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Questions Left Unanswered In High Court's Arkison Ruling

Law360, New York (June 09, 2014, 9:57 PM ET) -- In an anxiously awaited opinion addressing an issue created by its 2011 decision in Stern v. Marshall, 564 U.S. ___ (2011), the U.S. Supreme Court has closed the so-called "statutory gap" by recognizing the authority of a bankruptcy court to issue proposed findings of fact and conclusions of law, subject to de novo review by the district court, on claims that are beyond its final adjudicative authority under Article III of the Constitution.

Following the practice — although not necessarily the reasoning — of many lower courts, the court's unanimous opinion delivered by Justice Clarence Thomas in Executive Benefits Insurance Agency v. Arkison, No. 12-1200, 573 U.S. ___ (2014), essentially preserves the day-to-day division of labor between the bankruptcy courts and district courts that has arisen since Stern v. Marshall.

Significantly, however, the decision leaves unanswered certain fundamental questions concerning Article III limitations on the adjudicative authority of bankruptcy courts, including whether they may issue final judgments upon consent of the litigants and other affected parties.

In Executive Benefits, the bankruptcy court entered summary judgment on fraudulent transfer claims in favor of a Chapter 7 trustee and against Executive Benefits Insurance Agency. EBIA appealed to the district court, which affirmed after a de novo review and entered its own judgment.

The Supreme Court issued Stern during the pendency of EBIA's ensuing appeal to the Ninth Circuit, and in light of Stern, EBIA argued that Article III did not authorize the bankruptcy court to enter final judgment on the fraudulent transfer claims. The Ninth Circuit rejected this argument and affirmed the district court, concluding that although Article III does not authorize final adjudication of certain fraudulent transfer claims by a bankruptcy court absent consent of the parties, EBIA had impliedly consented to entry of final judgment by the bankruptcy court.

The Supreme Court affirmed, with a number of important issues about the limits of bankruptcy court adjudicatory power left unaddressed in Stern. The court's opinion expressly reserved on the question of whether litigants can consent expressly or impliedly to final adjudication of so-called "Stern claims" in

the bankruptcy court.

Rather, the court framed the issue as a procedural follow-on to Stern, which held that a certain class of "Stern claims" exists — claims that are "core" within the meaning of 28 U.S.C. § 157(b) and so within the statutory final adjudication power of the bankruptcy courts, but beyond their constitutional Article III power to adjudicate. What Stern did not decide, and what was resolved in Executive Benefits, is "how bankruptcy or district courts should proceed when a 'Stern claim' is identified." Executive Benefits Insurance Agency, slip op., at 1.

The answer, and the court's holding, is that a bankruptcy court confronted with a Stern claim is authorized to issue proposed findings of fact and conclusions of law, which must be reviewed by the district court de novo. In so holding, the court closed the so-called "statutory gap," as identified by courts and commentators following Stern, that arose from the absence in § 157(b) of express authority for bankruptcy courts to issue proposed findings of fact and conclusions of law in core proceedings. The language of 28 U.S.C. § 157(c) authorizing bankruptcy courts to issue proposed findings of fact and conclusions of law refers only to noncore proceedings.

In closing this "statutory gap," the court chose not to rely on the Ninth Circuit's reasoning, but rather applied the severability provision contained in an uncodified statutory note to 28 U.S.C. § 151. 98 Stat. 344, note following 28 U.S.C. § 151. The court's severability reasoning is interesting. While a natural reading of Stern suggests that only the act of "determining" a Stern claim was rendered unconstitutional by Stern, the court states that both the classification of a Stern claim as "core" and the attendant procedure for determination were unconstitutional. Executive Benefits slip op., at 9-10.

Having thus stricken the "core" label for such claims from § 157(b), the court then easily determined that § 157(c) applied to those claims by its plain language, id., reasoning that a Stern claim is "not a core proceeding" because Stern removed it from the "core" category. Id. at 10. As such a claim, however, is "otherwise related to a case under title 11," "§ 157(c) may be applied naturally to Stern claims." Id.

Having decided that, in general, a bankruptcy court confronted with Stern claims should issue proposed findings of fact and conclusions of law subject to de novo review by the district court, the court turned to the fact that in this case, the bankruptcy court had entered a summary judgment rather than proposed findings and conclusions.

The court held that this distinction did not lead to reversible error because there were no disputed factual issues and the district court reviewed the bankruptcy court judgment using the de novo review standard applicable to questions of law. Thus, the court reasoned that EBIA received precisely that to which it was entitled: de novo review by an Article III court and entry of judgment by that court. In effect, the district court's de novo review on appeal and independent entry of judgment in this case cured whatever procedural defect was inherent in the form of the bankruptcy court's decision.

Following Stern, many district courts around the country amended their standing orders of reference to permit bankruptcy courts to issue proposed findings of fact and conclusions of law when confronted

with Stern claims, and to permit district courts to treat judgments entered by bankruptcy courts as proposed findings and conclusions upon a determination that the bankruptcy court exceed its adjudicative authority under Article III. Executive Benefits essentially confirms this practice, and in so doing preserves the day-to-day division of labor between the bankruptcy courts and district courts in a manner that allows the bankruptcy system to continue to function efficiently.

The Executive Benefits decision, however, leaves a number of fundamental questions unanswered concerning bankruptcy courts and Article III. Perhaps most importantly, the court left unresolved the split among the courts of appeal whether Article III permits litigants to consent to final adjudication of Stern claims in bankruptcy court.

Depending on how broadly Stern is read, the decision not to reach this issue in Executive Benefits leaves a less than secure foundation for bankruptcy court orders in important and routine case matters that often affect third parties in ways that extend beyond claims allowance — matters such as approval of debtor-in-possession financing, sales free and clear of liens, assumption and assignment of executory contracts and unexpired leases, and confirmation of plans.

If consent does not cure the Article III problem, then the argument remains that such orders must be entered by the district court after de novo review. Following this line of argument, query whether "comfort orders" must be obtained from the district court in order to avoid any questions as to the finality and enforcement ability of bankruptcy court orders. The uncertainty surrounding consent also draws into question the use in several circuits of bankruptcy appellate panels, which are comprised of non-Article III bankruptcy judges to hear and decide appeals sent to them if neither party elects appeal to the district court — the functional equivalent of implied consent. See 28 U.S.C. § 158(b)(1).

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