No. 11-35162

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

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| In the Matter of:<br>BELLINGHAM INSURANCE AGENCY, INC.,<br>Debtor. | Ninth Circuit No. 11-35162 |
| EXECUTIVE BENEFITS INSURANCE AGENCY,<br>Appellant,<br>v.<br>PETER H. ARKISON, TRUSTEE, etc.,<br>Appellee. | District Court (W.D. Wash.)<br>No. 2:10-cv-00929-MJP<br><br>Bankruptcy Court (W.D. Wash.)<br>No. 06-11721<br>Adv. Proc. No. 08-1132-TTG |

Appeal from a Final Judgment of the United States District Court
for the Western District of Washington
Honorable Marsha J. Pechman, District Judge, Presiding

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# BRIEF OF *AMICI CURIAE* (1) IN RESPONSE TO COURT'S QUESTIONS (2) IN SUPPORT OF NEITHER PARTY

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## CORPORATE DISCLOSURE STATEMENT

This brief is submitted on behalf of individual *amici curiae* Alejandro Diaz-Barba and Martha Barba de la Torre. Because these *amici* are individuals, Federal Rule of Appellate Procedure 26.1 does not require a disclosure statement.

Dated: January 19, 2012

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*Amici curiae* Alejandro Diaz-Barba and Martha Barba de la Torre (collectively "*Amici*") respectfully submit this brief pursuant to Federal Rule of Appellate Procedure 29(c).

## INTEREST OF *AMICI CURIAE*

*Amici* are the appellants in Ninth Circuit Case No. 10-55933, entitled *In re Icenhower (Kismet Acquisition, Ltd. v. Diaz-Barba)* ("the *Diaz-Barba* appeal"). *Amici* filed a motion for leave to file a supplemental brief to address the effect of *Stern v. Marshall*, 546 U.S. __, 131 S.Ct. 2594, 180 L.Ed.2d 475 (2011), on the bankruptcy court's judgment on review in the *Diaz-Barba* appeal. In response, the merits panel (Chief Judge Kozinski and Circuit Judges Reinhardt and W. Fletcher) vacated the oral argument date (January 11, 2011) and invited the parties in the *Diaz-Barba* appeal to submit *amicus curiae* briefs in the present appeal:

> If the parties wish to express a view on the bankruptcy court's constitutional authority to enter a final judgment, they may file an amicus brief [in the *Bellingham* appeal, No. 11-35162] by the current deadline of January 19.

Dkt. Entry 43, *Diaz-Barba* appeal.

Because the parties' briefs in the present appeal do not sufficiently discuss the claims for relief or the judgment in the underlying adversary proceeding, *Amici* do not know enough to support either party. Thus, *Amici* will limit this brief to responding to the Court's questions presented to prospective *amici curiae* in this appeal.

This brief was funded and authored entirely and exclusively by *Amici* and their counsel — none of whom has any connection to the parties or counsel in the present appeal.

## INTRODUCTION

At the end of last term, the United States Supreme Court ruled that bankruptcy courts lack constitutional authority to enter final judgments in certain categories of core proceedings enumerated in subsection (b)(2) of 28 U.S.C. § 157 ("§ 157"). *Stern v. Marshall*, 564 U.S. __, 131 S.Ct. 2594, 180 L.Ed.2d 475 (2011). Relying heavily on its analyses in *Northern Pipeline Constr. Co. v. Marathon Pipe Line Co.*, 458 U.S. 50, 102 S.Ct. 2858, 73 L.Ed.2d 598 (1982), and *Granfinanciera, S.A. v. Nordberg*, 492 U.S. 33, 109 S.Ct. 2782, 106 L.Ed.2d 26 (1989), the Court in *Stern* ruled that a state law counterclaim did not involve "public rights" that were susceptible to final adjudication by an Article I bankruptcy court; instead, the counterclaim was a matter of "private right" involving state law tort claims which necessarily may be determined only by an Article III court. *Stern, supra*, 131 S.Ct. at 2614-15.

In reaching its decision, the Court explained that, even though § 157(b)(1) may grant statutory authority to bankruptcy courts to enter final judgments in the core proceedings enumerated in § 157(b)(2), bankruptcy courts lack the constitutional authority in at least one category of core proceedings — state

law counterclaims that are not resolved in the process of ruling on a creditor's proof of claim. *Stern*, *supra*, 131 S.Ct. at 2620.

As explained below, *Amici* respond as follows to this Court's questions in its Order to prospective *amici curiae* filed November 4, 2011 (Dkt. Entry 35):

Response No. 1: *Stern v. Marshall*, *supra*, 131 S.Ct. 2594 (2011), prohibits bankruptcy courts from entering a final, binding judgment in an action to avoid a fraudulent conveyance.

Response No. 2: Under the plain language of § 157(b)(1), (b)(2)(H) & (c)(1), bankruptcy courts may not merely hear the proceedings and submit a report and recommendation to a federal district court in lieu of entering a final, binding judgment in an action to avoid a fraudulent conveyance.

## DISCUSSION

Although bankruptcy courts may have statutory authority to enter a final, binding judgment to avoid a fraudulent conveyance, bankruptcy courts lack constitutional authority to do so. Because (1) § 157(b)(1) provides that a bankruptcy court "may hear and determine … all core proceedings" and (2) § 157(c)(1) limits a bankruptcy court's authority to "hear a proceeding" and "submit proposed findings of fact and conclusions of law to the district court" only in non-core proceedings, the judicial branch of the government many not

legislate that in certain core proceedings — *viz.*, fraudulent conveyance actions — bankruptcy courts may merely hear the proceedings and submit a report and recommendation to a federal district court in lieu of entering a final judgment.

## I. Bankruptcy courts may not enter final judgments in fraudulent conveyance actions

### A. Under *Stern v. Marshall*, bankruptcy courts lack constitutional authority to enter final judgments in certain categories of core proceedings

The district courts of the United States have "original and exclusive jurisdiction of all cases under title 11." 28 U.S.C. § 1334(a). Cases under title 11 of the United States Code are divided into three categories: those "arising under title 11"; those "arising in … a case under title 11"; and those "related to a case under title 11." § 157(a). District courts may refer any or all such proceedings to the bankruptcy courts in their district. *Id.* Congress has given bankruptcy courts statutory authority to hear and enter final judgments in "all core proceedings arising under title 11, or arising in a case under title 11." § 157(b)(1). Core proceedings include those to determine, avoid, or recover fraudulent conveyances and orders to turn over property of the estate. § 157(b)(2)(E) & (H).

However, the United States Supreme Court recently held that, although § 157(b)(1) grants statutory authority to bankruptcy courts to enter final judgments in the core proceedings enumerated in § 157(b)(2), bankruptcy courts lack constitutional authority to do so in the case of at least one category of core

proceeding — state law counterclaims that are not resolved in the process of ruling on a creditor's proof of claim. *Stern*, *supra*, 131 S.Ct. at 2620. As particularly applicable here, in creating this new category of unconstitutional core proceedings, the *Stern* court noted from its earlier opinion in *Granfinanciera*: "'Congress could not constitutionally assign resolution of the fraudulent conveyance action to a non-Article III court.'" *Id.* at 2614, n. 7 (*quoting from, Granfinanciera*, *supra*, 492 U.S. at 56, n. 11).

*Stern* arose from a dispute between Vickie Marshall ("Vickie"), the widow of a Texas billionaire, and Pierce Marshall ("Pierce"), the billionaire's son. Prior to her husband's death, Vickie filed a suit against Pierce in Texas probate court, alleging that Pierce fraudulently induced his father to sign a living trust that did not include her. *Id.* at 2601. After her husband died, Vickie filed for bankruptcy. *Id.* Pierce commenced an action for non-dischargeability against Vickie in the bankruptcy case, alleging that she had defamed him. *Id.* Pierce also filed a proof of claim. *Id.* Vickie responded by filing a counterclaim alleging the same claims for tortious interference that were pending in the Texas probate court. *Id*.

The bankruptcy court ultimately granted summary judgment to Vickie on Pierce's defamation claim and issued a $425 million judgment in Vickie's favor on her counterclaim. *Stern, supra,* 131 S.Ct. at 2601.

Pierce appealed to the district court, arguing the bankruptcy court lacked jurisdiction to enter a final judgment on the counterclaim, because the counterclaim was not a core proceeding under § 157(b)(2)(C). 131 S.Ct. at 2602. The district court ruled that, although the counterclaim fell within the literal language of § 157(b)(2)(C), to treat it as core would be unconstitutional under the Supreme Court's decision in *Marathon. Stern, supra,* 131 S.Ct. at 2601. The district court then treated the bankruptcy court's judgment as proposed rather than final, and conducted an independent review of the record, as required by § 157(c)(1) (which applies to non-core proceedings otherwise "related to" a case under title 1). *Id.*

On further appeal, this Court reversed. *In re Marshall,* 600 F.3d 1037 (9th Cir. 2010), *aff'd Stern v. Marshall, supra*, 131 S.Ct. 2594. The Ninth Circuit ruled that § 157 mandated "a two-step approach" under which the bankruptcy court may issue a final judgment in a proceeding only if the matter both "meets Congress' definition of a core proceeding and arises under or arises in title 11." *Id.* at 1055 (emphasis in original). The Court reasoned that allowing a bankruptcy judge to enter final judgments on all counterclaims raised in bankruptcy proceedings "would certainly run afoul" of the Supreme Court's decision in *Marathon. Id.* at 1057. As explained in *Marshall*: "'[A] counterclaim under § 157(b)(2)(C) is properly a core proceeding "arising in a case under" the [Bankruptcy] Code only if the counterclaim is so closely related to [a creditor's] proof of claim that the

resolution of the counterclaim is necessary to resolve the allowance or disallowance of the claim itself.'" *Id.* at 1058. While not relevant to the present appeal, the Ninth Circuit then concluded that Vickie's counterclaim was not "so closely related" to Pierce's defamation claim that the counterclaim had to be resolved in order to allow or disallow Pierce's claim. *Id.* at 1059.

The Supreme Court agreed with Pierce that designating all counterclaims as core proceedings raises serious constitutional concerns. *Stern, supra,* 131 S.Ct. at 2605. Relying heavily on its reasoning in *Marathon, supra,* and *Granfinanciera, supra,* the Supreme Court concluded that a core proceeding such as Vickie's counterclaim did not involve "public rights" that were susceptible to final determination by a bankruptcy court, but instead was a matter of "private rights" involving state law tort claims which could only be adjudicated by an Article III court. *Id.* at 2614-15. Because Vickie's state law counterclaim would not be resolved in the process of ruling on Pierce's proof of claim, the Supreme Court held that the bankruptcy court lacked constitutional authority to enter final judgment on Vickie's state law counterclaim. *Id.* at 2609, 2611.

In finding that Vickie's counterclaim did not fall within the "public rights" exception, the Supreme Court observed:

> Vickie's counterclaim — like the fraudulent conveyance claim at issue in *Granfinanciera* — does not fall within any of the varied formulations of the public rights exception in this Court's cases. It is not a matter that

> can be pursued only by grace of the other branches, or one that "historically could have been determined exclusively by" those branches. The claim is instead one under state common law between two private parties. It does not "depend[ ] on the will of congress"; Congress has nothing to do with it.

*Stern, supra,* 131 S.Ct. at 2614 (citations omitted).

Accordingly, the Supreme Court affirmed the judgment of the Ninth Circuit Court of Appeals. *Stern, supra,* 131 S.Ct. at 2620.

### B. Under *Stern, Marathon,* and *Granfinanciera,* bankruptcy courts lack constitutional authority to enter final judgments in avoidance actions

The Supreme Court's rationale in *Stern* is predicated on the distinction between "public rights" and "private rights," as reasoned in its prior decisions in *Marathon, supra,* 458 U.S. 50, and *Granfinanciera, supra,* 492 U.S. 33. Analyzing *Stern* in conjunction with *Marathon* and *Granfinanciera* leads to the conclusion that, as with Vickie's state law counterclaim in *Stern,* bankruptcy courts similarly lack constitutional authority to enter a final judgment in an action to avoid a fraudulent transfer.

#### 1. The public rights exception does not grant authority to bankruptcy courts to resolve and enter judgments on state common law claims

In *Marathon,* the Supreme Court explored whether bankruptcy judges appointed under the Bankruptcy Act of 1978 were constitutionally vested with authority to decide a state law contract claim against an entity that was not

otherwise part of the bankruptcy proceedings. *Marathon, supra*, 458 U.S. at 56. A plurality of the Court acknowledged there is a category of cases involving "public rights" that Congress can constitutionally assign to "legislative" courts for resolution. *Id.* at 66. However, the plurality limited the "public rights" exception "only to matters arising between" individuals and the Government "in connection with the performance of the constitutional functions of the executive or legislative departments … that historically could have been determined exclusively by those" branches. *Id*. at 67-68.

A full majority of the Court, while not agreeing on the scope of the exception, held that a state law damages action by a bankruptcy estate for breach of contract, misrepresentation, coercion and duress against a party that had not filed a proof of claim did not fall within the exception. *Id.* at 69-72. Therefore, the action could not be decided by an Article I bankruptcy court, because the right of a debtor in bankruptcy to recover "damages to augment its estate is 'one of private right,' that is, the liability of one individual to another under the law as defined" — not one of public right. *Id.* at 71-72 (emphasis added) (*quoting from*, *Crowell v. Benson*, 285 U.S. 22, 51, 52 S.Ct. 285, 76 L.Ed.2d 598 (1932)). The Court reasoned that "the restructuring of debtor-creditor relations, which is at the core of the federal bankruptcy power, must be distinguished from the adjudication of state-created private rights," which were what was at issue in *Marathon*. *Id.* at 71.

### 2. The public rights exception does not grant authority to bankruptcy courts to resolve and enter judgments in actions to avoid fraudulent conveyances

In *Granfinanciera*, the Supreme Court considered the issue of whether a party that had not filed a proof of claim was entitled to a jury trial under the Seventh Amendment on claims asserted by a bankruptcy trustee to recover a fraudulent transfer under Bankruptcy Code § 548. 492 U.S. at 36. Employing the "public rights" analysis used in *Marathon*, the Court held that the Seventh Amendment entitled the defendant to a jury trial, notwithstanding Congress's designation of fraudulent conveyance actions as "[c]ore proceedings" in § 157(b)(2)(H). *Granfinanciera*, *supra*, 492 U.S. at 36.

The Court reasoned that fraudulent conveyance actions were "quintessentially suits at common law that more nearly resemble state law contract claims brought by a bankrupt corporation to augment the bankruptcy estate than they do creditors' hierarchically ordered claims to a pro rata share of the bankruptcy res." *Id.* at 56. Consequently, the Court concluded that a fraudulent conveyance action was "more accurately characterized as a private rather than a public right as we have used those terms in our Article III decisions." *Id*. at 55. Thus, the Court ruled, Congress may not assign adjudication of such claims to a specialized non-Article III Court "lacking 'the essential attributes of the judicial power.'" *Id.* at 53 (*quoting from, Crowell v. Benson, supra,* 285 U.S. at 51).

In a concurring opinion, Justice Scalia offered the view that "a matter of public rights … must at a minimum arise between the government and others." *Granfinanciera,* 492 U.S. at 65 (Scalia, J., concurring). Justice Scalia repeated his observation in *Stern, supra,* 131 S.Ct. at 2620 (Scalia, J., concurring). This is not a new concept: "[T]he presence of the United States as a proper party to the proceeding is a necessary but not sufficient means of distinguishing 'private rights' from 'public rights.'"[1] *Marathon, supra,*, 458 U.S. at 69, n. 23.

*Granfinanciera* teaches that a defendant may invoke its Seventh Amendment right to a jury trial in a fraudulent transfer action brought under Bankruptcy Code § 548. *Granfinanciera, supra,* 492 U.S. at 36. This is because a fraudulent transfer claim does not fall under the "public rights" exception; rather, it is a "private right." *Id.* at 55.

Although *Granfinanciera* considered only whether the defendant was entitled to a jury trial in a § 548 fraudulent transfer claim, the "public rights" analysis conducted in *Granfinanciera,* as explained in *Stern,* applies equally to

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[1] More recently, the Court broadened the description of "public rights" to include claims that "derive[ ] from a federal regulatory scheme, or in which resolution of the claim by an expert Government agency is deemed essential to a limited regulatory objective within the agency's authority." *Stern, supra,* 131 S.Ct. at 2613 (*citing, United States v. Jicarilla Apache Nation,* 564 U.S. __, __, 131 S.Ct. 2313, 2323-24, 180 L.Ed.2d 187 (2011) (comparing private common-law trusts with federal statutory Indian trusts)).

all fraudulent conveyance claims: Bankruptcy courts may not adjudicate and enter final judgments in matters involving "private rights" — period. Thus, even where a jury is not demanded in a fraudulent transfer action, pursuant to *Stern* the matter cannot be heard by an Article I bankruptcy court.

For this reason, the result in all avoidance actions should be the same as the result reached in *Granfinanciera* under Bankruptcy Code § 548: They are matters of "private rights" involving common law claims that cannot be adjudicated by an Article I bankruptcy court.

## II. Given the statutory scheme in § 157, bankruptcy courts may not merely hear the proceedings and submit a report and recommendation to a federal district court in lieu of entering a final judgment in a fraudulent conveyance action

The Judiciary may not substitute a different procedure to fill the gap in legislation left by finding the Constitution does not allow Article I bankruptcy courts to enter a final binding judgment in action to avoid a fraudulent conveyance. The principal subsections of § 157 applicable to this analysis include:

§ 157(b)(1), which provides in relevant part: "Bankruptcy judges may hear

> and determine all cases under title 11 and all core proceedings arising under title 11, or arising in a case under title 11, referred under subsection (a) of this section and may enter appropriate orders and judgments … ."

§ 157(b)(2)(H), which defines "core proceedings" to include "proceedings to determine, avoid, or recover fraudulent conveyances."

§ 157(c)(1), which provides in full: "A bankruptcy judge may hear a proceeding that is not a core proceeding but that is otherwise related to a case under title 11. In such proceeding, the bankruptcy judge 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.

In the present appeal, the Court's second question to *amici curiae* asks whether the procedure set forth in § 157(c)(1) — for the bankruptcy court to submit proposed findings and conclusions to the district court — may be employed in the event this Court concludes that the Constitution precludes Article I bankruptcy courts from entering final judgments in fraudulent conveyance actions. *Amici* finds no support in Congress's detailed statutory framework that will allow the procedure for adjudicating non-core proceedings (under § 157(c)) to be substituted in place of the procedure for adjudicating a core proceeding.

The lack of constitutional authority to hear and determine one of the statutorily defined core proceedings under a specific procedure does not allow the

application of a different specific procedure applicable only in certain statutorily defined non-core proceedings. Very simply, the courts do not have authority to prescribe such a legislative remedy to fix the constitutional infirmities of § 157(b) as applied in certain cases.

There is a fundamental difference between a court filling a gap left by Congress's silence and a court rewriting rules that Congress has affirmatively and specifically enacted;[2] the judiciary has no authority to substitute its views for those expressed by Congress in a duly enacted statute. *Mobil Oil Corp. v. Higginbotham*, 436 U.S. 618, 625-26, 98 S.Ct. 2010, 56 L.Ed.2d 581 (1978). The fact that the Legislature might have acted with greater clarity or foresight does not give the Judiciary authority to redraft statutes in an effort to achieve that which the Legislature is perceived to have failed to do. *United States v. Locke* 471 U.S. 84, 95, 105 S.Ct. 1785, 85 L.Ed.2d 64 (1985).

Nor is a court authorized to attempt to soften the clear import of Congress's chosen words because the court believes the chosen words may lead to a harsh

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[2] There is no question but that the procedures set forth in § 157 are part of a detailed statutory scheme enacted by Congress. Title 28 of the United States Code deals with the judiciary and judicial procedure; part I of title 28 deals with the organization of the courts; chapter 6 of part I deals with bankruptcy judges; and § 157 in chapter 6 deals with the procedures Congress has authorized the bankruptcy judges to employ depending on the type of matter being heard.

result. *Locke, supra,* 471 U.S. at 95-97 (*citing Northwest Airlines, Inc. v. Transport Workers,* 451 U.S. 77, 98, 101 S.Ct. 1571, 67 L.Ed.2d 750 (1981)).

Deference to the Legislature, as well as recognition that elected officials in Congress typically vote on the language of a bill, requires the Judiciary to assume that "'the legislative purpose is expressed by the ordinary meaning of the words used.'" *Locke, supra,* 471 U.S. at 95 (*quoting from Richards v. United States,* 369 U.S. 1, 9, 82 S.Ct. 585, 7 L.Ed.2d 492 (1962)). The Supreme Court often has warned that going behind the plain language of a statute in search of a possibly contrary congressional intent is "a step to be taken cautiously." *Piper v. Chris-Craft Indus. Inc.,* 430 U.S. 1, 26, 97 S.Ct. 926, 51 L.Ed.2d 124 (1977).

As in all cases involving statutory construction, "[the] starting point must be the language employed by Congress," *Reiter v. Sonotone Corp.*, 442 U.S. 330, 337, 99 S.Ct. 2326, 60 L.Ed.2d 931 (1979), and the courts must assume "that the legislative purpose is expressed by the ordinary meaning of the words used," *Richards, supra*, 369 U.S. at 9. Thus "[a]bsent a clearly expressed legislative intention to the contrary, that language must ordinarily be regarded as conclusive." *Consumer Product Safety Comm'n v. GTE Sylvania, Inc.*, 447 U.S. 102, 108, 100 S.Ct. 2051, 64 L.Ed.2d 766 (1980).

The express language of subsection (b)(1) of § 157 provides that it applies to "all cases under title 11 and all core proceedings arising under title 11, or arising

in a case under title 11." The express language of subsection (b)(2)(H) of this same statute provides that it applies to a proceeding "to determine, avoid, or recover fraudulent conveyances." Finally, the express language of subsection (c)(1) of this same statute provides that it applies only to a proceeding "that is not a core proceeding but that is otherwise related to a case under title 11." (Emphasis added.)

Accordingly, if the Judiciary were to create a procedure whereby bankruptcy courts "hear and determine" a core proceeding under § 157(b)(1), yet then submit proposed findings and conclusions under the procedure limited to non-core proceedings under § 157(c)(1), the court will be establishing a procedure that Congress has not authorized — and easily could have — despite a detailed delegation of authority in such matters.

Under the Supreme Court precedents cited above, the Judiciary should not substitute its views for those expressed by the Legislature — here, in § 157. Although the courts certainly have the power (indeed, the duty) to declare a Congressional delegation of authority unconstitutional upon a sufficient showing, courts do not have the power to legislate the appropriate remedy for the unconstitutional delegation of authority.

As applicable here, therefore, finding that the Constitution does not allow Article I bankruptcy courts to hear and determine fraudulent conveyance actions

in core proceedings (under § 157(b)(1)) does not allow for the substitution of a judicially-created alternative procedure that Congress authorized only in non-core, related proceedings (under § 157(c)(1)). Only Congress can provide for an alternative procedure.

## CONCLUSION

Bankruptcy courts lack the constitutional authority to enter final, binding judgments in actions to avoid fraudulent conveyances.

Given the statutory scheme in 28 U.S.C. § 157, however, bankruptcy courts may not merely hear the proceedings and submit a report and recommendation to a federal district court in lieu of entering final, binding judgments in actions to avoid fraudulent conveyances. Any procedure replacing the unconstitutional delegation of authority to bankruptcy courts to adjudicate such actions must come from the Legislature, not the Judiciary.

Dated: January 19, 2012

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**BRIEF FORMAT CERTIFICATION**

We certify that the type size and type face of this brief comply with Federal Rules of Appellate Procedure 29(d) and 32(a)(5), (6) and (7). This brief contains 3,907 words, excluding the portions exempted by Federal Rule of Appellate Procedure 32(a)(7)(B)(iii).

Dated: January 19, 2012 s/ Edward I. Silverman

s/ D. Anthony Gaston