Appeal No. 11-35162

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

EXECUTIVE BENEFITS INSURANCE AGENCY,

Appellant,

v.

PETER H. ARKISON, TRUSTEE, solely in his capacity as Chapter 7 Trustee of the estate of Bellingham Insurance Agency, Inc.,

Appellee.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF WASHINGTON
HONORABLE MARSHA J. PECHMAN
CASE NO. 10-CV-00929

BRIEF OF JONES DAY AS AMICUS CURIAE SUPPORTING APPELLANT

Brian O'Neill
Christopher Lovrien
JONES DAY
555 South Flower Street
Fiftieth Floor
Los Angeles, CA 90071.2300
Telephone: +1.213.489.3939
Facsimile: +1.213.243.2539
E-mail: boneill@JonesDay.com

Tobias S. Keller
Aaron L. Agenbroad
Nathaniel P. Garrett
JONES DAY
555 California Street, 26th Floor
San Francisco, CA 94104
Telephone: +1.415.626.3939
Facsimile: +1.415.875.5700
E-mail: tkeller@JonesDay.com

Attorneys for Amicus Curiae
JONES DAY

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STATEMENT OF INTEREST

Amicus curiae Jones Day is an international law firm with over 2400 attorneys. In response to the Court's November 4, 2011 order inviting supplemental briefs, Jones Day respectfully submits this amicus brief to address: (1) whether *Stern v. Marshall*, 131 S. Ct. 2594 (2011), prohibits bankruptcy courts from entering a final, binding judgment on an action to avoid a fraudulent conveyance; and (2) if so, whether bankruptcy courts may hear such proceedings and submit a report and recommendation to a federal district court in lieu of entering a final judgment.

Over the past decade, Jones Day has hired dozens of partners from law firms that dissolved and declared bankruptcy. Trustees of two defunct law firms, Heller Ehrman LLP and Coudert Brothers LLP, have sued Jones Day (among other firms) under fraudulent conveyance theories of liability. *See* Amended Complaint, *Heller Ehrman LLP v. Jones Day*, Adversary Proceeding No. 10-03221 (Bankr. N.D. Cal. May 23, 2011); Complaint, *Development Specialists, Inc.*, Adversary Proceeding No. 08-1494 (Bankr. S.D.N.Y. Sept. 21, 2008). According to the plaintiffs in these actions, a bankruptcy trustee has the right to sue for profits generated by work that partners started at their old firms and took to their new positions, even though the new firm committed its own capital and effort to complete work that the failed firm could not. *See* Jacqueline Palank, *Debts of Defunct Law Firms Haunt Partners in Next Job*, WALL. ST. J., Nov. 7, 2011, at B1. In the wake of *Stern v. Marshall*, 131

S. Ct. 2594 (2011), Jones Day has challenged bankruptcy courts' constitutional and statutory authority to adjudicate fraudulent conveyance actions, giving rise to Jones Day's interest in this appeal. In the *Coudert* action, the district court recently withdrew the bankruptcy court reference on the ground that *Stern* requires fraudulent conveyance claims be finally decided by an Article III court. *See Dev. Specialists, Inc. v. Akin Gump Strauss Hauer & Feld LLP*, No. 11-5994, 2011 WL 5244463, at *9-10 (S.D.N.Y. Nov. 2, 2011). In the *Heller* action, Judge Charles R. Breyer of the Northern District of California recently agreed that fraudulent conveyance claims may not be finally decided by a bankruptcy judge. *See In re Heller Ehrman LLP*, --- F. Supp. 2d ----, 2011 WL 6179149 (N.D. Cal. Dec. 13, 2011).

SUMMARY OF ARGUMENT

This Court should rule that *Stern v. Marshall*, 131 S. Ct. 2594 (2011), prohibits bankruptcy courts from entering a final, binding judgment on an action to avoid a fraudulent conveyance. Further, the Court should rule that bankruptcy courts may not entertain fraudulent conveyance proceedings and submit a report and recommendation to a federal district court in lieu of entering a final judgment.

First, the *Stern* majority held that bankruptcy courts, as Article I courts, lack constitutional authority to enter final, binding judgments on common law claims that do not fall within the Supreme Court's limited "public rights" exception. *Stern* applied that holding to a counterclaim filed by the estate of a debtor. But this

Court need not grapple long with whether *Stern*'s holding extends to fraudulent conveyance actions. The Supreme Court already held, in *Granfinanciera, S.A. v. Nordberg*, 492 U.S. 33 (1989), that fraudulent conveyance actions—just like the counterclaims at issue in *Stern*—are akin to common law claims and do not fall within the public rights exception. *Granfinanciera* examined only whether defendants are entitled to a jury trial on fraudulent conveyance claims. But its reasoning, when combined with *Stern*'s analysis, compels the conclusion that fraudulent conveyance claims may be finally decided only in an Article III forum.

Second, bankruptcy courts lack the statutory authority to entertain fraudulent conveyance claims and submit a report and recommendation to the district court pursuant to 28 U.S.C. § 157(c)(1). Bankruptcy courts are creatures of Congress' creation, and are limited to the powers that Congress has conferred on them. Congress has authorized bankruptcy courts to adjudicate "non-core" bankruptcy claims and submit proposed findings of fact and conclusions of law to the district court. But bankruptcy courts lack statutory authority to render a report and recommendation on "core" claims. Unless and until Congress modifies the bankruptcy laws in response to *Stern*, fraudulent conveyance claims may be adjudicated only by Article III courts.

ARGUMENT

I. BANKRUPTCY COURTS LACK CONSTITUTIONAL AUTHORITY TO FINALLY DECIDE FRAUDULENT CONVEYANCE ACTIONS

A. *Stern*'s Holding Applies to Fraudulent Conveyance Claims

Stern is the third in a triad of Supreme Court cases that have demarcated the outer boundaries of bankruptcy courts' constitutional authority to hear and decide certain disputes. To understand the significance of *Stern* for fraudulent conveyance actions, the opinion must be analyzed in the context of the other two cases.

The Supreme Court first addressed the constitutional authority of bankruptcy courts to adjudicate disputes in *Northern Pipeline Construction Co. v. Marathon Pipe Line Co.*, 458 U.S. 50 (1982). In *Marathon*, the debtor filed state law counterclaims against a third party. *Id.* at 56-57. The third party sought dismissal of the suit, arguing that the 1978 Bankruptcy Act unconstitutionally conferred Article III judicial power on the bankruptcy courts. *Id.* A plurality of the Supreme Court agreed, suggesting that Congress may remove controversies from Article III courts in only three circumstances: (1) where Congress has created "territorial courts" (*id.* at 64-65); (2) where Congress has created military courts (*id.* at 66); and (3) where Congress has created legislative courts to adjudicate cases involving "public rights" (*id.* at 67). Put simply, the "public rights" exception applies "to cases in which the claim at issue derives 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*, 131 S. Ct. at 2614.

Marathon held that the debtor's counterclaims did not implicate any public right because they required "the adjudication of state-created private rights," rather than "the restructuring of debtor-creditor relations, which is at the core of the federal bankruptcy power." *Marathon*, 458 U.S. at 71. Accordingly, the Court held that Congress' broad grant of jurisdiction to bankruptcy courts over "all civil proceedings arising under Title 11 or arising in or related to cases under Title 11," violated Article III. *Id.* at 86-87 (quoting 28 U.S.C. § 1471 (1976)).

In response to *Marathon*, Congress enacted the Bankruptcy Amendments and Federal Judgeship Act of 1984. In an effort to maintain bankruptcy courts' constitutional authority, Congress provided that the judges of the new bankruptcy courts would be appointed by the judicial branch. And Congress permitted the newly constituted bankruptcy courts to enter final judgments only in "core" proceedings, as opposed to "non-core" proceedings, in which the bankruptcy court may issue only proposed findings of fact and law. *See* 28 U.S.C. § 157.

Five years later, the Supreme Court found that Congress failed to limit "core" matters to claims that involve public rights. In *Granfinanciera, S.A. v. Nordberg*, 492 U.S. 33 (1989), a majority of the Court held that, notwithstanding Congress' "core" designation, "proceedings to determine, avoid, or recover

fraudulent conveyances" (28 U.S.C. § 157(b)(2)(H)), do not involve public rights. In *Granfinanciera*, the debtor filed fraudulent conveyance claims against a third party that had not submitted a claim against the bankruptcy estate. *Id.* at 36. The defendant argued that he was entitled to a jury trial on the debtor's claims under the Seventh Amendment. *Id.* at 40-41. Because the Seventh Amendment is limited to "[s]uits at common law," the Court considered whether fraudulent conveyance claims "are analogous to common-law causes of action ordinarily decided in English law courts in the late 18th century." *Id.* at 42. Answering in the affirmative, the Court next examined whether Congress could nevertheless deny a trial by jury because the claims involved "public rights." *Id.* at 51. As to that question, the Court held that "a bankruptcy trustee's right to recover a fraudulent conveyance under 11 U.S.C. § 548(a)(2) seems to us 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. The Court explained that fraudulent conveyance actions are quintessentially state-law contract claims brought to augment the bankruptcy estate. *Id.*

Granfinanciera certainly called into doubt the constitutional authority of bankruptcy courts to enter final judgment in fraudulent conveyance proceedings. It noted that Congress' power to fashion statutory causes of action that are analogous to common-law claims and place them beyond the ambit of the Seventh

Amendment is coextensive with Congress' power to place adjudicative authority in non-Article III tribunals; in both circumstances, the critical question is whether the claim involves "public rights." *Granfinanciera*, 492 U.S. at 53. And in conducting its "public rights" analysis, the *Granfinanciera* Court relied on the same precedent as *Marathon*. *Compare id.* at 51 & n.8, *with Marathon*, 458 U.S. at 70 (citing *Atlas Roofing Co. v. Occupational Safety & Health Review Comm'n*, 430 U.S. 442 (1977); *Crowell v. Benson*, 285 U.S. 22 (1932)). The *Granfinanciera* Court was careful to note, however, that it was not expressing any view on a bankruptcy court's ability to adjudicate fraudulent conveyance actions under Article III. *Id.* at 64. That issue, the Court explained, "[w]e leave … for future decisions." *Id.*

Twenty-two years later, in *Stern*, the Supreme Court finally resolved the issue left open by *Granfinanciera*, holding that counterclaims involving private rights—just "like the fraudulent conveyance claim at issue in *Granfinanciera*" must be finally determined in an Article III forum. *Stern*, 131 S. Ct. at 2614. In doing so, *Stern* removed any doubt that a bankruptcy court's ability to finally adjudicate a particular claim turns on whether the claim involves a private or public right, not whether Congress has characterized the claim as "core" or "non-core." *Stern* thus "represents the first time a solid majority of the Supreme Court has applied the categorical, historical approach to limit the final adjudicative

authority of the Bankruptcy Court following the 1984 Act." *Dev. Specialists*, 2011 WL 5244463, at *9.

In *Stern*, the heir to a fortune (Pierce) sued his decreased father's bankrupt widow (Vickie) in the bankruptcy court for defamation. *Stern*, 131 S. Ct. at 2601. Vickie's estate counterclaimed against Pierce under Texas state law for tortious interference with a prospective gift. *Id.* The Supreme Court held that even though Congress designated counterclaims by the estate as "core" proceedings under § 157(b)(2)(C), bankruptcy courts lack constitutional authority to finally adjudicate them. The Court reasoned that when claims are made of "'the stuff of the traditional actions at common law tried by the courts at Westminster in 1789,'" and do not fall with "the category of cases involving 'public rights' that Congress could constitutionally assign to 'legislative' courts for resolution," then they must be decided by an Article III court. *Stern*, 131 S. Ct. at 2609-10. And it held that Vickie's counterclaim did not fall within the public rights exception. *Id.* at 2614.

As the Court noted at oral argument, *Stern* involved counterclaims by the estate, not claims for fraudulent conveyance. But faithfully applying *Stern*'s reasoning results in the inescapable conclusion that bankruptcy courts also lack the authority to enter final judgments in "proceedings to determine, avoid, or recover fraudulent conveyances." 28 U.S.C. § 157(b)(2)(H). Fraudulent conveyance claims, like the counterclaims at issue in *Stern*, are akin to common law actions

tried by 18th century English legal courts. *Granfinanciera*, 492 U.S. at 46-47. Additionally, fraudulent conveyance actions do not fall within the "public rights" exception. *Id.* at 55.

At oral argument, Appellee emphasized the "narrowness" of the *Stern* opinion. Courts resisting *Stern*'s application to fraudulent conveyance actions also suggest that "[t]he Supreme Court's holding in *Stern* was very narrow." *In re Safety Harbor Resort & Spa*, 456 B.R. 703, 705 (Bankr. M.D. Fla. 2011). But this Court need not interpret *Stern* expansively to recognize its application to fraudulent conveyance claims. If *Stern* has *any* application beyond its specific facts, it is to fraudulent conveyance claims. Indeed, the *Stern* majority repeatedly compared the counterclaim it was examining with the fraudulent conveyance claim in *Granfinanciera*. *See Stern*, 131 S. Ct. at 2611, 2614, 2618. And it held that "Vickie's counterclaim—*like the fraudulent conveyance claim at issue in* Granfinanciera," had to be heard by an Article III judge because it did not fall within the "public rights" exception. *Id.* at 2614 (emphasis added).

Because the Supreme Court "specifically linked the public rights exception in the Seventh Amendment context from *Granfinanciera* to the question of whether an Article I bankruptcy court had authority to enter a final judgment on a claim, finding a determination in one context dispositive of the other context as well," a court in the Northern District of California recently held that "*Stern* clearly

implied that the bankruptcy court lacks constitutional authority to enter final judgment on" fraudulent conveyance claims. *See In re Heller Ehrman*, --- F. Supp. 2d ----, 2011 WL 6179149, at *5. The same conclusion has been reached "by all of the district courts that have addressed the issue to date." *In re El-Atari*, No. 11-1090, 2011 WL 5828013, at *3 n.4 (E.D. Va. Nov. 18, 2011) (holding that "*Stern*, together with *Granfinanciera*, clearly supports the conclusion that the authority to issue a final decision in a fraudulent conveyance action is reserved for Article III courts").

Thus, a court in the Southern District of New York recently held that *Stern* does, in fact, preclude Article I courts from finally adjudicating fraudulent conveyance actions. *Dev. Specialists*, 2011 WL 5244463. The court interpreted *Stern* as holding that "some claims, while denominated 'core' under the [1984 Act], nonetheless implicate only private rights, which cannot be finally adjudicated in a Bankruptcy Court consistent with Article III." *Id.* at *5. Since fraudulent conveyance claims implicate only private rights, *Stern* effectively held that such claims "must be finally determined in an Article III forum." *Id.* at *9. Jones Day urges the Court to adopt the uniform view of the district courts that have addressed the issue by holding that, under *Stern* and *Granfinanciera*, bankruptcy courts lack the constitutional authority to enter a final, binding judgment on an action to avoid a fraudulent conveyance.

B. *Granfinanciera*, as Amplified by *Stern*, Overrules This Court's Precedent Allowing Bankruptcy Courts to Finally Adjudicate Fraudulent Transfer Claims

At oral argument, the Court expressed the opinion that *Stern* did not modify *Granfinanciera*, which means, if *Stern* applies to fraudulent conveyance claims, that the Ninth Circuit has been misinterpreting the law for twenty-two years.

As noted below, after *Granfinanciera*, one circuit did correctly anticipate that a majority of the Court would bar non-Article III tribunals from finally adjudicating claims involving private rights, such as claims for fraudulent conveyance. The Ninth Circuit, however, never had occasion to address its pre-*Granfinanciera* position, stated in *In re Mankin*, 823 F.2d 1296 (9th Cir. 1987), that such claims may constitutionally be adjudicated by Article I courts.

Mankin examined whether, in light of the Supreme Court's opinion in *Marathon*, Article III prevents bankruptcy judges from adjudicating fraudulent conveyance proceedings, which had been designated as "core" by the 1984 Act. The court recognized that a bankruptcy court is permitted to exercise federal judicial power: (1) where it is operating as an "adjunct court"; and (2) under the "public rights" doctrine. *Mankin*, 823 F.2d at 1302. In concluding that bankruptcy courts may finally adjudicate fraudulent conveyance claims, the Ninth Circuit found that such claims involve public rights. *Id.* at 1307-08.

Two years later, *Granfinanciera* held that fraudulent conveyance actions do not involve public rights. The Eleventh Circuit recognized that *Granfinanciera*

called cases like *Mankin* into doubt, but declined to resolve that "difficult issue."[1] *In re Davis*, 899 F.2d 1136, 1141 n.9 (11th Cir. 1990). The Fifth Circuit initially followed *Mankin*, characterizing *Granfinanciera*'s public rights analysis as dicta. *Matter of Texas Gen. Petroleum Corp.*, 40 F.3d 763, 769-70 & n.7 (5th Cir. 1994). On rehearing, however, the Fifth Circuit concluded that *Granfinanciera* does limit the bankruptcy court's authority to adjudicate fraudulent transfer claims. *Matter of Texas Gen. Petroleum Corp.*, 52 F.3d 1330, 1336-37 (5th Cir. 1995) (holding that, pursuant to *Granfinanciera*, bankruptcy courts lack the "ability to exercise full judicial power" over fraudulent conveyance claims); *see also In re Almac's Inc.*, 202 B.R. 648, 658 (D.R.I. 1996) ("If fraudulent transfer claims assert private rights that require a jury trial, then, under the reasoning in *Granfinanciera*, the power to render a final decision over such proceedings must lie with an Article III court."). The Tenth Circuit, by contrast, continued to hold that bankruptcy courts may finally adjudicate fraudulent conveyance actions, at least where the defendant filed a proof of claim. *In re Investment Bankers, Inc.*, 4 F.3d 1556, 1562 (10th Cir. 1993).

As far as Jones Day's research reveals, no party has challenged *Mankin*'s continuing viability on the basis of *Granfinanciera* in the past twenty-two years.

[1] The *Granfinanciera* dissent itself suggested that the majority opinion "calls into question" cases, including *Mankin*, that assumed "equitable proceedings . . . adjudicating creditor-debtor disputes, are adjudications concerning 'public rights.'" *Granfinanciera*, 492 U.S. at 89 & n.12 (White, J., dissenting).

Now that *Granfinanciera* has been amplified by *Stern*, making clear that claims involving private rights cannot be finally decided by an Article I court, it is plain that *Mankin* is no longer good law. Even if *Granfinanciera* and *Stern* did not expressly overrule *Mankin*, they "are closely on point." *Miller v. Gammie*¸ 335 F.3d 889, 899 (9th Cir. 2003) (en banc). Lower courts are "bound not only by the holdings of higher courts' decisions but also by their 'mode of analysis.'" *Id.* (quoting Antonin Scalia, *The Rule of Law as a Law of Rules*¸ 56 U. Chi. L. Rev. 1175, 1177 (1989)). *Granfinanciera*'s holding that fraudulent conveyance claims do not involve public rights, when combined with *Stern*'s holding that, notwithstanding the 1984 Act, claims involving private rights must be adjudicated by an Article III court, grossly "undermine[]" *Mankin*, and therefore supersede its holding. *Miller*, 335 F.3d at 899.

C. Appellee's Contrary Authority is Not Persuasive

At oral argument, Appellee urged the Court to follow the "in-depth analysis" of *Stern* provided by a Florida bankruptcy court, which held that *Stern* has no impact on bankruptcy courts' authority to adjudicate fraudulent conveyance claims. *See Safety Harbor*, 456 B.R. at 703.

To the extent the Court looks for guidance from any lower court precedent, the district courts' opinions in *Development Specialists*, *Heller Ehrman*, and *El-Atari* offer the most sophisticated analysis. In contrast, *Safety Harbor*, as well as the other bankruptcy courts that have resisted application of *Stern* to fraudulent

conveyance claims, all share a fatal flaw: they erroneously assume *Stern* would come out the other way in cases where the claim "stems from the bankruptcy itself or would necessarily be resolved in the claims allowance process." *Stern*, 131 S. Ct. at 2618; *see Safety Harbor*, 456 B.R. at 715; *In re Heller Ehrman LLP*, No. 08-35214, 2011 WL 4542512, at *5 (Bankr. N.D. Cal. Sept. 28, 2011).

These bankruptcy court cases focus on language from Part III.C.2 of the *Stern* decision. That portion of the opinion examined whether Vickie's counterclaim could be distinguished from the fraudulent transfer claim in *Granfinanciera* because the counterclaim defendant, by filing his own proof of claim in the bankruptcy proceedings, had consented to the bankruptcy court's jurisdiction. 131 S. Ct. at 2615-16. Despite earlier authority suggesting that a party "'who invokes the aid of the bankruptcy court . . . must abide by the consequences of that procedure'"—including resolution by the bankruptcy court, rather than an Article III judge—the *Stern* Court held that the defendant had not consented to the bankruptcy court's resolution of the plaintiff's counterclaim. *Id.* at 2616-17 (quoting *Katchen v. Landy*, 382 U.S. 323, 333 n.9 (1966)). In further distinguishing *Katchen* from the plaintiff's predicament, the Court noted that, unlike the federal claims to which the party was subjected to in *Katchen*, the plaintiff's counterclaim "in contrast, is in no way derived from or dependent upon bankruptcy law." *Id.* at 2618. The Court therefore held, "[w]e see no reason to

treat Vickie's counterclaim any differently from the fraudulent conveyance action in *Granfinanciera*." *Id.* In other words, a plaintiff may not rely on the "consent" exception to Article III unless her claim "stems from the bankruptcy itself or would necessarily be resolved in the claims allowance process." *Id.*

Courts like *Safety Harbor* have asserted that fraudulent transfer claims are distinguishable from state law counterclaims because they arise from bankruptcy law. That position misses *Stern*'s point entirely. A bankruptcy court cannot revoke the protections of Article III merely because the plaintiff seeks to adjudicate a claim that arises out of bankruptcy law. An exception to Article III exists only when the defendant has meaningfully consented to the bankruptcy court's jurisdiction *and* the plaintiff seeks to adjudicate a claim that stems from the bankruptcy itself. Where the defendant has not consented to the bankruptcy court's jurisdiction, the nature of the debtor's action is irrelevant.

In any event, fraudulent transfer claims do not "stem from the bankruptcy itself" as *Stern* used that phrase. Although deeming it a close question, the *Granfinanciera* Court already has determined that fraudulent transfer claims are "quintessentially" suits at common law that more nearly resemble state-law contract claims than "hierarchically ordered claims to a pro rata share of the bankruptcy res." *Granfinanciera*, 492 U.S. at 56. Notwithstanding the fact that Congress has codified a federal cause of action for fraudulent conveyance, such

claims "constitute no part of the proceedings in bankruptcy but concern controversies arising out of it."[2] *Id.* (quoting *Schoenthal v. Irving Trust Co.*, 287 U.S. 92, 94-95 (1932)). That is precisely why, in holding that Vickie's counterclaim did not "stem from the bankruptcy," *Stern* "s[aw] no reason to treat Vickie's counterclaim any differently from the fraudulent conveyance action in *Granfinanciera*." *Stern*, 131 S. Ct. at 2618. Bankruptcy courts lack the constitutional authority to finally decide fraudulent conveyance claims.

[2] "The universal rule under the Bankruptcy Act of 1898 and its predecessors had been that actions to set aside the bankrupt's transfers as fraudulent or preferential were actions outside the bankruptcy proceeding and were to be resolved by plenary proceedings in a different forum." *In re Harbour*, 840 F.2d 1165, 1172 (4th Cir. 1988), *vacated and remanded in light of Granfinanciera*, 492 U.S. 13 (1989); *see also Schoenthal*, 287 U.S. at 94 (holding that preference actions were to be considered outside the bankruptcy proceedings). Courts concluded, however, that by denominating fraudulent transfer actions "core" in the 1984 Act, Congress somehow had altered the nature of the claim. *See Harbour*, 840 F.2d at 1175. *Granfinanciera* effectively revived the pre-1984 precedent by making clear that Congress could not alter the true nature of conveyance claims merely by calling them "core."

Fraudulent conveyance claims are derived from state common law and exist outside the bankruptcy action. *See In re JTS Corp.*, 617 F.3d 1102, 1111 (9th Cir. 2010). Fraudulent conveyance claims resemble state law contract actions because, among other reasons, they often turn on issues of state law. As but one example, fraudulent transfer claims require that a plaintiff show there has been a transfer "of an interest of the debtor in property." 11 U.S.C. § 548(a)(1). Since "property of the debtor" is not defined by the Bankruptcy Code (*In re Bullion Reserve of N. Am.*, 836 F.2d 1214, 1217 (9th Cir. 1988)), courts "look to state law to determine whether property is an asset of the debtor." *In re Love*, 155 B.R. 225, 230 (Bankr. D. Mont. 1993).

II. BANKRUPTCY COURTS LACK STATUTORY AUTHORITY TO HEAR FRAUDULENT CONVEYANCE ACTIONS AND SUBMIT A REPORT AND RECOMMENDATION

Not only are bankruptcy courts constitutionally prohibited from entering a final, binding judgment on an action to avoid a fraudulent conveyance, they lack the statutory authority to hear the proceeding and submit a report and recommendation to a federal district court judge in lieu of entering a final judgment.

Bankruptcy courts are creations of statute, and are not contemplated by the U.S. Constitution. As a result, their power to act is limited by what Congress has authorized. *Matter of Grabill Corp.*, 967 F.2d 1152, 1156 (7th Cir. 1992) ("bankruptcy courts and other Article I tribunals are ordinary creatures of statute, and derive their authority solely from Congress"). Section 157(c)(1) of the Judicial Code provides that "[a] bankruptcy judge may hear a proceeding that is not a core proceeding but that is otherwise related to a case under title 11," and that "[i]n such proceeding, the bankruptcy judge shall submit proposed findings of fact and conclusions of law to the district court," to be reviewed de novo. Congress provided no similar authority to bankruptcy courts in "core" proceedings that, under *Stern*, may not be determined by a bankruptcy court as a constitutional matter.

Fraudulent conveyance actions fall within the Judicial Code's definition of "core" proceedings. 28 U.S.C. § 157(b)(2)(H). As a result, they are statutorily

ineligible for the report-and-recommendation procedure of § 157(c)(1). *See In re Blixseth*, No. 10-00088, 2011 WL 3274042, at *12 (Bankr. D. Mont. Aug. 2, 2011) ("Since this Court may not constitutionally hear the fraudulent conveyance claim as a core proceeding, and this Court does not have statutory authority to hear it as a non-core proceeding, it may in no case hear the claim.").

Some courts have solved this quandary by treating fraudulent conveyance claims as "non-core" claims, and thus subject to the report and recommendation procedure. *See, e.g.*, *In re Emerald Casino, Inc.*, No. 02-22977, 2011 WL 3799643, at *1 n.1 (Bankr. N.D. Ill. Aug. 26, 2011).[3] Yet federal law does not permit such a court-created *ad hoc* process that lacks any foundation in the Judicial Code. However expedient it may seem to refer a "core" proceeding to a bankruptcy judge and then to treat the bankruptcy judge's determination as "proposed findings and conclusions," that procedure simply is not contemplated by the scheme Congress established. An act of Congress is required to grant bankruptcy courts the authority to issue reports and recommendations on fraudulent transfer claims like those at issue here. *See Willy v. Coastal Corp.*, 503

[3] *Emerald Casino* erroneously suggested that the *Stern* Court endorsed this approach. 2011 WL 3799643, at *1 n.1 ("*Stern* states that the remedy for this constitutional violation is to remove counterclaims covered by the decision from core jurisdiction"). In fact, Pierce did not raise the argument that the bankruptcy court was barred from proposing findings of fact and conclusions of law on Vickie's counterclaims, and the Court accordingly did not adjudicate the question. *Stern*, 131 S. Ct. at 2620.

U.S. 131, 135 (1992) ("[F]ederal courts, in adopting rules, [are] not free to extend or restrict the jurisdiction conferred by a statute. Such a caveat applies a fortiori to any effort to extend by rule the judicial power of the United States described in Article III of the Constitution."); *Pressroom Unions-Printers League Income Sec. Fund v. Cont'l Assurance Co.*, 700 F.2d 889, 892 (2d Cir. 1983) ("It is beyond dispute that only Congress is empowered to grant and extend the subject matter jurisdiction of the federal judiciary, and that courts are not to infer a grant of jurisdiction absent a clear legislative mandate.").

The jurisdiction of the bankruptcy courts cannot be extended by judicial fiat, since there is no "clear legislative mandate." There are several types of claims that may relate to a bankruptcy, but that Congress nevertheless has ordered may only be heard by a district court, including "personal injury tort and wrongful death claims," and claims that require material consideration of non-bankruptcy federal law. *See* 28 U.S.C. §§ 157(b)(5), (d). Even if it is likely that Congress will maintain bankruptcy court jurisdiction over fraudulent conveyance claims, it cannot be assumed that it will respond to the constitutional concerns raised by *Granfinanciera* and *Stern* simply by extending the reach of § 157(c)(1), which provides *de novo* review only of final judgments, rather than adopting a more extensive scheme of Article III oversight, as it has, for instance, for federal Magistrate Judges. *See* 28 U.S.C. § 636; Fed. R. Civ. P. 72 (providing review for

pre-trial orders). In light of *Stern*, it is up to Congress to determine whether claims such as those filed here should be heard by the bankruptcy court pursuant to the report and recommendation process or adjudicated outright by the district court. Unless and until Congress enacts a legislative fix, fraudulent transfer claims like those asserted here must be heard by an Article III court.

CONCLUSION

For the foregoing reasons, this Court should hold that *Stern v. Marshall*, 131 S. Ct. 2594 (2011), prohibits bankruptcy courts from entering a final, binding judgment on an action to avoid a fraudulent conveyance, and that bankruptcy courts lack the statutory authority to submit a report and recommendation on such claims.

Dated: January 19, 2011

Respectfully submitted,

Jones Day

By: s/ Nathaniel P. Garrett
Nathaniel P. Garrett
Attorneys for Amicus Curiae
JONES DAY

CERTIFICATE OF COMPLIANCE PURSUANT TO FEDERAL RULES OF APPELLATE PROCEDURE 29(D) AND 32(A)(7)

Pursuant to Federal Rules of Appellate Procedure 29(d) and 32(a)(7), I certify that that attached brief is proportionately spaced, has a typeface of 14 points and contains 4399 words.

Dated this nineteenth day of January, 2012.

By s/ Nathaniel P. Garrett
Nathaniel P. Garrett

9th Circuit Case Number(s) 11-35162

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I further certify that some of the participants in the case are not registered CM/ECF users. I have mailed the foregoing document by First-Class Mail, postage prepaid, or have dispatched it to a third party commercial carrier for delivery within 3 calendar days to the following non-CM/ECF participants:

Signature (use "s/" format)