IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

Case No. 11-35162

In the Matter of: BELLINGHAM INSURANCE AGENCY, INC., Debtor

EXECUTIVE BENEFITS INSURANCE AGENCY, INC.

Appellant,

v.

PETER H. ARKINSON, Trustee, solely in his capacity as
Chapter 7 Trustee for the estate of BELLINGHAM INSURANCE AGENCY, INC.

Appellee.

On Appeal from the United States District Court
For the Western District of Washington

Case No. 10-00929-MJP

Brief of *Amicus Curiae* Timothy L. Blixseth in of Support of Appellant Executive Benefits Insurance Agency, Inc.

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INTEREST OF AMICUS CURIAE[1]

Timothy L. Blixseth ("Mr. Blixseth"), files this *amicus* brief pursuant to the Court's November 4, 2011 Order. Mr. Blixseth's interest in this case stems from his denial of his constitutional rights to adjudication by an Article III court on claims against him in several adversary proceedings pending in the United States Bankruptcy Court for the District of Montana in the matter of *Yellowstone Mountain Club, LLC*, Case No. 08-61570-11 and its related adversary proceedings.

In view of this Court's invitation to any *amicus curiae* to file a brief regarding the application of *Stern* to the question presented in this case, *see* Order, Nov. 4, 2011, ECF No. 35, *amici* offer their views for the Court's consideration.[2]

[1] Pursuant to Federal Rule of Appellate Procedure 29(c), counsel for *amici curiae* states that no counsel for a party authored this brief in whole or in part, and that no person or entity other than *amici curiae* or their counsel made a monetary contribution intended to fund the preparation and submission of this brief.

[2] For simplicity, Mr. Blixseth joins in the *Amicus Curiae* Brief submitted by Professors S. Todd Brown, G. Marcus Cole, Ronald D. Rotunda, and Todd J. Zywicki, at ECF No. 48, in all respects other than their Argument, Section II, where the *Amici* erroneously conclude that a bankruptcy court can make proposed findings of fact and conclusions of law to the district court on "core" claims.

1. INTRODUCTION AND SUMMARY OF ARGUMENT

In its November 4, 2011 Order inviting the input of *amici curiae*, this Court presented two questions raised by the Supreme Court's recent decision *Stern v. Marshall*, __ U.S. __, 131 S. Ct. 2594, 180 L. Ed. 2d 475 (2011). First, "Does *Stern v. Marshall* . . . prohibit bankruptcy courts from entering a final, binding judgment on an action to avoid a fraudulent conveyance?" Second, if bankruptcy courts are prohibited from entering a final binding judgment of fraudulent conveyance actions, "may the bankruptcy court hear the proceeding and submit a report and recommendation to a federal district court in lieu of entering a final judgment?"

In short, the plain language in *Stern* prevents a bankruptcy court from entering a final, binding judgment on an action to avoid a fraudulent conveyance. *Stern* and standard rules of statutory interpretation provide the clear answer to the second question. The plan language of 28 U.S.C. §157(b) and (c)(1) states that a claim is either "core" or "non-core." A bankruptcy court can only make proposed findings of fact and conclusions of law on non-core claims. It can only enter a final order or judgment on "core" claims. Because the statute is unambiguous, it is inappropriate for this Court to examine Congressional intent. Instead, this Court is constrained by the plain language of § 157. A bankruptcy court has no statutory

authority to make proposed findings of fact and conclusions of law to a federal district court upon matters that Congress has defined as "core."

2. ARGUMENT

A. THE PLAIN LANGUAGE OF *STERN V. MARSHALL* ALREADY HOLDS THAT THE STATUTORY GRANT OF AUTHORITY TO ENTER A FINAL JUDGMENT ON ACTIONS TO AVOID FRAUDULENT CONVEYANCES IS UNCONSTITUTIONAL BECAUSE THESE TYPES OF CLAIMS ARE STATE COMMON LAW CLAIMS THAT CAN ONLY BE AJUDICATED BY ARTICLE III JUDGES.

The Supreme Court could not have been clearer -- a fraudulent conveyance claim is a "private right" that "simply attempts to augment the bankruptcy estate -- the very type of claim that we held in *Northern Pipeline* and *Granfinaciera* must be decided by an Article III court." *Stern*, 131 S.Ct. at 2616. Accordingly, the bankruptcy court "lacks the constitutional authority to enter a final judgment" on a claim that is statutorily defined as a "core" claim that arises in or arises under Title 11 and would not be resolved in the process of ruling on a creditor's Proof of Claim. *Id.* at 2620.

In so holding, the Supreme Court once again emphasized that Article III "is the guardian of individual liberty and separation of powers" *Stern*, 131 S.Ct. at 2616. The fundamental constitutional protection of an *independent and tenured* judiciary established by Article III of the Constitution, is at the heart of *Stern*. The Founding Fathers understood the importance of judicial independence as they

proclaimed that English judges' dependence upon the King's Will was one of the "repeated injuries and usurpations . . . [that established an] absolute Tyranny over these States." *See* DECLARATION OF INDEPENDENCE para.2 (U.S. 1776). Alexander Hamilton, in defense of the Constitution, wrote that "complete independence of the courts of justice is peculiarly essential in a limited Constitution . . . [and] without this, all the reservations of particular rights or privilege would amount to nothing." Federalist Paper 78, p. 434 (C. Rossister ed. 1961). "The Federal Judiciary was therefore designed by the Framers to stand independent of the Executive and Legislature—to maintain the checks and balances of the constitutional structure, and also to guarantee that process of adjudication remained impartial." *N. Pipeline v. Marathon*, 458 U.S. 50, 58 (1982) (plurality opinion). The Constitution "unambiguously enunciates a fundamental principle – that the 'judicial Power of the United States' must be reposed in an independent Judiciary . . . [and] commands that that independence . . . be jealously guarded . . ." *Id.* at 60 (plurality opinion). John Adams wrote that we "are a government of laws and not of men." John Adams, "Novanglus No. 7", "*The Works of John Adams*" vol. 4, 106 (Charles Francis Adams ed., 1851). The current bankruptcy framework fuels the latter and undermines the former.

Chief Judge Roberts followed the plurality opinion in *Marathon* and reminds us all that the constitutional guarantee of an independent judiciary to exercise the

"judicial power" in the United States is reserved solely for Article III judges. *See Stern*, 131 S.Ct. at 2615, 2619-2620. This guarantee, as well as the right to a jury trial, is so sacrosanct to our system of government that countervailing concerns of convenience and expediency apparently offered by the bankruptcy courts (particularly in the present economy) will not yield to the restraints within the Constitution.

As the *Stern* Court stated:

> A statute may no more lawfully chip away at the authority of the Judicial Branch than it may eliminate it entirely. "Slight encroachments create new boundaries from which legions of power can seek new territory to capture." *Reid v. Covert*, 354 U.S. 1, 39, 77 S.Ct. 1222, 1 L.Ed.2d 1148 (1957) (plurality opinion). Although "[i]t may be that it is the obnoxious thing in its mildest and least repulsive form," we cannot overlook the intrusion: "illegitimate and unconstitutional practices get their first footing in that way, namely, by silent approaches and slight deviations from legal modes of procedure." *Boyd v. United States*, 116 U.S. 616, 635, 6 S.Ct. 524, 29 L.Ed. 746 (1886). We cannot compromise the integrity of the system of separated powers and the role of the Judiciary in that system, even with respect to challenges that may seem innocuous at first blush.

131 S.Ct. at 2620 (emphasis added). This reasoning is consistent with and a continuation of Justice Brennan's reasoning in *Marathon*, which resulted in the Court concluding that the 1978 Bankruptcy Reform Act was unconstitutional because it impermissibly delegated Article III judicial power to Article I

bankruptcy judges. *N. Pipeline*, 458 U.S. at 73 (plurality opinion) (rejecting argument that "Congress may create courts free of Art. III's requirements whenever it finds that course expedient").

These very dangers recognized by the Founding Fathers and highlighted by the Supreme Court in *Stern* are documented in this Amicus briefing. *See* Part C *infra*. Mr. Blixseth, a defendant in several adversary proceedings seeking to set aside the California Superior Court's division of marital property as alleged fraudulent conveyances in the Montana Bankruptcy Court, has been deprived of fundamental due process, including the deprivation of his right to a jury trial, right to cross claim and counterclaim against third parties under the Federal Rules of Civil Procedure, his right to challenge the filing of a demonstratively bad faith bankruptcy petition, and the entry of a judgment based on a fraudulent conveyance claim, all without the protections of an Article III court.[3]

The *Northern Pipeline* plurality held the delegation of Article III adjudication power by Congress to a bankruptcy judge is only constitutional when "the grant of power to the Legislative and Executive Branches [is] historically and

[3] The factual underpinnings to Mr. Blixseth's contentions are well-documented in the appeal of *In re Yellowstone Mountain Club, LLC* to the U.S. District Court for the District of Montana, No. CV-9-47-BU-SEH, Appellant's Opening Brief, ECF No. 6 and Reply, ECF No. 55 as well as Mr. Blixseth's Statement of Undisputed Facts in *Michael Snow, et al.*, vs. *BLX Group, Inc. f/k/a Blixseth Group, Inc., et al.*, No. 09-00018, ECF No. 309, all of which are incorporated by reference herein.

constitutionally so exceptional that the Congressional assertion of a power to create legislative courts [is] consistent with, rather than threatening to, the constitutional mandate of separation of powers." *N. Pipeline*, 458 U.S. at 64 (plurality opinion). Such recognized exceptions are territorial courts, courts-martial, and the claims involving "public rights." *Id.* at 64-67.

Stern establishes that Congress never fixed the constitutional defects inherent in the bankruptcy system identified by Justice Brennan. *See In re Med. Educ. & Health Services, Inc.*, 2011 WL 3880931, at **15-16 (Bankr.D.Puerto Rico Sept. 2, 2011); *In re Teleservices Group, Inc.*, 456 B.R. 318, 321-25, 327-28 (Bankr.W.D.Mich. 2011). Despite Congress identifying actions to avoid fraudulent conveyances as "core" in §157(b)(2) and empowering a bankruptcy judge to enter final orders in such cases, actions to avoid fraudulent conveyance do not fall within the recognized exceptions identified in *Northern Pipeline*. 458 U.S. at 64-67. Fraudulent conveyance claims are "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 . . . [and are] 'more

accurately characterized as a private rather than a public right . . .'" *Stern*¸ 131 S.Ct. at 2614 (quoting *Granfinanciera, S.A. v. Nordberg*, 492 U.S. 33, 55 (1989).[4]

The majority in *Stern* goes farther than *Northern Pipeline*'s plurality opinion and *Granfinanciera's* limited seventh amendment ruling to hold that actions to avoid fraudulent conveyances "implicating private rights must be finally determined in an Article III forum." *Dev. Specialist v. Akin Gump*, No. 11-CV-5994, 2011 WL 5244463, at *8-9 (S.D.N.Y. Nov. 2, 2011)(emphasis added). Thus, the holding in *Stern* that prevents bankruptcy judges from entering final orders in common law counterclaims also prevents the same judges from entering final orders in common law actions to avoid fraudulent conveyances.

B. CONGRESS DID NOT GRANT THE BANKRUPTCY COURTS THE POWER TO ISSUE PROPOSED FINDINGS OF FACTS AND CONCLUSIONS OF LAW IN "CORE" MATTERS.

Since *Stern*, several bankruptcy courts have attempted to limit the holding in *Stern*, most often under the guise that the bankruptcy court could still make proposed findings of fact and conclusions of law on fraudulent conveyance claims.

[4] Some courts, in their desire to limit the influence of *Stern*, have held that *Stern* only applies to cases under 28 U.S.C. §157(b)(2)(C) and reject the application of *Stern* to other actions under §157(b)(2) that are designated as "core" yet involve adjudicating rights that are private rather than public. *In re Bujak*, No. 11-6038, 2011 WL 5326038, at *2 (Bankr.D.Idaho Nov. 3, 2011)(*Stern* inapplicable because Trustee's complaint to avoid constructively fraudulent conveyances is not a state law counterclaim). These courts' efforts to limit *Stern* to only cases that fall within §157(b)(2)C) are simply wrong. *See* discussion *infra* Part B.

These courts simply ignore *Stern*. As the first Court of Appeals to directly address *Stern*, the Seventh Circuit has adopted a straightforward statutory approach lifted from *Stern*, which holds that *Stern* prevents a bankruptcy judge from treating "core" claims as "non-core" under § 157(c)(1). *In re Ortiz*, No. 10-3465, ---F.3d---, 2011 WL 6880651, at *7 (7th Cir. Dec. 30, 2011)

The *Ortiz* Court stated,

> Even though Congress gave the bankruptcy judge statutory authority to adjudicate the debtors' claims as "core" matters under 28 U.S.C. § 157(b), *Stern v. Marshall* reveals the absence of constitutional authority for the bankruptcy judge to enter summary judgment, or any form of final judgment, on the debtors' claims. . . . For the bankruptcy judge's orders to function as proposed findings of fact or conclusions of law under 28 U.S.C. § 157(c)(1), we would have to hold that the debtors' complaints were "not a core proceeding" but are "otherwise related to a case under title 11." Id. As we just concluded, the debtors' claims qualify as core proceedings and therefore do not fit under § 157(c)(1).

Id. at **1, 7.

The Seventh Circuit's approach follows *Stern* and is also in step with this Court's precedent that leads to the conclusion that bankruptcy judges cannot submit proposed findings of facts and conclusions of law in actions to avoid fraudulent conveyances.

It is fundamental to our system of government that a court of the United States may not grant relief absent a constitutional or valid statutory grant of jurisdiction." *A-Z Intern. v. Phillips*, 323 F.3d 1141, 1144 -1145 (9th Cir. 2003).

Bankruptcy courts' power to adjudicate is purely statutory. *See In re Valdez Fisheries Dev. Ass'n, Inc.*, 439 F.3d 545, 549 (9th Cir. 2006); *Celotex Corp. v. Edwards*, 514 U.S. 300, 307 (1995) ("[J]urisdiction of the bankruptcy courts . . . is grounded in, and limited by, statute."). Bankruptcy courts' jurisdiction is derived from 28 U.S.C. § 1334(b) and 28 U.S.C. § 157. *In re Ray*, 624 F.3d 1124, 1130 (9th Cir. 2010). "28 U.S.C. § 1334(b) gives federal district courts subject matter jurisdiction over 'all civil proceedings arising under title 11, or arising in or related to cases under title 11.' 28 U.S.C. § 157(a) allows district courts to refer any of these proceedings to bankruptcy courts." *In re Harris*, 590 F.3d 730, 736-737 (9th Cir. 2009) (footnote omitted). Thus, 28 U.S.C. § 157(b) and (c)(1) provide *only two categories* from which bankruptcy courts have the authority to preside: "core" and "non-core." As discussed below, if a claim is *statutorily defined* as "core," it cannot be "non-core" nor can it be adjudicated as if it were "non-core." Proceedings to determine, avoid, or recover fraudulent conveyances are "core" and cannot be adjudicated as if they were "non-core." 28 U.S.C. §157(b)(2)(H); *Ortiz*, 2011 WL 6880651, at *7.

Unlike "non-core" proceedings under §157(c), Congress did not grant bankruptcy courts the statutory authority to enter proposed findings of fact and conclusions of law in "core" proceedings. *See Ortiz*, 2011 WL 6880651, at *7; *In re Blixseth*, 2011 WL 3274042, at *12 (Bkrtcy.D.Mont. Aug. 1, 2011); *see also In*

re Int'l Payment Group, No. 08-03453-HB, 2011 WL 5330783, at *3 n.10 (Bankr.D.S.C. Nov. 3, 2011). Likewise, Congress did not empower parties the ability to consent to a bankruptcy court making final decisions on "core" proceedings, unlike "non-core" proceedings under §157(c)(2). *Blixseth*, 2011 WL 3274042, at *12.[5]

Stern put it clearly. A bankruptcy court can enter a final judgment on core claims, *i.e.* those that "arise in or arise under Title 11." *Stern*, 131 S.Ct. at 2605. A bankruptcy court can only make proposed findings of fact and conclusions of law on non-core claims, *i.e.*, claims that neither arise in nor arise under Title 11 but are

[5] Although the Court did not request comment regarding the impact of *Stern* with respect to all pending adversary proceedings that were in progress when *Stern* was decided, given that another Amicus party raises issues of consent, Ninth Circuit precedent states that any relinquishment of a constitutional right must be knowing and voluntary. *Gete v. I.N.S.*, 121 F.3d 1285, 1293 (9th Cir. 1997). Thus, defendants in cases pending while *Stern* was decided could not waive their constitutional rights to an Article III judge in unconstitutionally "core" cases because they simply did not know that they had a right to an Article III judge in such unconstitutional proceedings. *In re Teleservices*, 456 B.R. 318, 339 n.66. (Bankr.W.D.Mich. 2011) (finding that a defendant could not have consented pre-*Stern* to entry of a final judgment on a "core" but state law cause of action by a bankruptcy court because there was no way for the defendant to have known of its right to entry of a final judgment by an Article III judge on that core claim). Moreover, consenting to jurisdiction and consenting to final adjudication are distinct. *Dev. Specialists*, 2011 WL 524463, at *11("Consenting to jurisdiction . . . under "related to" doctrine . . . is not the same as consenting to the entry of a final determination by a non-Article III tribunal").

related to a case under Title 11. *Id.* "There is no such thing as a core matter that is "related to" a case under Title 11." *Id.* A bankruptcy court therefore does not have the authority to enter proposed findings of fact and conclusions of law. *Id.*; *See Stern*, 131 S. Ct. at 2604-2605 ("non-core" and "related to" are "synonymous")("It does not make sense to describe a "core" bankruptcy proceeding as merely "related to" the bankruptcy case; oxymoron is not a typical feature of congressional drafting"); *See also In re Palazzola*, No. 10-3254, 2011 WL 3667624, at **4-6 (Bankr. N.D. Ohio Aug. 22, 2011) (A "core" claim, by definition is not a "related to" claim; thus, bankruptcy courts are precluded from adjudicating "core" claims as "non-core" under Section 157(c)(1)).[6]

Some courts have concluded that bankruptcy judges may also issue findings of fact and conclusion of law on "core" claims by treating such claims as if they were "non-core."[7] These courts are attempting to create a third category of

[6] In addition, the Federal Rules of Bankruptcy Procedure limit review of proposed findings of fact and conclusions of law to "non-core" proceedings. F.R.B.P. Rule 9033(a).

[7] *In re Canopy Fin., Inc.*, No. 11-A-581, 2011 WL 3911082, at 5 (N.D.Ill Sept. 1, 2011)(Because bankruptcy courts may propose findings of fact and conclusions of law in "non-core" proceedings, they can employ the same procedure in "core" proceedings). *In re Teleservices Group, Inc.* 456 B.R. 318, 340 (Bankr.W.D.Mich. 2011) (no prejudice . . . to convert . . . to a report and recommendation..."); *In re Bujak*, No. 11-6038, 2011 WL 5326038, at *5 (Bankr.D.Idaho Nov. 3, 2011)("Even if the Court lacks the constitutional power to finally decide Trustee's §548 and §544(b) claims against the County, the County can always request *de novo* review of this Court's findings and conclusions by the district court."). *In re*

"related to" "core" proceedings expressly rejected in *Stern* by hypothesizing that Congress would have wanted it that way. Congressional intent in enacting § 157 is irrelevant. "If Congress has directly spoken to the issue and the intent of Congress is clear, then the courts must give effect to the "unambiguously expressed intent of Congress." *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 842-43 (1984).

Other courts have justified this hybrid category of related-to core claims as being more expedient. "It goes without saying that the fact that a given law or procedure is efficient, convenient and useful in facilitating functions of government, standing alone, will not save it if it is contrary to the Constitution." *Stern*, 131 S.Ct. at 2619; *see also Herman Family Revocable Trust v. Teddy Bear*, 254 F.3d 802, 807 (9th Cir. 2001) ("[E]fficiency [does] not undergird jurisdiction. Nor is jurisdiction a question of equity - a court lacking jurisdiction to hear a case may not reach the merits even if acting 'in the interest of justice.'").. These rationales are fundamentally flawed. "When a suit is made of 'the stuff of the traditional actions at common law tired by the courts at Westminster in 1789' . . . and is brought within the bounds of federal jurisdiction, the responsibility for

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Davis, No. 07-05181-L, 2011 WL 5429095, at *16 (Bnkr.W.D.Tenn. Oct. 5, 2011) (bankruptcy judge may prepare proposed findings of fact and conclusions of law in "core" proceedings); *In re Tevilo Industries, Inc.*, No. 09-07311, 2011 WL 4793343, at *2 (Bkrtcy.W.D.Mich. Aug. 30, 2011)(Treat "core" proceeding as "non-core").

deciding that suit rests with Article III judges in Article III courts.". *Stern*, at 2609 After all, "[t]he 'experts' in the federal system at resolving common law counterclaims . . . are the Article III courts". *Id*. at 2615.

Therefore, *Stern* not only prevents a bankruptcy court from entering final judgment in actions to set aside fraudulent conveyances, but *Stern* and the bankruptcy code prevent a bankruptcy judge from entering proposed findings of facts and conclusions of law in "core" claims.

C. BANKRUPTCY COURTS LACK THE SAFEGAURDS FOUND IN ARTICLE III COURTS AND SHOULD BE LIMITED.

The most basic safeguard, which was addressed in *Marathon* and *Stern* and previously discussed, is the insulation from political pressure that life tenure and non-reduction in salary bring to Article III courts. *See N. Pipeline*, 458 U.S. at 84-85; *Stern*, 131 S.Ct. at 2609-2610. After all, the concept of an independent judiciary embodied in Article III is rooted in the disgust that colonists had with the King's abuses. *See N. Pipeline*, 458 U.S. at 59-60. The "right to have claims decided before judges who are free from potential domination by other branches of government" as extoled by Justice Burger, certainly offers practical safeguards to the public. *United States v. Will*, 449 U. S. 200, 218 (1980). However, beyond the traditional Article III protections portrayed by Justice Brennan in *Marathon*, additional safeguards that are found within the Article III courts are absent in bankruptcy courts. *Id.*, at 59, no. 10. (plurality opinion).

(1) Adjudicating actions to avoid fraudulent conveyances by the Bankruptcy Courts deprives litigants of their constitutional rights to a jury.

The examination clause within the seventh amendment to the Constitution provides that "no fact tried by a jury, shall be otherwise re-examined in any court of the United States, than according to the rules of the common law." U.S. CONST. AMEND. VII. Rules of the common law, as described in the examination clause, require that facts once tried cannot be re-examined unless a trial court rules that the verdict is against the weight of the evidence or an appellate court determines no substantial evidence exists to support the verdict. Robert G. Skelton & Donald F. Harris, *Bankruptcy Jurisdiction and Jury Trials: The Constitutional Nightmare Continues*, 8 Bank. Dev. J. 469, 502 (1991)(citations omitted).

The examination clause is relevant since the right to a jury trial exists in fraudulent conveyance actions where the defendant has not and does not file a claim with the bankruptcy court. *Granfinanciera*, 492 U.S. 33, 64. No constitutional right to a jury exists where a creditor files a claim against the estate and it defends itself by bringing a counterclaim against the defendant. *Id.* at 57-59 (discussing *Katchen v. Landy*, 382 U.S. 323 (1966)).

Rules of the common law, as adopted by the examination clause in the seventh amendment, do not allow a court to re-exam the findings of a jury *de novo*. *Id*. Therefore, a bankruptcy court cannot conduct a jury trial of a "non-core"

proceeding since the district court's *de novo* review of a jury's findings violates the seventh amendment's examination clause. Under no circumstances is the constitutional right to a jury allowable in fraudulent conveyance actions before a bankruptcy court, since allowing the matter to be adjudicated as a "core" proceeding is unconstitutional (*Stern*) and allowing the same proceedings as a "non-core" proceeding violates the seventh amendment's examination clause by reviewing the jury's findings *de novo*.

(2) Bankruptcy Judges are both Administrator and Adjudicator.

The amalgamation of roles by the same bankruptcy judge acting as both administrator and adjudicator makes him or her more susceptible to bias and the appearance of partiality than Article III judges. *See In re Manoa Fin. Co., Inc.*, 781 F.2d, 1370, 1373 (1986) ("The alleged bias . . . stem[s] from one judge's handling both administrative and adversary matters in the same case . . . to the extent a bankruptcy judge must play both administrative and judicial roles, he is an actor as well as an adjudicator; intimate contact with day-to-day affairs of an estate and close contact with the trustee may make objective appraisal difficult and may create the appearance of partiality.").

Bias from the dual hats of a bankruptcy judge can also arise where "the judge appears 'boxed in' by prior rulings such that he will be forced to reach a certain result in an adversarial proceeding regardless of the merits." *Frates v.*

Weinshienk, 882 F.2d 1502, 1504 (10th Cir. 1989). In other words, it does appear that a bankruptcy judge may "[prejudge] adversarial proceedings or . . . [place] himself in a position where it appears he will be forced to decide one or more of the adversary proceedings in [a party's] favor." *Id.* This bias and underlying partiality is at its peak when the primary vehicle of funding a reorganization plan or payment for the administration of the estate hinges upon the favorable outcome in an adversary proceeding for the debtor-in-possession or the bankruptcy trustee. Certainly, actions to avoid fraudulent conveyances are susceptible to these pressures because they allow the bankruptcy estate to augment itself for the benefit of the debtor, creditors, and trustees.

Likewise, bankruptcy judges, as both administrators and adjudicators, are susceptible to pre-judge common law adversary proceedings based upon prior rulings made in the administration of the main case. Recently, a litigant in a high-profile bankruptcy case actually argued the benefit of a bankruptcy judge drawing upon "surrounding issues" during the course of the chapter 11 reorganization in an effort to deny the debtor's motion to remove a common law claim to Virginia Circuit Court. *See In re BearingPoint, Inc.*, 453 B.R. 486, 492-93 (S.D.N.Y. 2011). Although Judge Gerber recognized that "it would be manifestly improper for [him] to determine adjucative facts on evidence from outside that record, or based on knowledge or perceptions developed in the course of the earlier chapter

11 case," it is still a danger that other bankruptcy judges would not be so aware of this predisposition. *Id*. at 493. Remarkably, a bankruptcy court, in this Circuit, has referred to facts outside of the record in determining motions for summary judgment by stating that motions for summary judgment are not in a "vacuum" and then went on to find disputed factual issues based on "a lot of testimony" that it had heard "over the past 22 months" in the "Yellowstone Club and associated proceedings." *See In re Blixseth*, No. 03-100-RBK, 2011 WL 3824183, at *13-14 (Bankr.D.Mont. Sept. 27, 2010). Clearly, some bankruptcy judges do not seem to grasp the manifest injustice that can occur from pre-judging common law adversary proceedings based upon prior rulings made in administrative matters within the main bankruptcy case. Thus, to prevent such injustice from occurring in fraudulent conveyance actions, only Article III judges should hear these cases.

(3) The mechanics of bankruptcy undermine the protections of the Federal Rules of Civil Procedure involving third party litigation

Because administrative fees and professional fees are paid out of the bankruptcy estate, expeditious resolution is a critical goal of bankruptcy judge, which can lead to "organizing and condensing the typically-lengthy United States federal litigation process . . ." Timothy B. DeSieno and Rupal Shah Palanki, *The United States' Specialized Bankruptcy Courts*, at Forum for Asian Insolvency Reform (Feb. 7-8, 2011), *available at http://www.oecd.org/dataoecd/7/8/1873680.pdf*. Rather than allow the full development of a cause of action in

an Article III court, negotiations are the "lifeblood of bankruptcy" that "lies outside of the channels of Article III appellate review." Troy A. McKenzie, *Judicial Independence, Autonomy, and the Bankruptcy Courts*, 62 Stan. L. Rev. 747, 784 (2010). Rather than protect the interests of all litigants, the mechanics of bankruptcy push for expeditious settlements that are outside the review of Article III supervision. In such instances, as recited herein, the protections afforded by the Federal Rules of Civil Procedure are often abandoned.

(4) The principle of Equitable Mootness precludes third party rights before appellate review occurs.

The equitable mootness doctrine, which strongly favors the finality of bankruptcy orders, severely limits the rights of third parties but not before the appellate courts are involved. *See In re Onouli-Kona Land Co.*, 846 F.2d 1170, 1171-72 (9th Cir. 1988) (In the context of an asset sale, "[f]inality in bankruptcy has become the dominant rationale for our decisions" and "the mootness rule regardless of whether a purchaser has taken irreversible steps following the sale . . . requires appellants to obtain a stay before appealing a sale of assets"); *In re Clarke*, 98 B.R. 979, 980 (B.A.P. 9th Cir. 1989) (applying *Onouli-Kona* to dismiss an appeal of a chapter 11 plan confirmation order as moot). "Ultimately, the decision whether to unscramble the eggs turns on what is practical and equitable." *In re Baker & Drake, Inc.*, 35 F.3d 1348, 1352 (9th Cir. 1994). In the context of fraudulent conveyance actions, third party litigants could be prejudiced by

bankruptcy judges hearing such actions because by the time an appeal could be heard, the doctrine of equitable mootness might prevent the appellate court from unscrambling the eggs. *See* McKenzie, 62 Stan. L. Rev. at 790 (Justification on "concern that unraveling substantially consummated transactions threatens to impose risk costs on a bankruptcy estate and therefore reduce the recovery for creditors").

(5) The current safeguards utilized to review bankruptcy judges' rulings by Article III judges lack teeth.

The current system of review of bankruptcy judges' rulings and findings by the district court is ineffective as bankruptcy judges are either electing to disregard the holdings of the districts or believe they are not bound by the district court's decisions. George W. Kuney, *Where We Are and Where We Think We Are: An Empirical Examination of Bankruptcy Precedent*, *28* Cal. BANKR. J. 71, 84, 94-96. (2005)(Only half of bankruptcy judges feel bound by the decisions of the district judges); *See In re Harris*, 155 B.R. 135, 136 (Bankr. E.D. Va. 1993)(citing but choosing to disregard the holding in *In re Schialdone*, Civ. No. 88-189-N, 1988 U.S. Dist. LEXIS 18645 (E.D. Va. June 1988)(unpublished opinion). Even in matters as prejudicial as exculpating non-debtors claims in the context of chapter 11 plans, the Montana bankruptcy judge is unwilling to heed the district court's decision about invalidating those clauses. *See In re Yellowstone Mountain Club*,

No. 08-61570, Mem. of Decision, Sept. 30, 2011, ECF No. 2352 (bankruptcy court upheld exculpation clause as permissible despite district court reversing plan because of the identical clauses). While the question posed by this Court does not concern exculpation clauses, disregarding the district court's appellate mandate raises serious doubts about the safeguards that an Article III review of bankruptcy judges' decisions truly brings. Therefore, to fully protect litigants, Article III courts should hear the entire adversarial case involving state law claims and not allow bankruptcy judges to make findings of facts and conclusions of law.

(6) The close ties between bankruptcy judges and the bankruptcy bar raise suspicion and fuel the constitutional concerns underlying *Stern*.

Given the reality that the audience of the bankruptcy judges is significantly smaller than Article III judges' audience, the frequency of the trustee's appearances before the same judge, and routine communications *ex parte* that come with an administrative function, some have questioned the partiality of the bankruptcy judges. *See* McKenzie, 62 Stan. L. Rev. at 799 (citing LYNN M. LOPUCKI, COURTING FAILURE: HOW COMPETITION FOR BIG CASES IS CORRUPTING THE BANKRUPTCY COURTS 97-122 (2005). Bankruptcy judges, in order to please the local members, are too generous in awarding fees to counsel from the debtor's estate. *Id.* (citing LoPucki at 40-48). After all, the reappointment of bankruptcy judges is largely based upon support of the local bar. *See Scholl v. U.S.*, 54 Fed. Cl.

640, 642-43 (Fed. Cl. 2002). In a recent case with the Ninth Circuit, a trustee's firm was awarded $707,078.00 in fees in connection with its representation of the debtor while two different firms on behalf of the estate were awarded $1,876,262.00 and $1,625,533.00 for their work in the bankruptcy –many of which were not reduced at all. *See In re Yellowstone Mountain Club, LLC*, No. 08-61570-RBK, ECF Nos. 189, 320, 663, 1051, 1223, 1018, 1135, 1224, 1229, and 1702. It is difficult to disregard the self-interested nature of the bankruptcy bar and its influence over the bankruptcy judges. Therefore, taking private common law claims away from the bankruptcy judges is the only appropriate safeguard.

(7) In re Yellowstone Mountain Club, LLC is a startling example of an Article I court disregarding the constitutional protections that must be afforded to litigants.

Concerns about constitutional and procedural safeguards are not theoretical. Rather, such insidious constitutional abuses have actually occurred in the Yellowstone Club bankruptcy proceedings involving Mr. Blixseth as a third party litigant, and no citizen should ever be subject to such abuses. *All* of the above mentioned safeguards were disregarded by Montana's sole bankruptcy judge in *In re Yellowstone Mountain Club, LLC*, No. 08-61570-11-RBK and its associated adversary proceeding no. 09-00014 ("AP-14"). AP-14 involved an action to avoid an alleged fraudulent conveyance.

In that case, the bankruptcy court, in an effort to keep the reorganization process moving (as discussed in Part C, Sec. 3 *supra*), commenced AP-14's trial against Mr. Blixseth on April 29, 2009 even though the debtors only named Mr. Blixseth a defendant on April 27, 2009. *See UCC v. Credit Suisse, et al.*, Adv. No. 09-14, UCC's Answer and Countercl., ECF No. 98. Mr. Blixseth was neither afforded the right to a jury (as discussed in Part C, Sec. 1 *supra*) nor allowed to assert any cross-claims, indemnity claims or third party claims because the bankruptcy court approved exculpation clauses in the Third Amended Plan of Reorganization which prevented him from exercising fundamental rights embodied in the Federal Rules of Civil Procedure . *In re Yellowstone Mountain Club, LLC*, No. 08-61570, Third Am. Plan of Reorganization, § 8.4, ECF No. 995. Moreover, the bankruptcy court denied Mr. Blixseth the *opportunity* to even present relevant evidence that the bankruptcy petition was filed in bad faith by the debtor as a defense in AP-14. *See UCC v. Credit Suisse, et al.*, Adv. No. 09-14, Order, ECF No. 257.

The bankruptcy court demonstrated an utter lack of trial expertise imposing over a $40 million dollar judgment against Mr. Blixseth based upon a single affidavit that contained known errors in the damages calculation despite its previously ruling that the Court did not have enough facts to determine what was owed. *See* Aff. Charles Hingle, Aug. 27, 2010, ECF No. 577-1; Ap-14 Mem. of Decision 4, Sept. 7, 2010, ECF No. 580. The court also characterized Mr.

Blixseth's adherence to the Federal Rules of Civil Procedure as delay tactics. In addition, as stated above and in direct contradiction to *In re Manoa* (as discussed in Part C, Sec. 2 *supra*), the bankruptcy judge referred to facts outside of the record in determining motions for summary judgment by finding disputed factual issues based on "the past 22 months" in the "Yellowstone Club and associated proceedings." *See Western Capital Partners, LLC v. Edra D. Blixseth*, No. 09-100, Mem. of Decision 24-25, Sept. 27, 2010, ECF No. 40.

The bankruptcy court even disregarded its appellate mandate (as discussed in Part C, Sec. 5 *supra*). *See Blixseth v. U.S. Bankruptcy Court for District of Montana*, No. CV-11-62-BU-RFC, Br. Supp. Writ of Mandamus 5-8, ECF No. 2. There, the district court reversed the bankruptcy court's order confirming the Third Amended Plan of Reorganization on the ground that "the language of Section 8.4 [the exculpation clause], whatever its intended scope may have been, goes well beyond the limitation of Section 524 (e). Its approval was plain error." *In re Yellowstone Mountain Club, LLC*, No. 08-61570, Order 4, Nov. 2, 2010, ECF No. 1993. In direct derogation of the district court's November 2, 2010 order, the bankruptcy court issued its order after remand on September 30, 2011, stating "The exculpation clause in the case *sub judice* is not barred by Ninth Circuit Law." *In re Yellowstone Mountain Club, LLC*, No. 08-61570-11, Mem. of Decision 36, Sept. 30, 2011, ECF No. 2352. Thus, despite the appellate mandate to the contrary, an

Article I judge allowed the same exculpation clauses that prevented Mr. Blixseth from asserting counterclaims in AP-14 to remain within the plan.

Finally, the close tie between the bankruptcy bar and its judges is clearly demonstrated in the *Yellowstone* case. Not only did that court award huge professional fees to its bar (*See* discussion *supra* Section C, No. 6), but it also engaged in *ex parte* advocacy and *ex parte* communications with parties and their attorneys. The court invited and entertained advocacy against Mr. Blixseth by inquiring about the reputation of Mr. Blixseth's counsel *ex parte* in an unrelated hearing. *See Atigeo, LLC, et al. v. Samson, et al.*, No. 09-105, Hr'g Tr. 30:15-33, Oct. 12, 2010, ECF No. 146. Andy Patten, counsel for debtor, even engaged in two distinct *ex parte* communications with members of the Montana Bankruptcy Court, which is fully documented in Mr. Blixseth's Motion for Reassignment before this Court in the matter of *Blixseth v. Yellowstone Mountain Club, LLC, et al.*, No. 10-36073, ECF No. 22-2, which is incorporated herein. First, Patten requested a law clerk to keep AP-14 confidential until the actual filing via email, and shockingly, the Montana Bankruptcy Court sent Andy Patten trial strategy advice two days before AP-14's trial to look up certain cases that could help the debtor against Mr. Blixseth. Despite bringing these wholly improper communications to the court's attention, the bankruptcy judge did not disqualify himself, adjudicated AP-14, and robbed Mr. Blixseth of the safeguards found

within Article III courts. Such events should never have happened. The constitution does not allow these "specialized courts" to hear matters that are reserved for the Article III courts. The Founding Fathers created an Article III federal system to resolve common law claims and preserve trial by jury. Continued erosion of that system by bankruptcy expediencies must be halted.

3. CONCLUSION

Stern is indeed a "watershed" opinion that extends *Marthon*'s plurality opinion to actions to avoid fraudulent conveyances. *Stern* not only prevents a bankruptcy court from entering final judgment in actions to set aside fraudulent conveyances, but *Stern* and the bankruptcy code also prevents a bankruptcy judge from entering proposed findings of facts and conclusions of law in "core" matters. Frankly, fundamental constitutional safeguards afforded parties in adjudicating common law claims, including judicial independence, partiality and a trial by one's peers, are not present in bankruptcy courts. Thus, this Court must uphold judicial independence and require actions to set aside fraudulent conveyance to be heard and adjudicated by the Article III judges alone.

CERTIFICATE OF COMPLIANCE

I hereby certify that this brief complies with the type-volume limitation of Rule 32(a)(7)(C)(i) of the Federal Rules of Appellate Procedure. The foregoing brief contains 6,479 words of Time News Roman (14 pt) proportional type. Microsoft Word is the word-processing software that was used to prepare this brief.

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