No. 11-35162

In the United States Court of Appeals For the Ninth Circuit

IN RE: BELLINGHAM INSURANCE AGENCY, INC.,

EXECUTIVE BENEFITS INSURANCE AGENCY,
Appellant,

v.

PETER H. ARKISON, AS TRUSTEE FOR THE BANKRUPTCY ESTATE OF BELLINGHAM INSURANCE AGENCY, INC.,
Appellee.

On Appeal from the United States District Court For the Western District of Washington Case No. 06-11721, Adversary Proceeding No. 08-1132

BRIEF OF *AMICUS CURIAE* PROFESSOR JOHN A.E. POTTOW

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INTEREST AND AUTHORITY OF *AMICUS CURIAE*

Amicus curiae John Pottow ("Amicus") has no financial or other connection to this case. He offers his assistance as an expert in the field of bankruptcy law who has lectured specifically on the implications of Stern v. Marshall, 131 S. Ct. 2594 (2011), to members of the bankruptcy bench and bar. Amicus files this brief pursuant to the Court's permission by order dated November 4, 2011. See Order, Dkt. 35, No. 11-35162 (9th Cir. Nov. 4, 2011) (requesting assistance of and granting filing permission to *amicus curiae*).

ARGUMENT

The Court's primary question to *amici curiae* can be answered quickly and dispositively. Stern permits the entry of a final judgment in a fraudulent conveyance action by a bankruptcy judge in the absence of timely objection. In this case, the defendant in the adversary proceeding and appellant before this Court, Executive Benefits Insurance Agency, Inc. ("EBIA"), did not object to proceeding before an Article I jurist until well after its claim was resolved by an adverse final order. And appealed. Twice. As such, it has waived any claim under Stern. In the alternative, any claim under Stern must be dismissed as moot given the de novo review of this case by the district court. In the further alternative, the fraudulent conveyance in this specific case, given its centrality to

the resolution of the debtor-creditor relationship, would be accorded Article I adjudicability under Stern.

I. EBIA Waived Its Constitutional Rights

EBIA was sued by the bankruptcy Trustee, Peter Arkinson, on behalf of the estate of Bellinghman Insurance Agency, Inc., the debtor. After Arkinson was appointed the trustee of the debtor's estate and came to review its affairs, he initiated an adversary proceeding (an intra-bankruptcy lawsuit) against EBIA and other related defendants alleging they were involved in a scheme to loot the debtor of its assets and render it an empty shell. Specifically, among other claims, Arkinson alleged EBIA was a mere continuation/successor alter ego to the debtor and that it received fraudulent conveyances of the debtor's assets (both under a "hard fraud" theory of intentional wrongdoing and "soft fraud" theory of gratuitous insolvency-state transfer). See 11 U.S.C. § 548(a)(1)(A) (hard fraud); (B) (soft fraud).

In defending against the suit, none of the defendants made a timely demand for a jury trial. (One made a belated demand, after which the bankruptcy court assigned the trial phase to district court, but the district court, treating the assignment as a motion to withdraw the reference, ultimately denied it, dismissing

the cause back to bankruptcy court. See Jury Demand, Dkt. 171, No. 06-11721 (Bankr. W.D. Wash. Aug. 6, 2008) (belated jury demand; also filed in wrong docket); Order, Dkt. 39, Adv. Pro. No. 08-01132 (Bankr. W.D. Wash. Dec. 31, 2009) (order transferring trial phase to district court); Order, Dkt. 1, No. 2:10-cv-00171 (W.D. Wash. Jan. 28, 2010) (docketed as motion to withdraw reference); Order, Dkt. 8 (W.D. Wash. July 2, 2010) (order denying motion to withdraw reference).) As such, EBIA waived its right to a jury trial under the Seventh Amendment, just as it waived its right to proceed before an Article III jurist. See United States v. Olano, 507 U.S. 725, 731 (1993) ("No procedural principle is more familiar to this Court than that a constitutional right, or a right of any sort, may be forfeited . . . by the failure to make a timely assertion of the right before a tribunal having jurisdiction to determine it . . . ."") (internal quotation marks and citations omitted), cited in Stern, 131 S. Ct. at 2608.

EBIA's belated regret at not having raised a constitutional objection earlier is too little too late. Unlike Pierce Marshall, the respondent in Stern, who objected consistently and vociferously to Article I adjudication of the claim he was defending (long before he could learn of the constitutional significance his case would take), EBIA never uttered a peep about Article III issues until after reading Stern and discovering that Pierce Marshall was a shrewder litigant. This silence began in its responsive pleadings to the adversary proceeding, was followed in its

unsuccessful defense against the summary judgment motion, was followed even further in its review of that adverse outcome in district court, and was followed further still in its merits brief to this Court. As such, whatever "Stern rights" it had to non-Article I adjudication were forfeited years ago. See Northern Pipeline Construction Co. v. Marathon Oil Pipe Co., 458 U.S. 50, 56-57 (1982) (plurality opinion) at 56-57 (noting defendant right from the outset contested the constitutionality of requiring it to defend before an Article I judge); cf. Granfinanciera v. Nordberg 492 U.S. 31, 36-37 (1989) (noting defendant right from the outset insisted on its rights to a jury trial). (One defendant did contest Arkinson's statutory classification of the fraudulent conveyance claim as core, a frivolous position under section 157(b)(2)(H), which explicitly lists fraudulent conveyances as core proceedings. See Answer, Dkt. 170, No. 06-11721 (Bankr. W.D. Wash. Aug. 6, 2008) (misfiled answer to adversary proceeding complaint).)

II. Nothing in *Stern* Precludes Waiver of Those Constitutional Rights

EBIA's belated objection to Article I adjudication of its long-concluded adversary proceeding might be appropriate to consider at this eleventh hour were its grievance related to the subject matter jurisdiction of the bankruptcy court. Just as a party cannot consent to the absence of subject matter jurisdiction, it generally

cannot forfeit an objection thereto; subject matter claims can be raised at any time, including on collateral review. See, e.g., Kontrick v. Ryan, 540 U.S. 443, 455 (2004). (A rare de facto exception is the rule of toehold jurisdiction: a court's conclusion, even if erroneous, that it has subject matter jurisdiction is not subject to collateral attack. See Stoll v. Gottlieb, 305 U.S. 168 (1938).) The allocation of judicial authority between the Article III and Article I jurists within the federal court system, however, is not such a matter of subject matter jurisdiction. It is not even analogous.

The subject matter jurisdiction rules for the bankruptcy courts are found at 28 U.S.C. § 1334. Section 157 of that title deals only with intra-federal court assignment of matters between the Article III and Article I judges, which occurs only subsequent to federal subject matter jurisdiction attaching. In discussing section 157, the Supreme Court explained unambiguously its non-jurisdictional status:

> Section 157 allocates the authority to enter final judgment between the bankruptcy court and the district court. See §§157(b)(1), (c)(1). That allocation does not implicate questions of subject matter jurisdiction. See §157(c)(2) (parties may consent to entry of final judgment by bankruptcy judge in non-core case). By the same token, §157(b)(5) simply specifies where a particular category of cases should be tried. Pierce does not explain why that statutory limitation may not be similarly waived.
>
> We agree with Vickie that Pierce not only could but did consent to the Bankruptcy Court's resolution of his defamation claim.

Stern, 131 S. Ct. at 2607 (emphasis added).

In relying on section 157(c)(2) – which grants bankruptcy courts the right in the presence of party consent to enter final and binding judgments on non-core matters (i.e., those for which Article III presumptively prevents bankruptcy judge final adjudication) – the Supreme Court demonstrated that the constitutional rights bestowed by Article III are waiveable. If a party has authority to consent to non-Article III adjudication of such claims under section 157(c)(2), a party similarly has authority to waive Article III objections thereto. See Stern at 2606 ("Vickie argues, [that] a party may waive or forfeit any objections under § 157(b)(5), in the same way that a party may waive or forfeit an objection to the bankruptcy court finally resolving a non-core claim.") (citations omitted, including explicit quotation of 157(c)(2)).

The waiveable nature of these claims likely explains the Court's contrasting treatment of Pierce's own claim against Vickie's bankruptcy estate (defamation) from her estate's counterclaim against him (tortious interference). When discussing Pierce's conduct respecting his own claim, the Court cited numerous instances in which he demonstrated consent to bankruptcy court resolution. See, e.g., id. at 2608. When discussing the counterclaim, the Court underscored in contrast that he did not consent to its resolution in bankruptcy court. See id. at 2607 ("Although Pierce had objected in July 1996 to the Bankruptcy Court's

exercise of jurisdiction over Vickie's counterclaim, he advised the court at the time that he was 'happy to litigate [his] claim' there.") (alteration in original, emphasis added). Elsewhere it concluded, "Given Pierce's course of conduct before the Bankruptcy Court, we conclude that he consented to that court's resolution of his defamation claim (and forfeited any argument to the contrary)." Id. at 2608. Thus, in summarizing its overall holding in Stern, the majority explained:

> The dissent reads our cases differently, and in particular contends that more recent cases view Northern Pipeline as establishing only 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. Just so: Substitute "tort" for "contract," and that statement directly covers this case.

Id. at 2615 (internal quotations marks, citations, and alterations omitted; emphasis added).

Accordingly, just as the parties can consent to non-Article III resolution of their non-core claims in bankruptcy court, so too can they waive Article III objections thereto in the absence of a timely objection. Stern not only poses no problem for this proposition, it affirms it.

III. Even If EBIA's Untimely Objection Were Permitted, It Should Be Dismissed as Moot

Suppose this Court were inclined to grant consideration of EBIA's untimely request for Article III adjudication of the defense to the fraudulent conveyance/mere continuation proceeding (perhaps animated out of equitable doctrines of excusable neglect, etc.). The claim should nevertheless fail as moot. This is for the simple reason that a "Stern claim" should be heard as a non-core proceeding, and EBIA was accorded the full judicial process to which a non-core proceeding is entitled. (A "Stern claim" in Amicus' taxonomy is a nominally core claim under section 157(b) that cannot be given final judgment by a bankruptcy court under Article III in the absence of consent by the parties and hence must be recharacterized as a non-core claim falling under section 157(c).)

In Stern, the Supreme Court made clear that core and non-core are exhaustive categories of the universe of claims that fall within the subject matter jurisdiction of the federal courts under title 11. See Stern at 2604 (clarifying further that "core" is synonymous with "arising under or in" and "non-core" with "related to" a case or proceeding under title 11, another exhaustive dichotomy – or perhaps technically, trichotomy). Indeed, in concluding that its holding was

narrow, the Court explained that no one was taking the position that "bankruptcy courts are barred from hearing all counterclaims or proposing findings of fact and conclusions of law [as non-core claims] on those matters." Id. at 2620 (internal quotation marks and citations omitted). Thus: "We do not think the removal of counterclaims such as Vickie's from core bankruptcy jurisdiction [to become non-core proceedings] meaningfully changes the division of labor in the current statute . . . ." Id. Therefore, a claim unconstitutionally classified as a core proceeding under section 157(b)'s statutory text in violation of Article III – a Stern claim – becomes recharacterized as non-core and relocated to section 157(c).

As non-core matters, Stern claims may therefore be heard by bankruptcy judges, but only as magistrates who cannot enter final judgments. They propose findings of fact and conclusions of law for the district judge's consideration, but "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). Therefore, assuming (arguendo only) that EBIA's alleged fraudulent conveyance is a Stern claim, there are two and only two ways in which it could have suffered cognizable harm by the claim's unconstitutional classification as core: (a) it suffered under an arguably ultra vires judicial order during the period between the bankruptcy court's "order" and the district court's

(valid) order affirming it; and (b) it was subjected to a different standard of review in scrutinizing the bankruptcy court's judgment in generating that valid district court order – the more deferential standard accorded core proceedings as final judgments, see Fed. R. Bankr. P. 8013 (findings of fact subject to clearly erroneous review), in contrast to the de novo (re)consideration of fact and law conducted in non-core proceedings, see 28 U.S.C. § 157(c)(1). Because EBIA can point to no conceivable harm under either of these grounds, any Stern objections must be rejected as moot.

Consider point (a) first. Other than perhaps existential angst, EBIA suffered no harm in the intervening time between the bankruptcy court's order and the district court's order. No one did anything different in the legal universe, and no one's rights changed. This is in marked contrast to the one-in-a-million outcome in Stern itself, where – by law-school-exam-worthy fluke – a parallel state court proceeding came to final judgment in this interim period. That timing had profound legal consequence. If the bankruptcy court could enter a final judgment, then the (subsequent) state court proceeding was subordinate under preclusion law principles; if the bankruptcy court could only enter proposed findings of fact and conclusions of law, then the state court (prior) proceeding was dominant under preclusion law principles. To say that Pierce Marshall suffered cognizable harm by the bankruptcy court's mistaken belief it could enter a final judgment in this

context is putting it mildly. By contrast here, EBIA points to nothing suggesting it was hurt in any way whatsoever by the bankruptcy court's purported order being given legal effect in the interim period before the district court order was entered.

Now consider point (b). Had the district court accorded the bankruptcy court's judgment any deference on appeal, EBIA might plausibly have a claim for harm flowing from the alleged constitutional error. That is, had the district court treated the bankruptcy court's findings of fact as subject to, say, a clearly erroneous standard of review, or had it otherwise indicated it was according the bankruptcy court the sort of the discretion appellate courts traditionally grant lower courts in reviewing their final judgments, EBIA could plausibly contend that the unconstitutional mischaracterization of its Stern claim as core caused it cognizable legal harm.

But this did not happen, as EBIA well knows. On the contrary, the district court made clear that it was conducting a de novo review of the bankruptcy court order – appropriately so as it was a question of summary judgment. "The Court reviews the Bankruptcy Court's order de novo." Order Affirming Summary Judgment at 5, Dkt. 15, No. 10-929 (W.D. Wash. Jan. 21, 2011) ("District Court Order"). Indeed, a review of the District Court Order reveals not only the wholly non-deferential exercise of de novo reconsideration, but a thorough and independent analysis that found the presented claims utterly meritless. For

example, on an avoidance claim on which Arkinson sought summary judgment, the district court held that EBIA "failed to raise any dispute of fact that might preclude entry of [summary] judgment . . . ." Id. (emphasis added). The court further held that in contrast to Arkinson's considerable evidence – including the debtor's own accounting records showing transfers out to the recipients – the only evidence submitted by a defendant was a "self-serving" declaration sheepishly proclaiming either ignorance of the transfers or at best a "clerical error." Id. at 6. The district court thus concluded that "[t]he Bankruptcy Court did not err . . . ." Id.

Similarly, in the face of overwhelming evidence of actual fraud in the fraudulent conveyance claims (including wholesale transfers of the debtor's assets within three days of an adverse arbitration ruling), the district court likewise noted that:

> [EBIA] has done nothing to point out where in the record contradictory facts exist. It attempts to argue that EBIA received nothing from [the debtor] and that it was an entirely different business. This is supported only by Defendant Paleveda's self-serving declaration, which, as explained above, fails to raise a genuine issue of material fact.

Id. at 8.

Additionally, the district court in upholding the "mere continuation" ruling in Arkinson's favor even went so far as to point out that the arguments presented by EBIA actually hurt rather than helped its case, resulting in no "plausible basis

for reversal . . . ." Id. at 10. Again, the district court found "no error in the Bankruptcy Court's conclusion on this matter." Id. at 8. The district court's own ultimate conclusion demonstrates one last time that it conducted a thorough and de novo review of the bankruptcy court's disposition of EBIA's claim:

> Appellant has done nothing to show any defect in the Bankruptcy Court's grant of summary judgment. Procedurally, Appellant has done everything to hinder the Court in assessing the merits of the appeal. On the merits, Appellant has failed to show any dispute of material fact in the record that could possibly support the reversal of the Bankruptcy Court's order. The Court DISMISSES the appeal and AFFIRMS the Bankruptcy Court.

Id. at 10 (emphasis added).

This is exactly the sort of review that EBIA would have received had its fraudulent conveyance claim been treated as non-core and the bankruptcy court presented only proposed findings of fact and conclusions of law. The district court upon timely objection would conduct its de novo review under section 157(c)(1), which is just what it did here. Whatever EBIA's Stern-animated complaint in this appeal is, it cannot be that an Article III district court lacks the authority to enter a summary judgment order such as the one in this case granting relief on all the Trustee's claims. Therefore, whether the district court did so *ab initio* (as it could have under section 157(d)), whether it did so upon reviewing proposed findings of fact and conclusions of law de novo (as it would have to under section 157(c)(1) were EBIA entitled to Stern relief), or whether it did so reviewing a

"constitutionally flawed" order de novo (as EBIA contends it did in this case), is legally irrelevant. All roads lead to the entry of the order, now under appeal to this Court, that no one contends lacks constitutional authority: the de novo order of the District Court of January 21, 2011 granting summary judgment. Therefore, even if EBIA suffered a Stern violation – an assumption with which Amicus disagrees but grants for sake of argument – it suffered no cognizable harm. It did nothing in the interim period between the bankruptcy court order and the district court order adversely affecting its rights and it appealed the bankruptcy judge's order in the exact same manner as it would an adverse proposed finding of fact and conclusion of law under section 157(c)(1). As such, even if it were allowed to plead a Stern grievance belatedly, it should have its claim dismissed as moot given this lack of harm.

IV. Were the Merits of EBIA's *Stern* Objection Ever Considered, Its Fraudulent Conveyance Would Likely Be Adjudicable in Bankruptcy Court

In Stern, the Court struggled to articulate just what sorts of claims survive its holding. Cf. Stern, 131 S. Ct. at 2621 (Scalia, J., concurring) ("The sheer surfeit of factors . . . the Court was required to consider in this case should arouse the suspicion that something is seriously amiss with our jurisprudence in this area. I count at least seven different reasons given in the . . . opinion for concluding that an Article III judge was required . . . ."). Whatever its wording, Stern makes clear

that some claims are so intertwined with the bankruptcy process that they are permitted Article I adjudication. See, e.g., Stern at 2618 ("Granfinanciera's distinction between actions that seek to augment the bankruptcy estate and those that seek a pro rata share of the bankruptcy res reaffirms that . . . the question is whether the action at issue stems from the bankruptcy itself or would necessarily be resolved in the claims allowance process."); id. at 2598 ("In other words, it is still the case that what makes a right public rather than private is that the right is integrally related to particular Federal Government action.") (internal quotation marks and citations omitted). Thus, the Court in Stern reaffirmed that at least some non-claims allowance matters are "bankruptcy-ish" enough to piggyback on the main bankruptcy case into Article I adjudication. (Although there have been some footnote qualifications, the Supreme Court has taken for granted that the bankruptcy system may be considered integrally related to a particular federal government action and hence a public right. See id. at 2614, n.7; Granfinanciera, 492 U.S. at 56, n.11.)

In this regard, the fraudulent conveyance in Granfinanciera can be importantly contrasted to the fraudulent conveyance at issue in this appeal. In Granfinanciera, the Court at several times pointed out that the fraudulent conveyance action at issue was a gratuitous one in the sense that it would at most augment the estate. See, e.g., Granfinanciera, 492 U.S. at 58. It had nothing to do

with the claims against the debtor that were being processed and was launched against a defendant that was not even a participant in the bankruptcy proceeding (and that vociferously objected to violation of its constitutional rights from the outset). See id. at 37. In fact, the Granfinanciera fraudulent conveyance was not even brought until well after the reorganization plan was confirmed and the assets of the debtor liquidated. See id. at 61, n. 15. As such, it was hardly "integral to the restructuring of debtor-creditor relations" in that case. Id. at 58.

The contrast to the instant case could not be more striking. Here, the fraudulent conveyance/mere continuation actions are the crux of Arkinson's case as Trustee. EBIA and the other defendants were not mere fraudulent conveyance recipients bearing only tangential connection to the case, dragged in unexpectedly against their wills just to augment the estate. Arkinson contends (and was found to have encountered no resistance of genuine fact) that the defendants looted the debtor of all its assets by parking them in purportedly separate entities. This is not a throwaway claim to a long-settled bankruptcy; this claim is the very essence of this entire bankruptcy. One scarcely sees how there could possibly be resolution of the competing creditor claims to the bankruptcy res in this case without the predicate question answered whether this is an empty shell bankruptcy estate of no assets or a wrongly looted bankruptcy estate whose entire res was fraudulently diverted elsewhere and is recoverable.

Accordingly, were this Court inclined to explore the Supreme Court's gradations of fraudulent conveyance permissibility after Stern, it should find that this particular fraudulent conveyance case with these particular facts presents just the sort of Article I adjudicable claim left open after Stern. (Were this Court inclined to address such fact-intensive matters, Amicus would respectfully request an opportunity for additional oral argument given the nature and focus of the oral argument that already occurred on the appeal's merits.)

V. Bankruptcy Courts Can Hear, Even When They Cannot Decide, *Stern* Claims

The Court's second question asks whether bankruptcy courts can hear (but not decide) Stern claims. They can. The only argument that they cannot is based on the following reasoning: As a statutory matter, section 157 only grants bankruptcy courts the right to enter proposed findings of facts and conclusions of law as magistrates for non-core proceedings. See 157(c)(1). Stern claims are those which by statute are defined as core (albeit unconstitutionally). See 157(b). Therefore, Stern claims cannot be heard by bankruptcy judges at all; there is no constitutional basis to hear them as final judges and there is no statutory basis to hear them as magistrates.

Fortunately, all bankruptcy courts to have considered this argument have rejected it. Indeed, the only one that initially accepted it Amicus could find

subsequently reversed itself upon further reflection. See Samson v. Western Capital Partners LLC (In re Blixseth), 2011 Bankr. LEXIS 4887, *8 (Bankr. D. Mont. Dec. 14, 2011), vacating in part Samson v. Blixseth (In re Blixseth), 2011 Bankr. LEXIS 2953 (Bankr. D. Mont. Aug. 1, 2011). More importantly, the Supreme Court itself indirectly dismissed it in the Stern opinion. When reciting the district court's treatment of the tortious interference counterclaim, the Court – without a whiff of disapproval – noted that the district court recharacterized the bankruptcy court's putative final judgment on a statutorily defined core matter as a proposed finding of fact and conclusion of law subject to de novo review. See Stern at 2602.

The only court Amicus is able to find even considering this "no man's land" argument regarding Stern claims is a recent decision from the U.S. Court of Appeals for the Seventh Circuit. There, the panel expressed attraction to this argument in dictum, but ultimately dismissed the appeal at issue for lack of appellate jurisdiction. See Ortiz v. Aurora Health Care, Inc. (In re Ortiz), No. 10-3465 slip op. at 3 (7th Cir. Dec. 30, 2011) ("Without a final judgment we lack a statutory basis for appellate jurisdiction.").

The reason why courts have uniformly rejected this argument, apart from following the Supreme Court's indirect approval in Stern, is that a contrary holding – that bankruptcy judges cannot hear Stern claims as magistrates – would run

squarely into the absurdity doctrine. It is impossible to concoct a plausible reason Congress would choose to accord greater adjudicative authority to bankruptcy court judges over non-core claims, which are by definition only tangential to the bankruptcy process, than to more centrally bankruptcy-connected claims, such as fraudulent conveyances and other proceedings Congress statutorily located under section 157(b). See generally Clinton v. City of New York, 524 U.S. 417, 429 (1998) (discussing the absurdity doctrine).

CONCLUSION

For the myriad reasons presented here – but chiefly the straightforward waiver/forfeiture posture – this Court should answer the question offered for *amici curiae* input in the negative: Stern does not prohibit bankruptcy courts from entering final, binding judgments in actions to avoid fraudulent conveyances, at least in the absence of timely objection to Article I adjudication. The second question – which Amicus believes has spawned no serious disagreement anywhere in bankruptcy case law – should be answered in the positive, but more accurately should not be answered as moot.

Because *amici curiae* were neither invited nor granted permission to opine on the merits of the appeal, Amicus makes no recommendation on whether EBIA has presented genuine issues of material fact sufficient to preclude dismissal of its case on summary judgment. He only submits that Stern offers it no help here.

Dated: January 18, 2012 Respectfully submitted,

By: /s/ John A.E. Pottow

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CERTIFICATE OF COMPLIANCE

I certify that pursuant to Fed. R. App. P. 29(d) and 9th Cir. R. 32-1, the attached amici brief is proportionally spaced, has a typeface of 14 points or more and contains 4459 words.

Submission dated: January 18, 2012

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