

**Book Two in the Stern Jurisdiction Trilogy:
Executive Benefits vs. Arkison
By: Hon. Michael G. Williamson, United States Bankruptcy Judge**

The Supreme Court’s recent decision in *Executive Benefits Insurance Agency v. Arkison*¹ may aptly be described as Book Two of a bankruptcy jurisdiction trilogy that started nearly three years ago in *Stern v. Marshall*.² As we all know, in *Stern*, the Court held that Article III of the U.S. Constitution prohibits Congress from vesting a bankruptcy court with the authority to finally adjudicate certain types of proceedings (i.e., enter a final judgment) by designating those proceedings as “core” under 28 U.S.C. § 157.

Under 28 U.S.C. § 157, bankruptcy proceedings are bifurcated into two categories: “core” and “non-core” proceedings.³ Section 157 expressly authorizes bankruptcy courts to enter final judgments in “core” proceedings.⁴ But in “non-core” proceedings, bankruptcy courts are only authorized to “submit proposed findings of fact and conclusions of law to the district court,” which the district court must then review *de novo* before entering any final orders or judgments.⁵

There are two principal questions left unanswered by *Stern*. First, *Stern* does not address how a bankruptcy court should address a “*Stern* claim”—a claim designated for final adjudication in the bankruptcy court as a statutory matter, but a claim that the bankruptcy court is without power to finally adjudicate as a constitutional matter. Second, *Stern* left unanswered whether or not the constitutional limitation on a bankruptcy court to finally adjudicate a non-core matter is cured when the parties consent to the bankruptcy court’s entering a final judgment.

Regarding the first issue—how are *Stern* claims to be treated—a number of courts since *Stern* concluded that *Stern* claims fall into a gap between section 157(b)—which authorizes bankruptcy courts to enter final judgments in matters statutorily defined as “core” proceedings”—and section 157(c)(1)—which only permits bankruptcy courts to submit to the district court for *de novo* consideration proposed findings of fact and conclusions of law in matters that are statutorily defined as “non-core” proceedings.

In *Executive Benefits*, the Supreme Court held that section 157’s savings clause instructs bankruptcy courts how to proceed.⁶ The savings clause provides that if any provision of section 157 is held invalid, the remainder of that section will not be affected.⁷ Under the Supreme Court’s analysis in *Stern*, while section 157(b) is no longer valid regarding *Stern* claims, that does not affect the validity of section 157(c)(1). So bankruptcy courts should look to section 157(c)(1) when dealing with *Stern* claims, which means bankruptcy courts are authorized to enter proposed findings of facts and conclusions of law when addressing *Stern* claims.

Although the bankruptcy court in *Executive Benefits* entered summary final judgment (rather than proposed findings of fact and conclusions of law) on the chapter 7 trustee’s fraudulent transfer claims, the Supreme Court nevertheless affirmed its ruling. That is because Article III, at bottom, simply requires *de novo* review of the trustee’s claim. And the defendants in that case received that.

¹ ___ U.S. ___, 134 S. Ct. 2165 (2014).

² 564 U.S. ___, 131 S. Ct. 2594, 180 L. Ed. 2d 475 (2011).

³ Compare 28 U.S.C. § 157(b)(2) (“core” proceedings) with 28 U.S.C. § 157(b)(4) (“non-core” proceedings).

⁴ 28 U.S.C. § 157(b)(1).

⁵ 28 U.S.C. § 157(c)(1).

⁶ *Executive Benefits Ins. Agency v. Arkison*, ___ U.S. ___, 134 S. Ct. 2165, 2172-74 (2014).

⁷ See 98 Stat. 344, note following 28 U.S.C. § 151.

Judge Williamson (continued):

In other words, even if the bankruptcy court's final judgment was defective, the district court's *de novo* review and entry of final judgment cured the bankruptcy court's error.

So the decision in *Executive Benefits* is significant because it provides guidance to bankruptcy courts on how to handle *Stern* claims going forward. The Court's decision, however, does not extend beyond that. Because it ruled that the defendants received a *de novo* review of their claims, the Court was not required to address the second question left unanswered by *Stern*—whether the defendants could consent to the bankruptcy court's adjudication of a "*Stern* claim."⁸

Because the split in the circuits concerning consent to the bankruptcy judges entering a final judgment on a *Stern* claim was not resolved by *Executive Benefits*, on July 1, 2014, less than three weeks after *Executive Benefits* was decided, the Supreme Court granted certiorari in a case that will most likely become Book Three of the trilogy. The case was *Wellness Int'l Network v. Sharif*⁹, in which the Seventh Circuit Court of Appeals held that the debtor could not waive its *Stern* objection or consent to entry of final judgment in a *Stern* matter.

According to the Seventh Circuit, a constitutional objection based on *Stern* cannot be waived because it implicates separation-of-powers principles. When Article III limitations are at issue, the court reasoned, "notions of consent and waiver cannot be dispositive because the limitations serve institutional interests that the parties cannot be expected to protect." The Seventh Circuit then held that the bankruptcy court lacked constitutional authority to finally adjudicate Wellness Network's alter ego claim.

It will most likely be a year to so until we have an answer to the consent question. So for now, our courts will be governed by *Stern* and *Executive Benefits*. Here is a recap of what *Executive Benefits* holds, what it reaffirmed, what it does not hold, and what it leaves for future resolution.

Holding of Executive Benefits.

The problem created by *Stern* is that it does not instruct us on how to deal with *Stern* claims which, while defined as core, cannot constitutionally be decided by the bankruptcy court and are also not within matters considered statutorily to be non-core that can be decided by the procedures in section 157(c) that deal with non-core matters.

In *Executive Benefits*, the Supreme Court closed this gap in the bankruptcy statute by holding that *Stern* claims may be adjudicated as non-core within the meaning of section 157(c) based on the severability provision found in title 28. This severability provision "closes the so-called 'gap' created by *Stern* claims."¹⁰

What Executive Benefits reaffirms.

In footnote 8 of *Executive Benefits*, Justice Thomas reaffirms the statement made by Justice Roberts in *Stern* that removal of claims from core bankruptcy jurisdiction does not "meaningfully change the division of labor in the current statute."¹¹ This is an important quote from Justice Thomas's opinion in *Executive*

⁸ See *Executive Benefits*, 134 S. Ct. at 2170 n.4.

⁹ *Wellness Intern. Network, Ltd. v. Sharif*, 727 F. 3d 751 (7th Cir. 2013).

¹⁰ *Executive Benefits*, 134 S. Ct. at 2173.

¹¹ *Id.* at 2173 n.8.

Judge Williamson (continued):

Benefits because it supports the conclusion that Stern is to be read narrowly as has been the holding of many, but not all, cases interpreting *Stern*.¹²

What Executive Benefits does not hold.

The Supreme Court did not hold that any other provisions of 28 U.S.C. § 157 were unconstitutional beyond 28 U.S.C. § 157(b)(2)(H) that was found to be unconstitutional in *Stern*. This is important because it leaves intact 11 U.S.C. § 157(c)(2). This provision provides that the District Court, with the consent of all parties, may refer a case under title 11 to a bankruptcy judge to hear and determine and to enter appropriate orders and judgments subject to appellate review.¹³

So even in cases involving a *Stern* claim or non-core proceeding pending before the bankruptcy court, the parties may consent to the bankruptcy court entering a final judgment. This is actually common in our local experiences, and in the vast majority of cases dealing with *Stern* claims or non-core matters, parties consent to the bankruptcy court entering the final judgment. While the Fifth, Sixth, and Seventh Circuits¹⁴ have held this to be unconstitutional, the Ninth Circuit in *Executive Benefits*¹⁵ held to the contrary and the Eleventh Circuit has not addressed the issue. So absent an Eleventh Circuit or Supreme Court ruling that 11 U.S.C. § 157(c)(2) is unconstitutional, the conduct of cases in our court will continue as usual.

It is also noteworthy that even though in theory *Stern* claims are subject to *de novo* review by the District Court, there is nothing in 28 U.S.C. § 157(c)(1) that requires an actual *de novo* review except on matters “to which any party has timely and specially objected.”¹⁶ This language is implemented in part by Federal Rule of Bankruptcy Procedure 9033(d), which requires *de novo* review “of any portion of the bankruptcy judges finding of fact and conclusions of law to which specific written objections have been made in accordance with this rule.”¹⁷

What Executive Benefits leaves for future consideration.

Because the Supreme Court in *Executive Benefits* concluded that the District Court did conduct a *de novo* review of the final judgment, which is all that *Stern* requires, the Court did not need to address whether from a constitutional perspective the Petitioner could consent to the bankruptcy court’s adjudication of a *Stern* claim. The Court reserved that question for another day. That day will occur on resolution of the *Sharif* case in what will be Book Three of the Supreme Court’s jurisdictional trilogy.

¹²See, e.g., *In re Safety Harbor Resort and Spa*, 456 B.R. 703 (Bankr. M.D. Fla. 2011).

¹³11 U.S.C. § 157(c)(2).

¹⁴*In re BP RE, L.P.*, 735 F.3d 279 (5th Cir. 2013); *Wellness Int’l Network, Ltd. v. Sharif*, 727 F.3d 751 (7th Cir. 2013), cert. granted, ___ U.S. ___, 2014 WL 497624 (2014); *Waldman v. Stone*, 698 F.3d 910 (6th Cir. 2012), cert. denied, ___ U.S. ___, 133 S. Ct. 1604, 185 L. Ed. 2d 581 (2013).

¹⁵*Executive Benefits Ins. Agency v. Arkison (In re Bellingham Ins. Agency, Inc.)*, 702 F.3d 553 (9th Cir. 2012).

¹⁶11 U.S.C. § 157(c)(1).

¹⁷Fed. R. Bankr. P. 9033(d).