ninth Circuit, the parties disputed whether the defendant had consented to the entry of final judgment by the bankruptcy court. The Ninth Circuit held that the defendant had consented, and that-even though the claim was a matter of private right-nothing in Article III barred the bankruptcy court from entering judgment upon the parties' consent. The defendant petitioned for *certiorari*, contending that (1) Article III does not permit a bankruptcy court to enter final judgment in a non-core matter even with the parties' consent; and (2) the decision in *Stern* left a "statutory gap" under which bankruptcy courts could not even enter findings of fact and conclusions of law in non-core matters that Congress had improperly designated as "core."

**The Supreme Court's Decision.** In a unanimous opinion by Justice Thomas, the Court addressed only the second question, holding that no such statutory gap exists; bankruptcy courts can enter findings of fact and conclusions of law for *de novo* review by the district court in all non-core matters, including "*Stern* claims" that had been improperly designated as core. Because, in this case, the district court had reviewed the bankruptcy court's judgment *de novo*, the Court concluded, it had no occasion to reach the first, constitutional question. In doing so, the Court departed from the paths laid out by the parties and followed the approach urged by a group of bankruptcy and federal courts scholars who filed a brief as *amici curiae*.<sup>1</sup>

Specifically, the Court reasoned that there was no "statutory gap" because, although the statute provides that bankruptcy courts may enter final judgment on matters designated as "core," it also authorizes bankruptcy courts to make proposed findings and conclusions, subject to *de novo* review by the district court, on "non-core" matters. To the extent the statute improperly includes matters of private right among the enumerated "core matters," the Court held that ordinary principles of severability require that such claims be treated as non-core matters, permitting bankruptcy courts to issue proposed findings and conclusions for *de novo* review by the district court.

In *Executive Benefits* itself, the bankruptcy court awarded summary judgment to the trustee on his fraudulent transfer suit. By definition, that grant of summary judgment was subject to *de novo* review in the district court, which in fact conducted a *de novo* review and affirmed. The defendant had thus received precisely the same *de novo* review in an Article III court to which he would have been entitled had the bankruptcy court treated the matter as non-core. The Court accordingly did not need

to, and did not, reach the questions whether the defendant had validly consented, or whether (if so) a bankruptcy court may, consistent with Article III of the Constitution, enter judgment in a matter of private right with the parties' consent.

**Implications.** As a practical matter, the most significant points regarding the *Executive Benefits* decision are as follows:

- The question of whether a bankruptcy court may enter final judgment in a matter of private right with the parties' consent, which has divided the circuits, remains unresolved. While the Ninth Circuit held in *Executive Benefits* that a bankruptcy court may do so, the Fifth, Sixth and Seventh Circuits have held, citing to separation of powers concerns, that the parties' consent is insufficient to cure the "structural" problems caused by having a non-Article III court exercise the "judicial power of the United States." See *In re BP RE*, 735 F.3d 279 (5th Cir. 2013); *Waldman v. Stone*, 698 F.3d 910 (6th Cir. 2012); *Wellness Int'l Network, Ltd. v. Sharif*, 727 F.3d 751 (7th Cir. 2013); see also *In re Frazin*, 732 F.3d 313, 321 n.3 (5th Cir. 2013) (noting that "structural [separation of powers] concerns cannot be ameliorated by ... consent or waiver"). The questions at oral argument suggest that the Court is likely closely divided on this issue; because the issue has given rise to a circuit split, it is likely to come before the Court again.

Notably, the constitutionality of the federal magistrate system likely also turns on the answer to this question. Because the bankruptcy and magistrate systems share a similar structure, if consent is insufficient to permit a bankruptcy court to enter final judgment, the same is likely true of magistrate courts.

- If a bankruptcy court may enter final judgment in a non-core matter with the parties' consent, the question remains whether that "consent" must be express, or can be implied. Bankruptcy Rule 7012(b) states that consent must be "express." But in the magistrate context (on a rather unusual set of facts) the Supreme Court held that a party may implicitly consent to having a magistrate judge enter final judgment. *Roell v. Withrow*, 538 U.S. 580 (2003). As a result of the Court's determination in *Executive Benefits* not to address the question of consent, *Roell*'s applicability to the bankruptcy context remains unresolved.
- *Executive Benefits* supports the view that, while it is certainly significant, *Stern v. Marshall* does not completely eviscerate the authority of bankruptcy courts even in cases involving private rights. The Supreme Court emphasized in *Stern* that its decision would not "meaningfully chang[e] the division of labor" between bankruptcy courts and district courts. 131 S. Ct. at 2620.

Although *Executive Benefits* did not reach the constitutional question presented, its analysis of the statutory question is fully consistent with the notion that *Stern* does not work a revolution in the bankruptcy courts. The Court applied ordinary principles of severability to hold that there is no "statutory gap" and that the statute does not create a set of claims as to which bankruptcy courts may neither enter final judgment nor make proposed findings

and conclusions. Rather, the Court construed the statute, consistently with common sense, to give effect to Congress' obvious purpose of giving bankruptcy courts as much authority as Article III of the Constitution permits.<sup>2</sup>

Put differently, on matters that may be resolved by the bankruptcy court on a motion to dismiss or summary judgment, *Stern* changes only the label of the bankruptcy court's determination. As a practical matter, it makes no difference whether the bankruptcy court's ruling on a motion to dismiss or summary judgment motion is called a judgment or proposed findings and conclusions, since, either way, it will be subject to *de novo* review in the district court. As a result, district courts will retain the discretion-based on the facts and circumstances of the case-to deny motions to withdraw the reference in non-core matters until after the resolution of dispositive motions in the bankruptcy court.

Matters that go all the way to trial present different considerations. It may be possible in some cases-for example, where the credibility of witnesses is not at issue-for the bankruptcy court to hear the evidence and make proposed findings of fact and conclusions of law, after which the district court can review the record *de novo*. But in many cases, it may not be possible for the district court to make a *de novo* determination of disputed issues of fact without hearing live testimony. Many district courts do "withdraw the reference" from the bankruptcy court, so they can preside over any trial, in cases where the defendant has the right to entry of final judgment by an Article III court. We expect this general practice to continue.

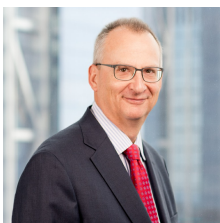
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<sup>1</sup> The scholars in question are S. Todd Brown, G. Marcus Cole and Ronald D. Rotunda. WilmerHale represented the scholars as *amici* in the Supreme Court.

<sup>2</sup> Accordingly, in matters of private right, including *Stern* claims, bankruptcy courts may enter proposed findings and conclusions, subject to *de novo* review in the district court. Many courts, including the Southern District of New York, have issued standing orders to this effect. See *In re Standing Order of Reference re: Title 11*, No. 12-MISC-32 (S.D.N.Y. Jan. 31, 2012). The *Executive Benefits* decision validates this approach.

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