Constitutional/Jurisdictional/ Standing Issues

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Written Materials for Constitutional/Jurisdiction/Standing Issues

This panel will discuss "*Stern* problems" regarding bankruptcy court jurisdiction and the standing of various parties in light of the Supreme Court's ruling in *Executive Benefits Insurance Agency v. Arkinson* in order to identify simple solutions to these complex constitutional problems. The faculty will explain the key Supreme Court cases on constitutional jurisdiction and apply these cases to fact patterns involving preference claim, a Ponzi scheme case, a typical fraudulent conveyance claim, and a typical state law contract claim. The panel will also present the leading cases on standing and attempt to integrate a discussion of standing into the fact patterns.

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Executive Benefits Insurance Agency v. Arkison

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In *Stern v. Marshall*, 131 S.Ct. 2594 (2011), 134 S. Ct. 2165 (2014), the Supreme Court held that bankruptcy judges do not have the constitutional authority under Article III to finally decide certain claims, despite the claims being classified as "core" proceedings undersection 157(b)(1) of Title 28. *Executive Benefits Insurance Agency v. Arkison*, decided on June 9, 2014, provides further guidance on how bankruptcy courts should proceed with respect to a "*Stern* claim" — i.e., a claim that a bankruptcy court has statutory, but not constitutional, authority to decide. In a unanimous decision authored by Justice Thomas affirming the Ninth Circuit, the Court held that when faced with a *Stern* claim, section 157 permits a bankruptcy court to follow the procedures for non-core claims set forth in section 157(c)(1) and issue proposed findings of fact and conclusions of law for *de novo* review in the district court. *Id.* at 2170. The presumably "core" fraudulent conveyance claims at issue in *Arkison* (notably, the parties did not dispute that these were *Stern* claims) were within the scope of section 157(c)(1) and the bankruptcy court was authorized to adjudicate the claims as non-core. *Id.* at 2174. The District Court's *de novo* review of the bankruptcy court's decision and entry of its own valid judgment cured any potential error in the bankruptcy court's entry of judgment. *Id.* at 2174.

A. *Stern* and the Statutory Scheme

Under the Bankruptcy Amendments and Federal Judgeship Act of 1984, 28 U.S.C. § 151 *et seq*., "federal district courts have 'original and exclusive jurisdiction of all cases under title 11,' § 1334(a), and may refer to bankruptcy judges any 'proceedings arising under title 11 or arising in or related to a case under title 11,' § 157(a)." *Id.* at 2171. The statute divides all matters that may be referred to the bankruptcy court into two categories, "core" and "non-core," and provides separate procedures for each category. *Id.* (citing generally to 11 U.S.C. § 157). Section 157(b)(2), governing "core" proceedings, allows bankruptcy courts to "hear and determine" an enumerated, non-exhaustive list of claims and to "enter appropriate orders and judgments" on those claims. *Id.* Under section 157(c)(1), bankruptcy judges may hear "non-core" proceedings that are "otherwise related to a case under title 11" but may not enter final judgments. *Id.* at 2172. Instead, the bankruptcy court can "hear [the] proceeding," and then "submit proposed findings of fact and conclusions of law to the district court." *Id.* (quoting 11 U.S.C. § 157(c)(1)). The bankruptcy court may only hear and determine the "non-core" proceeding if the parties consent. *Id.* at 2172 (citing 11 U.S.C. § 157(c)(2)).

In *Stern*, the Supreme Court held that Article III of the Constitution precludes Congress from assigning certain "core" bankruptcy proceedings involving private-right controversies to non-Article III bankruptcy judges for final adjudication. 131 S. Ct. at 2608. Because the tort claim at issue in *Stern* was fundamentally a state law claim and did not implicate a public right, it was only amenable to final determination and entry of judgment by an Article III judge, at least absent the parties' consent otherwise. *Id.* at 2611.

B. The Background of *Arkison*

Arkison arises out of the Chapter 7 bankruptcy proceedings of the Bellingham Insurance Agency, Inc. ("BIA"). 134 S. Ct. at 2168. The bankruptcy trustee, Peter Arkison (the "Trustee") filed a complaint in the bankruptcy court, asserting federal and state law claims against Executive Benefits Insurance Company ("EBIA") and others. *Id.* The Trustee alleged that assets that should have been part of BIA's bankruptcy estate were fraudulently transferred to EBIA. EBIA's answer denied the Trustee's allegations. *Id.* The bankruptcy court granted summary judgment on the Trustee's claims, including the fraudulent conveyance claims, and EBIA appealed to the district court. *Id.* After *de novo* review, the district court affirmed the bankruptcy court's decision and entered judgment for the Trustee. *Id.*

EBIA appealed to the Ninth Circuit. While the appeal was pending in the Ninth Circuit, the Supreme Court decided *Stern*. EBIA thereafter argued on the basis of *Stern* that the bankruptcy court lacked the authority to decide the fraudulent conveyance claims. *Id.* The Ninth Circuit rejected EBIA's argument and affirmed the district court, holding that while Article III did not permit the bankruptcy court to enter final judgment on the fraudulent conveyance claims in the absence the parties' consent, EBIA had "impliedly consented to the Bankruptcy Court's jurisdiction and therefore the Bankruptcy Court's adjudication of the fraudulent conveyance claim was permissible." *Id.* In addition, the Ninth Circuit noted that the "Bankruptcy Court's judgment could instead be treated as proposed findings of fact and conclusions of law, subject to *de novo* review by the District Court." *Id.* at 2170 (*citing In re Bellingham Ins. Agency, Inc.,* 703 F.3d 553 (2012)).

C. The Court's Decision

The Supreme Court granted *certiorari* in *Executive Benefits Ins. Agency v. Arkison* to address two questions left open after *Stern*: (1) whether Article III of the Constitution permits bankruptcy judges to exercise the judicial power of the United States to finally decide a private-right controversy on the basis of litigant consent, and, if so, whether a litigant's conduct can constitute "implied" consent; and (2) whether a bankruptcy judge may submit proposed findings of fact and conclusions of law for *de novo* review in the district court in a "core" proceeding under 28 U.S.C. § 157(b). The Court did not reach the first question, but answered the second in the affirmative. In a unanimous decision entered on June 9, 2014, the Court held that when the

Constitution does not permit a bankruptcy court to enter final judgment on a "core" claim, the Bankruptcy Code nevertheless permits a bankruptcy court to issue proposed findings of fact and conclusions of law subject to *de novo* in the district court. *Arkison*, 134 S. Ct. at 2168. In this case, the "core" fraudulent conveyance claims were within the scope of section 157(c)(1), and the district court's *de novo* review and entry of a separate judgment cured any potential error in the bankruptcy court's entry of final judgment. *Id.* at 2174. Accordingly, the Court affirmed the Ninth Circuit's decision. *Id.*

1. Stern *claims may statutorily proceed as non-core within the meaning of § 157(c)(1).*

Because bankruptcy judges cannot finally decide *Stern* claims (at least without the parties' consent), but are only expressly authorized to issue proposed findings of fact and conclusions of law on non-core claims, petitioners argued that there was a statutory "gap" and that bankruptcy courts were powerless to take any action with respect to *Stern* claims. *Id.* at 2172. The Court disagreed and concluded that the plain text of the statute's severability provision closed any statutory gap. *Id.* at 2173. The severability provision instructs that where a "provision of the Act or [its] application ... is held invalid, the remainder of th[e] Act ... is not affected thereby." *Id.* (*citing* 98 Stat. 344, note following 28 U.S.C. § 151). The Court explained that "[w]hen a court identifies a *Stern* claim, it has 'held invalid' the 'application' of § 157(b)— i.e. the 'core' label and its attendant procedures." *Id.* The "remainder … not affected thereby" includes § 157(c). *Id.* at 2173 (*quoting* 98 Stat. 344). Accordingly, the Court held that where a *Stern* claim otherwise satisfies section 157(c)(1), the bankruptcy court should simply treat the claim as non-core and submit proposed findings of fact and conclusions of law to the district court for *de novo* review and entry of judgment. *Id.*

The Court concluded that this approach accords with the Court's general approach to severability, whereby the Court "ordinarily give[s] effect to valid portions of a partially constitutional statute so long as it 'remains fully operative as a law,' and so long as it is not 'evident' from the statutory text and context that Congress would have preferred no statute at all." *Id.* at 2173 (internal citations omitted). Neither concern was present in *Arkison*, and because the petitioners presented no evidence from the statute's text or historical context that made it "evident" that Congress would prefer to suspend *Stern* claims in limbo, section 157(c) could "be applied naturally to *Stern* claims." *Id.* Moreover, the Court noted that if the severability clause did not apply and district courts, rather than bankruptcy courts, were required to hear all *Stern* claims in the first instance, the division of responsibility set by Congress would be dramatically altered. *Id.* at 2173 n.8.

2. Section 157(c)(1)'s procedures apply to the fraudulent conveyance claims in this case.

After determining that *Stern* claims may proceed under the same procedural framework as non-core claims in section 157(c)(1), the Court next confronted the issue of whether the fraudulent conveyance claims brought by the trustee were within the scope of section 157(c)(1)— proceedings "otherwise related to a case under title 11." *Stern*, 131 S. Ct. at 2174 (citing 11 U.S.C. § 157(c)(1)).

First, the Court assumed, without deciding, that the fraudulent conveyance claims were *Stern* claims, as held by the Ninth Circuit and undisputed by the parties. *Id.* Second, the Court held that the fraudulent conveyance claims were "self-evidently related to a case under title 11" because the claim asserts that the property in question "should have been part of the bankruptcy estate and therefore available for distribution to creditors pursuant to Title 11 and was improperly removed." *Id.* (internal citations omitted). Thus, the Court held that section

157(c)(1)'s procedures did apply, stating that the "[fraudulent conveyance] claims fit comfortably within the category of claims governed by [the provision]" and that therefore the bankruptcy court was permitted to follow the non-core procedure, i.e. submit proposed findings of fact and conclusions of law for the district court's review *de novo*. *Id*.

3. The district court's de novo review and entry of its own valid final judgment cured any potential error in the Bankruptcy Court's entry of judgment.

EBIA contended "that it was constitutionally entitled to review by an Article III court regardless of whether the parties consented to adjudication by a bankruptcy court," and in the alternative, that even if adjudication by consent were constitutionally permissible, it did not in fact consent. *Id.* The Court declined to decide EBIA's consent arguments because the district court conducted a *de novo* review of the summary judgment claims and, in accordance with its statutory authority over matters related to bankruptcy under section 1334(b), separately entered judgment in favor of the Trustee. *Id.* The Court therefore held that even if the bankruptcy court's entry of judgment was invalid, any error was cured because the district court "[i]n effect" provided "the same review" that EBIA claimed it was entitled to under Article III. *Id.*

Because the Court concluded that EBIA actually received what it claimed it was entitled constitutionally to receive, the case did not require the Court to address whether Article III permits a bankruptcy court, with the consent of the parties, to enter final judgment on a *Stern* claim or whether EBIA in fact consented to the bankruptcy court's adjudication of the Trustee's fraudulent conveyance claims. *Id.* at 2169 n.4. The Court explicitly reserved that question for another day. *Id.*

15369706.1.LITIGATION

Standing in the Bankruptcy Arena

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I. <u>General Requirements Under Article III</u>

The Supreme Court has held that to have standing under Article III of the Constitution, a plaintiff must establish:

(1) an injury in fact (*i.e.,* a „concrete and particularized‟ invasion of a „legally protected interest‟);
(2) causation (*i.e.,* a „fairly ... trace[able]‟ connection between the alleged injury in fact and the alleged conduct of the defendant); and
(3) redressability (*i.e.,* it is „likely‟ and not „merely speculative‟ that the plaintiff‟s injury will be remedied by the relief plaintiff seeks in bringing suit").

Sprint Communications Co., L.P. v. APCC Services, Inc., 554 U.S. 269, 273-274 (2008) (quoting *Lujan v. Defenders of Wildlife*, 504 U.S. 555, 560-561 (1992)). *See also Kerr v. Hickenlooper,* 759 F.3d 1186, 1189 (10th Cir. 2014) ("The Article III standing requires the plaintiff to have a suffered an „injury in fact,‟ a causal connection between the injury and the challenged conduct, and that the injury be redressable by a favorable decision."). The legally protected interest need not necessarily be an economic interest. *See, e.g., Lujan,* 504 U.S. at 562-563 (holding the "desire to use or observe an animal species, even for purely esthetic purposes, is undeniably a cognizable interest for purpose of [Article III] standing").

Article III limitations on jurisdiction apply to bankruptcy courts because bankruptcy courts‟ jurisdiction is derived from the jurisdiction vested in the districts courts. *Kilen v. United States (In re Kilen)*, 129 B.R. 538, 542 (Bankr. N.D. Ill. 1991).

II. <u>Standing in Bankruptcy Appeals</u>

A. *Qualifying as a "person aggrieved" with prudential standing to appeal*

In addition to constitutional standing, appellate review of bankruptcy court decisions is limited by the principle of prudential standing; the appellant must be a "person aggrieved." "Persons aggrieved" are "those persons whose rights or interests are „directly and adversely affected pecuniarily‟ by the decree or order of the bankruptcy court." *Holmes v. Silver Wings Aviation, Inc*., 881 F.2d 939, 940 (10th Cir. 1989). "[W]ithout such a requirement, bankruptcy litigation could easily "become mired in endless appeals brought by a myriad of parties who are indirectly affected by every bankruptcy court order." *Id.*

In *In re Krause,* 637 F.3d 1160, 1167 (10th Cir. 2011), the bankruptcy court ruled that an entity called Drake Enterprises was the alter ego of the debtor and entered a sanction order requiring Drake to turn over property of the estate. Those affected by the bankruptcy court‟s

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[1] I thank my law clerk, Jaya Rhodes, for her assistance preparing this paper.

ruling, the debtor and his wife, did not seek to appeal. Instead, their sons appealed. Because the sons had no interest whatsoever in Drake enterprises, the Tenth Circuit determined their connection to the sanction order was too tenuous to confer prudential standing to appeal. The court also noted that because prudential standing is not jurisdictional, "a sticky prudential standing question may be bypassed in favor of deciding the case on the merits when it‟s clear that the appellant will lose there anyway." *Id.* at 1168.

Prudential standing "is more stringent in bankruptcy appeals than the case or controversy standing requirement of Article III." *C.W. Mining Co. v. Aquila, Inc. (In re C.W. Mining Co.)*, 636 F.3d 1257, 1261, n. 5 (10th Cir. 2011). For example, prudential standing to appeal, unlike Article III standing, is limited to direct pecuniary harm.

B. *Standing to appeal also requires Article III standing*

In *C & A Const. Co. v. DHC Development,* 2012 WL 5383062, * 12 (10th Cir. 2012), the Chapter 7 debtor wished to vacate or reduce a judgment against it. The debtor‟s liabilities exceeded its assets by at least $9 million. The Tenth Circuit held that in addition to lacking prudential standing, a hopelessly insolvent Chapter 7 debtor lacks constitutional standing to appeal because it could not demonstrate any injury to its pecuniary interests that would be redressed by a judgment in its favor.

III. <u>Standing Before the Bankruptcy Court</u>

A. *Prudential standing*

At the trial court level, "prudential standing encompasses „the general prohibition on a litigant‟s raising another person‟s legal rights, the rule barring adjudication of generalized grievances more appropriately addressed in the representative branches, and the requirement that a plaintiff‟s complaint fall within the zone of interests protected by the law invoked.‟" *Elk Grove Unified Sch. Dist. v. Newdow*, 542 U.S. 1, 12 (2004) (quoting *Allen v. Wright*, 468 U.S. 737, 751 (1984)).

In *In re Heathtrio, Inc.,* 2013 WL 6500478 (Bankr. D.Colo. 2013), the bankruptcy court entered an order for relief granting an involuntary petition under Chapter 7. Several creditors sought to set aside the order under Rule 60(b). The court determined the creditors did not have prudential standing because the order was entered against the debtor and the creditors were in effect seeking to vindicate the debtor‟s legal rights, not their own. *See also In re Grason,* 486 B.R. 448, 460 (Bankr. C.D.Ill. 2013) (prospective buyer of debtor‟s property, who was not a creditor or other party in interest in the bankruptcy case, lacked prudential standing to contest debtor‟s eligibility for Chapter 13 on behalf of the foreclosing creditor).

B. *Creditor's standing to seek stay relief*

To have standing to seek stay relief to collect a debt from the debtor, an entity or individual must be a "creditor," meaning that it has a right to payment from the debtor. *Miller v. Deutsche Bank National Trust Co. (In re Miller),* 666 F.3d 1255, 1262 (10th Cir. 2012). In

Miller, the bankruptcy court granted stay relief to a bank without determining whether the bank physically possessed the note evidencing the debt secured by the subject property. The debtors appealed, arguing that the bank was not a "party in interest" entitled to seek stay relief. The Tenth Circuit, applying Colorado‟s version of the UCC, determined that to demonstrate standing the bank had to prove: (1) it was the successor holder of the note; and (2) it obtained physical possession of the note from the original noteholder. The Tenth Circuit reversed the bankruptcy court because the evidence below was insufficient to establish that the bank had possession of the note; therefore, granting the bank‟s request for stay relief was deemed an abuse of discretion.

Shortly after *Miller* was issued, the Tenth Circuit BAP clarified what level of proof is required to show that a bank has standing to seek stay relief. *See In re Thomas,* 469 B.R. 915 (10th Cir. BAP 2012). The court held that the movant "must prove that it has a „colorable claim‟ to an ownership interest in the [p]roperty or, in other words, „a facially valid security interest,‟" to seek stay relief. The evidence necessary to prove such colorable claim "should include a demonstration that the movant has the right under applicable state law to enforce the mortgage; however, standing should not require evidence which would be necessary to prevail over a claim objection or to prevail in an adversary proceeding asserting that the claimant does not hold a valid, perfected and enforceable lien." *Id. at* 923 (internal quotations omitted).

C. *Article III versus prudential standing/real-party-in-interest*

In *Smith v. United Parcel Service,* 578 Fed.Appx. 755 (10th Cir. 2014) (unpublished), the Tenth Circuit addressed the difference between standing and real-party-in-interest principles. There the defendant asserted the Chapter 7 trustee, not the debtor, had standing to pursue the debtor‟s prepetition employment discrimination claims. The court observed:

> [Debtor‟s] employment discrimination claims satisfy the minimum constitutional requirements for standing -- a concrete injury, causation, and redress.… The question is who is the real party in interest to prosecute the claims. … Upon the filing of the bankruptcy petition and the appointment of a bankruptcy trustee, the trustee became the real party in interest, and he was the only one who could prosecute claims belonging to the bankruptcy estate. … [Debtor‟s] legal rights and interest in any pending litigation were extinguished, and his rights transferred to the trustee, who acts on behalf of the bankruptcy estate.

The Tenth Circuit concluded that despite the debtor‟s constitutional standing, only the trustee could pursue the employment discrimination claims.

D. *When Chapter 7 debtors have standing even though there is an insolvent estate*

Courts have held that Chapter 7 debtors have a stake in the outcome of certain matters regardless of whether a surplus exists. For example, they may object to an involuntary petition filed under 11 U.S.C. § 303 or litigate an objection to a claim of exemption. Chapter 7 debtors also have standing to participate in a nondischargeability or discharge action regardless of whether a surplus will exist.

Chapter 7 debtors may have standing to object where the outcome of the matter could affect the amount of the distribution to a creditor whose claim will not be discharged. As one court reasoned:

> [T]o the extent that a nondischargeable claim is satisfied in some measure by a distribution, it is in the debtor‟s interest to maximize that distribution so that the debtor will be relieved from some or all of the claim of that creditor which would survive the bankruptcy case.

In re Zendeli, 2012 WL 1565305, *1 (Bankr. W.D. Mo. 2012).

See also In re Lona, 393 B.R. 1, 4 (Bankr. N.D. Cal. 2008) (noting that debtors may object to a claim that will not be discharged); *In re Ellis,* 2014 WL 1725810 (Bankr. S.D. Ind. 2014) ("[A] chapter 7 debtor with a nondischargeable debt has standing to object to the trustee‟s fee application because it may result in more money being freed up to pay a greater distribution on the nondischargeable claim."); *In re McGuirl,* 86 F.3d 1232, 1235 (D.C.Cir.1996) (reasoning that "[b]ecause all of the McGuirls‟ debts are non-dischargeable, any reduction in administrative expenses will necessarily reduce the amount of non-dischargeable claims that remain unpaid and for which the McGuirls would be liable post-bankruptcy).

In re Knight-Celotex, LLC, 695 F.3d 714, 720 (7th Cir. 2012) addressed the issue of whether a debtor has standing to object to the assignment of a claim where the movant only seeks to recover from the debtor‟s insurer. The Seventh Circuit found a strong possibility that at least some of the claims would be nondischargable based on fraud in the individual debtor‟s personal bankruptcy. Since the policy was a "wasting" policy and excluded coverage for intentional fraudulent acts, the court therefore concluded that the individual debtor had standing to object because he faced potential liability notwithstanding the insurance coverage.

E. *When Chapter 7 debtors lack standing because the estate is insolvent*

Often, to have standing in a contested matter a Chapter 7 debtor must show a reasonable possibility of surplus after satisfying all debts.

In re Brutsche, 500 B.R. 62, 72 (Bankr. D.N.M. 2013) held that to have standing to object to a proposed settlement, the debtor out of possession:

> [M]ust have a financial interest in the outcome of the proposed settlement agreement. *See In re Stinnett,* 465 F.3d 309, 315 (7th Cir. 2006); *In re Lunan*, 523 Fed.Appx. 339, 340 (6th Cir. 2013). To demonstrate this, the debtor must show a reasonable possibility of surplus after satisfying all debts. *See In re Cult Awareness Network, Inc.,* 151 F.3d 605, 608 (7th Cir. 1998); *In re East 80th Street Equities, Inc*., 218 F.3d 109, 116 (2d Cir. 2000). The debtor must offer some evidence that a surplus may result, not just that there is a theoretical chance of a surplus. *See In re Lunan*, 523 Fed.Appx. at 340; *In re Rybka*, 339 B.R. 464 (Bankr. N.D. Ill. 2006).

Likewise, generally Chapter 7 debtors must show there exists a surplus estate to have standing to object to a sale of property under 11 U.S.C. § 363. *See In re 60 East 80 Street Equities, Inc.,* 218 F.3d 109, 115 (2d Cir. 2000) ("It is well-established that a Chapter 7 debtor is a „party in interest‟ and has standing to object to a sale of the assets, or otherwise participate in litigation surrounding the assets of the estate, only if there could be a surplus after all creditors‟ claims are paid.").

F. *The relationship between 11 U.S.C. § 1109 and Article III*

Section 1109(b) addresses statutory standing in Chapter 11 cases. It states:

> A party in interest, including the debtor, the trustee, a creditors‟ committee, an equity security holders‟ committee, a creditor, an equity security holder, or any indenture trustee, may raise and may appear and be heard on any issue in a case under this chapter.

Several circuits have commented on the interplay between § 1109 and Article III.

The Third Circuit has held that "Article III standing and standing under § 1109 are effectively coextensive[]," adopting the "legally protected interest" test as a "helpful amplification" of its "sufficient stake in the proceeding[s]" test. *In re Global Indus. Technologies, Inc,* 645 F.3d 201, 210-211 (3d Cir. 2011). The court reasoned that "[i]nterpreting the „party in interest‟ requirement as an additional obstacle to bankruptcy standing would frustrate the purpose of § 1109(b), which was intended to confer broad standing at the trial level and to continue in the tradition of encouraging and promoting greater participation in reorganization cases." *Id.* at 211 (internal quotations and citations omitted).

The Seventh Circuit determined that § 1109(b) was not intended to confer standing on only those identified in the statute, but rather was meant to give standing to "anyone who has a legally protected interest that could be affected by a bankruptcy proceeding." *In re James Wilson Assocs.,* 965 F.2d 160, 169 (7th Cir. 1992). The court noted that "everyone with a claim to the res has a right to be heard before the res is disposed of since that disposition will extinguish all such claims." *Id.*

The Fourth Circuit has observed: "Although the Code does not define the term „party in interest,‟ the term is generally understood to include all persons whose pecuniary interests are directly affected by the bankruptcy proceedings." *In re Hutchinson,* 5 F.3d 750, 756 (4th Cir. 1993) (internal quotations and citations omitted).

The Ninth Circuit appears to construe § 1109(b) as creating an additional limitation on standing. It has held that "[t]o have standing in bankruptcy court, Appellants must meet three requirements: (1) they must meet statutory „party in interest‟ requirements under § 1109(b) of the bankruptcy code; (2) they must satisfy Article III constitutional requirements; and (3) they must meet federal court prudential standing requirements." *In re Thorpe Insulation Co*., 677 F.3d 869, 884 (9th Cir. 2012). Other influential courts have taken this approach. *See, e.g., In re Teligent, Inc*., 417 B.R. 197, 210 (Bankr. S.D.N.Y. 2009) ("Generally, a „party in interest‟ with respect to a particular issue will also meet the requirement for Article III standing with respect to that issue. Thus, the inquiries overlap. A party in interest must still satisfy the prudential limitations on standing, and cannot raise the rights of a third party even though it has a financial stake in the case.") (internal citations omitted).

In re C.W. Mining Company and Standing

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Questions of "standing" or authority to take action are often present in bankruptcy litigation, and the implications of standing can be significant. In I*n re C.W. Mining Company*, 636 F.3d 1257 (10^{th} Cir. 2011) ("C.*W. Mining*"), the United States Court of Appeals for the Tenth Circuit addressed standing in the bankruptcy context, and rendered an opinion that is grounded in bedrock principles and which recognizes the different interests of different parties in interest at different times in a bankruptcy case. Nonetheless, the Tenth Circuit's opinion is often misunderstood or misconstrued. This paper, and our discussion at the 2015 ABI Rocky Mountain Conference, are intended to bring understanding and clarity to the analysis.

Legal Principles

Article III of the Constitution limits the jurisdiction of federal courts to "cases" and "controversies." U.S. Const. Art. III, § 2. The concept of "standing" is built into Article III's requirements and limitations. To establish Article III standing, "a plaintiff must show (i) an 'injury in fact,' (ii) a sufficient 'causal connection between the injury and the conduct complained of,' and (iii) a 'likel[ihood]' that the injury 'will be redressed by a favorable decision.'" *See Susan B. Anthony List v. Driehaus*, 134 S.Ct. 2334, 2341 (2014) (quoting *Lujan v. Defenders of Wildlife*, 504 U.S. 555, 560 (1992)).

In re C.W. Mining Company

The C.W. Mining case involved an involuntary chapter 11 bankruptcy filing. *C.W. Mining*, 636 F.3d 1257, 1259 (10^{th} Cir. 2011). Involuntary relief was granted, and the debtor sought reconsideration of that ruling. Shortly thereafter the chapter 11 case was converted to a chapter 7 liquidation. *Id*. A chapter 7 trustee was appointed. A week later the pending motion to reconsider was denied, and shortly after that, the debtor's former counsel, claiming to act on behalf of the debtor through former management ("Management"), appealed that ruling. *Id*.

On appeal to the Bankruptcy Appellate Panel ("BAP") the trustee sought to have the appeal dismissed, arguing (i) that the debtor was hopelessly insolvent and lacked standing to appeal after the trustee was appointed, and (ii) that's the debtor's former counsel, purporting to act on behalf of the debtor through Management, was not authorized to file an appeal on behalf of the debtor in the first instance. *Id*. The BAP denied the motion to dismiss, but affirmed the bankruptcy court on the merits. *Id*. Management then appealed to the Court of Appeals. *Id*.

The Court of Appeals began by phrasing the issue before it as follows:

> This case turns on a simple question – following appointment of a Chapter 7 trustee in a corporate debtor's bankruptcy, may former management appeal an adverse bankruptcy court ruling *on the debtor's behalf*?

Id. at 1260 (emphasis supplied).

The Tenth Circuit's analysis began with an explanation of the test for determining whether a party has *standing to appeal* a ruling of the bankruptcy court. This analysis addressed the question of whether the *debtor*, C.W. Mining, had standing to appeal (which question is separate and distinct from the question of whether *Management* had standing to act *on behalf of the debtor* post-appointment of the trustee). "[S]tanding 'is more stringent in bankruptcy appeals that the case or controversy requirement of Article III.'" *Id*. at 1261 n.5. In the Tenth Circuit, in order for a party in interest to have standing to appeal they must satisfy the "person aggrieved" test, which is a "prudential limitation" rather than an Article III requirement. *Id*. In order to qualify as a "person aggrieved" and be able to pursue an appeal, a party's "rights or interests must be 'directly and adversely affected pecuniarily by the decree or order of the bankruptcy court.'" *Id*. (citing *Holmes v. Silver Wings Aviation, Inc*., 881 F.2d 939, 940 (10th Cir. 1989)).

In general, "[u]nless the estate is solvent and excess will eventually go to the debtor, or unless the matter involves rights unique to the debtor, the debtor is not a party aggrieved by orders affecting the administration of the bankruptcy estate." *Id*. at 1260. Although the trustee argued that the debtor was hopelessly insolvent, the Court of Appeals recognized (in a footnote) that in the context of an appeal challenging the commencement of an involuntary case, "being forced into bankruptcy certainly injured the company" and that the debtor, C.W. Mining, satisfied the "person aggrieved" standard. *Id*. at 1260-61, 1261 n.5.

The Court of Appeals then addressed the more narrow question in the case – "whether the Managers [had] authority to appeal *on C.W.'s behalf*." *Id*. at 1261. In addressing this point it is important to recall that Management did *not* purport to appeal on behalf of individual managers based on a claim that those individuals were creditors or were harmed by entry of the order on appeal; to the contrary, they purported to appeal *on behalf of the debtor itself*. *See id*. at 1261-1263. In other words, they continued to act as management. They asserted no independent, personal rights or harm.

Looking to the Supreme Court's opinion in *Commodity Futures Trading Commission v. Weintraub*, 471 U.S. 343 (1985), the Tenth Circuit recognized that once a trustee in bankruptcy is appointed, *only the trustee* may act on behalf of the debtor. *Id*. at 1262. Accordingly, the Court of Appeals found that only the trustee could appeal on behalf of C.W. Mining, and emphasized that the rule granting exclusive authority to the trustee "was created 'as a means to control, in an orderly manner, proceedings that often involve numerous creditors . . . .'" *Id*. Looking to its prior decision in *Log Furniture, Inc. v. Call*, 180 Fed. Appx 785, 787-88 (10th Cir. 2006) (unpublished), the Court of Appeals affirmed the principle that "[t]he only person with standing or legal capacity to represent [the Debtor] in any litigation, including these appeals, is its Trustee." *C.W. Mining*, 636 F.3d at 1263 (citing *Log Furniture, Inc*., *supra*).

Management asked the Court of Appeals to recognize an equitable exception to this rule, based on a claim of unfairness in not allowing the involuntary debtor, C.W. Mining, to appeal. The Court of Appeals rejected this approach:

> No one took away C.W.'s right to appeal. As discussed above, C.W. – the corporate entity – may in fact have standing to appeal as a "person aggrieved." But C.W.'s standing does not authorize the Managers to act on C.W.'s behalf.

Id. at 1264.

<u>Practice Points</u>

There are a few things that the Managers did not do in *C.W. Mining* that could have made a substantial impact on the case.

First, although the Managers opposed and appealed the bankruptcy court's decision to grant involuntary relief, they (i) did not object to the motion seeking appointment of a chapter 11 trustee, (ii) did not object to the motion to convert to chapter 7, and (iii) did not object to the appointment of a chapter 7 trustee. If the Managers had asserted objections to these matters, the case may have come out differently.

Second, the Managers did not seek a stay pending appeal of the ruling on the involuntary petition. Had a stay been put in place, it could have prevented the trustee from being put in control of the debtor and being given exclusive authority to make decisions on behalf of the debtor.

Third, the Managers did not assert any personal or individual rights or claims as a basis for standing. Had the Managers been able to assert claims or interests sufficient to overcome an objection based on standing, they may have been able to pursue their appeal on their own behalf, rather than on behalf of the debtor entity.

Conclusion

The "standing" requirement in federal litigation is grounded in Article III of the Constitution. In bankruptcy cases, courts often apply "prudential limitations" that are more stringent than Article III's requirements, owing to the unique nature of bankruptcy proceedings. Cases like *C.W. Mining* demonstrate that a failure to demonstrate standing can be fatal to a party's position, and that careful consideration must be given as to how to proceed in the various aspects of a bankruptcy case in order to properly assert, and protect, standing.

Excerpts taken from

PREFERENCES ARE PUBLIC RIGHTS

BROOK GOTBERG

2013 Wis. L. Rev. 1356

In the wake of the Supreme Court's decision in *Stern v. Marshall*, there is widespread uncertainty as to what other proceedings may constitutionally fall within a bankruptcy court's core jurisdiction. The Supreme Court has identified a "public rights exception" to the general rule that the judicial power must be exercised only by judges with life tenure and salary protection. The reasoning of the Court strongly suggests that a trustee's motion to avoid preferences would fall under the public rights exception, as a proceeding stemming exclusively from bankruptcy law and necessary to resolve claims against the estate.

. . . In each case where the Court has addressed the jurisdictional authority of bankruptcy judges, it has raised the issue of "public rights," a concept first identified in the mid-1800s, but notoriously vague and largely undefined.[1] The Court has stated that public rights, as distinguished from private rights, are "integrally related to particular federal government action"[2] and "must at a minimum arise 'between the government and others.'"[3] However, the Court has been reluctant to positively identify specific bankruptcy proceedings as falling inside the category of public rights.[4] In cases involving public rights, the Court has reiterated time and again, final adjudication outside an Article III court is warranted and permissible, but those

1. *See* S. Todd Brown, *Constitutional Gaps in Bankruptcy*, 20 AM. BANKR. INST. L. REV. 179, 202 (2012); Kenneth G. Coffin, *Limiting Legislative Courts: Protecting Article III from Article I Evisceration*, 16 BARRY L. REV. 1, 5 (2011).
2. *Stern v. Marshall*, 131 S. Ct. 2594, 2613 (2011).
3. *N. Pipeline Constr. Co. v. Marathon Pipe Line Co.*, 458 U.S. 50, 69 (1982) (quoting *Ex Parte Bakelite Corp.*, 279 U.S. 438, 451 (1929)).
4. *Murphy v. Felice* (*In re Felice*), 480 B.R. 401, 412–13 (Bankr. D. Mass. 2012); *see* Tyson A. Crist, Stern v. Marshall: *Application of the Supreme Court's Landmark Decision in the Lower Courts*, 86 AM. BANKR. L.J. 627, 627–28.

charged with implementing Supreme Court decisions in bankruptcy legislation and legal rulings are left to surmise what actually qualifies as a public right.[5] The Court has identified some boundaries by excluding counterclaims by the estate against a creditor who has filed a claim[6] and fraudulent conveyance proceedings against a creditor who has not filed a claim[7] from the category of public rights. Other courts have expanded on these rulings, concluding that actions by the trustee to recover preferential transfers, which are payments made by the debtor to a creditor in the ninety days prior to bankruptcy, must also be outside this category such that a bankruptcy judge may not enter a final judgment in preference proceedings.[8]

The conclusion that preference proceedings, by virtue of their similarities to fraudulent conveyance proceedings,[9] are outside the authority of bankruptcy judges to issue final judgments is misguided. Up to now, the justification for treating preferences like fraudulent conveyances has focused on the cosmetic similarities between the two types of proceedings, with little attention given to differences relevant to the public rights/private rights distinction. Focusing on those differences, it becomes clear that preferences, which stem exclusively from bankruptcy law and are necessary in resolving claims against the estate, are public rights and thus may be administered by non-Article III judges under the public rights doctrine.

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5. *See generally* Brown, *supra* note 1, at 202.
6. *Stern*, 131 S. Ct. at 2608.
7. *Granfinanciera, S.A. v. Nordberg*, 492 U.S. 33, 55 (1989).
8. *See Meoli v. Huntington Nat'l Bank* (*In re Teleservices Grp., Inc.*), 469 B.R. 713, 717 (Bankr. W.D. Mich. 2012); *Tabor v. Kelly* (*In re Davis*), No. 05-15794-GWE, Adv. No. 07-05181-L, 2011 WL 5429095, at *12 (Bankr. W.D. Tenn. Oct. 5, 2011). *But see Zazzali v. 1031 Exch. Grp.* (*In re DBSI, Inc.*), 467 B.R. 767, 772–73 (Bankr. D. Del. 2012) (holding that bankruptcy courts have the constitutional authority to enter final judgments in preference proceedings); *Burns v. Dennis* (*In re Se. Materials, Inc.*), 467 B.R. 337, 367 (Bankr. M.D.N.C. 2012); *West v. Freedom Med., Inc.* (*In re Apex Long Term Acute Care-Katy, L.P.*), 465 B.R. 452, 468 (Bankr. S.D. Tex. 2011).
9. This Article presumes, as the Ninth Circuit has held, that the holding in *Granfinanciera* is sound and that it signifies that fraudulent conveyances are outside the realm of public rights in both in the jury trial and Article III context. . . . [T]his Article demonstrates that even assuming fraudulent conveyances are not public rights, as the Supreme Court has stated, see *Granfinanciera*, 492 U.S. at 55, and therefore outside a bankruptcy judge's permitted authority to issue final judgments, as the Ninth Circuit has concluded, see *In re Bellingham Ins. Agency Inc.*, 702 F.3d at 562, preferences are public rights and are constitutionally within a bankruptcy judge's ability to issue final rulings.

This paper makes the case that bankruptcy judges rightly possess the constitutional authority to issue final rulings in preference proceedings. . . .

[THE PUBLIC RIGHTS DOCTRINE]

It is generally accepted among scholars that the first manifestation of the public rights doctrine, and perhaps the first recognition that the exercise of executive or legislative authority might interfere with the judicial branch's constitutional authority, arose in the case commonly referred to as *Murray's Lessee*.[10] . . .

In upholding the congressional action, Justice Benjamin Curtis rejected the argument that the actions taken constituted an exercise of Article III judicial power.[11] Although "the auditing of the accounts of a receiver of public moneys may be, in an enlarged sense, a judicial act,"[12] he argued,

> [T]here are matters, involving public rights, which may be presented in such form that the judicial power is capable of acting on them, and which are susceptible of judicial determination, but which congress may or may not bring within the cognizance of the courts of the United States, as it may deem proper.[13] [. . .]

After several decades of relative obscurity,[14] discussion of public rights resurfaced dramatically in the monumental case of *Northern Pipeline v. Marathon*.[15] There, the Court rejected the appellants' argument that the bankruptcy law should be upheld by virtue of the public rights doctrine, noting that the public rights doctrine is limited to matters arising "'between the Government and persons subject to its authority . . . '"[16] and in the case at hand,

10. *See, e.g.*, Alec P. Ostrow, *Constitutionality of Core Jurisdiction*, 68 AM. BANKR. L.J. 91, 95 n.33 (1994); Robert G. Skelton & Donald F. Harris, *Bankruptcy Jurisdiction and Jury Trials: The Constitutional Nightmare Continues*, 8 BANKR. DEV. J. 469, 477 (1991); Gordon G. Young, *Public Rights and the Federal Judicial Power: From* Murray's Lessee *through* Crowell *to* Schor, 35 BUFF. L. REV. 765, 789–95 (1987).
11. *Id.* at 280–81.
12. *Id.* at 280.
13. *Id.* at 284.
14. [Footnote omitted for space.]
15. 458 U.S. 50 (1982).
16. *Id.* at 67–68 (quoting *Crowell*, 285 U.S. at 50).

the issue was one of "'the liability of one individual to another . . . [,]'"[17] a matter "'inherently . . . judicial'" in nature.[18] The Court did not explicate the distinction between public and private rights, but recognized the doctrine as sound, if inapplicable to the challenged proceeding.

The Court made reference to the public rights doctrine again in *Granfinanciera* [, suggesting that actions to recover a fraudulent conveyance do not constitute a "public right".] . . .

[THE PUBLIC RIGHTS NATURE OF PREFERENCES]

. . . Application of the public rights doctrine reveals that the differences between preferences and fraudulent conveyances are sufficient to justify different constitutional treatment; preferences qualify as public rights, even if fraudulent conveyances do not. This conclusion is bolstered by the hesitation expressed by the Court in finding that fraudulent conveyances should be categorized as private, rather than public rights,[19] and its indication in *Stern* that a preference action would call for a different outcome than the result in that case.[20] The Court in *Granfinanciera* acknowledged the "debate" surrounding this issue, suggesting that a few slight differences would and are sufficient for analysis of a similar, but distinct proceeding, to reach a contrary outcome.[21] The Court in *Stern* contrasted the counterclaim against preference actions to

17. *Id.* at 69–70 (quoting *Crowell*, 285 U.S. at 51).

18. *Id.* at 68 (quoting *Ex parte Bakelite Corp.*, 279 U.S. 438, 458 (1929)). *See also* Baird, *supra* note **Error! Bookmark not defined.**, at 6 (noting that "resolving a contest between two creditors" is "the ordinary business of courts, and it is exactly what the Framers had in mind when thinking about the judicial power").

19. *See Granfinanciera*, 492 U.S. at 55; *see also id.* at 72–73 (White, J., dissenting) ("*Katchen* makes it clear that when Congress does commit the issue and recovery of a preference to adjudication in a bankruptcy proceeding, the Seventh Amendment is inapplicable.").

20. *Stern*, 131 S. Ct. at 2618 (comparing the preference actions brought in *Katchen* and *Langenkamp* with the claim at issue, noting that "Vickie's claim, in contrast, is in no way derived from or dependent upon bankruptcy law").

21. *See Granfinanciera*, 492 U.S. at 55.

demonstrate that the counterclaim was not a matter of public rights.[22] The contrast suggests, and other factors explained below confirm, that preference actions are public rights.[23] . . .

[P]reference law arose largely from the same concerns that shape the law of fraudulent conveyances, also known as fraudulent transfers.[24] Both sought to punish the debtor for transfers made with the intent to hinder, delay, or defraud creditors. Accordingly, such transfers constituted "acts of bankruptcy," and could cost the debtor a discharge in bankruptcy.[25] [However,] preference law developed away from any intent requirements, reflecting the attitude that the purpose was not to punish an individual creditor, but rather to achieve equitable distribution among all creditors.[26] . . .

[U]nlike preference law, the law of fraudulent conveyance was historically applicable outside of bankruptcy,[27] as it still is today. State law regarding fraudulent conveyances outside of bankruptcy is generally uniform, thanks in large part to the Uniform Fraudulent Conveyance Act (UFCA),[28] which was replaced in 1984 with the Uniform Fraudulent Transfer Act (UFTA).[29] The UFTA has been adopted by forty-three states, as well as the District of Columbia.[30] . . .

The ability of the trustee to incorporate a state law cause of action is the most relevant distinction between preference actions and fraudulent conveyance actions for the purposes of the

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22. *Stern*, 131 S.Ct. at 2618.
23. *See id.*
24. [Footnote omitted.]
25. *See* Vern Countryman, *The Concept of a Voidable Preference in Bankruptcy*, 38 VAND. L. REV. 713, 715–18 (1985).
26. [Footnote omitted.]
27. *See* Countryman, *supra* note 25, at 714. For a thorough history of the origins of the fraudulent conveyance cause of action, *see* 1 GARRAD GLENN, FRAUDULENT CONVEYANCES AND PREFERENCES 79–99 (rev. ed. 1940).
28. The Uniform Fraudulent Conveyance Act (UFCA) was adopted by the National Conference of Commissioners on Uniform Laws in 1918. The UFCA was enacted in twenty-four states and used as a model in many others. ELIZABETH WARREN & JAY LAWRENCE WESTBROOK, THE LAW OF DEBTORS AND CREDITORS 73 (6th ed. 2009).
29. UNIF. FRAUDULENT TRANSFER ACT (1984), 7A PT. II U.L.A. 2 (2006)
30. *Id.* at 2–3.

public rights exception.[31] Courts have generally recognized that private rights are those that most resemble state law claims, or claims that would have been brought under the common law, and actions to set aside fraudulent conveyances, with their frequent and intentional link to state law, are thereby more easily categorized as private rights.[32] However, there is no such link between state law and preference proceedings. This distinction is crucial for purposes of analysis under the public rights doctrine. . . .

In making the case that the counterclaim at issue did not fall within Congress's power to bypass Article III, the Court indicated [in *Stern*] that "the question is whether the action at issue stems from the bankruptcy itself or would necessarily be resolved in the claims allowance process."[33] In so stating, the Court appears to be presenting two mechanisms by which non-Article III adjudication can be justified, or rather, two manifestations of the public rights doctrine. [M]ost preference actions satisfy both prongs of the *Stern* test, accordingly, their final determination before a non-Article III judge should not be in question.[34]

[*Prong One: Preference Actions Stem from Bankruptcy*]

The public rights test suggested by *Stern* is satisfied because preference law stems from the bankruptcy itself, and from no other source. It is widely acknowledged that preference doctrine is

31. The two actions have also historically been treated differently in the courts. *See, e.g.*, John C. McCoid, II, *Right to Jury Trial in Bankruptcy*: Granfinanciera, S.A. v. Nordberg, 65 AM. BANKR. L.J. 15, 22–23 (1991) (observing that historically preference actions were brought in a court of law, whereas fraudulent conveyance actions were typically brought in a court of equity). *But see Granfinanciera, S.A. v. Nordberg*, 492 U.S. 33, 48–49 (1989) (indicating that the preference action in *Schoenthal v. Irving Trust Co.*, 287 U.S. 92 (1932) is "indistinguishable from" the fraudulent conveyance suit at issue).

32. *See Granfinanciera*, 492 U.S. at 55–56.

33. *Stern v. Marshall*, 131 S. Ct. 2594, 2618 (2011); *see also id.* at 2611 (distinguishing the debtor's counterclaim from cases that were "federal claims under bankruptcy law, which would be completely resolved in the bankruptcy process of allowing or disallowing claims").

34. [Footnote omitted.]

a central feature of bankruptcy law.[35] As the Supreme Court recently stated, the authority to avoid preferential transfer "has been a core aspect of the administration of bankrupt estates since at least the 18th century."[36] In addition, preference actions, unlike fraudulent conveyance actions, counterclaims by the estate against creditors, and other similar efforts to "augment" the estate, are strictly creatures of federal law, established by Congress in the Bankruptcy Code itself.

Although the Supreme Court has not issued a ruling on the basis of preference actions' origins in bankruptcy, it has referenced preference law's close relationship with bankruptcy law by way of counterexample. The decision in *Stern* made much of the fact that the debtor's counterclaim was not established by Congress.[37] In finding that the counterclaim did not fall within "the varied formations of the public rights exception," the Court noted "[i]t is not a matter that can be pursued only by grace of the other branches . . . [, i]t does not 'depend[] on the will of congress'; Congress has nothing to do with it."[38] The Court further observed that the "claimed right to relief does not flow from a federal statutory scheme, as in *Thomas*, or *Atlas Roofing*. It is not 'completely dependent upon' adjudication of a claim created by federal law, as in *Schor*."[39] These observations cannot be said for preference actions, which do depend on the will of Congress, and flow entirely and exclusively from a federal statutory scheme. Indeed, the Court in

35. Robert Weisberg, *Commercial Morality, the Merchant Character, and the History of the Voidable Preference*, 39 STAN. L. REV. 3, 3 (1986) ("[T]he preference, unlike its somewhat mismatched partner, the fraudulent conveyance, is strictly a creature of bankruptcy law, rather than a part of nonbankruptcy commercial law that simply receives special enforcement in the bankruptcy process.").

36. *Cent. Va. Cmty. Coll. v. Katz*, 546 U.S. 356, 372 (2006) ("[T]hose who crafted the Bankruptcy Clause would have understood it to give Congress the power to authorize courts to avoid preferential transfers and to recover the transferred property."). *But see Schoenthal*, 287 U.S. at 94–95 (observing that under the bankruptcy act of that time, "[s]uits to recover preferences constitute no part of the proceedings in bankruptcy but concern controversies arising out of it. They may be brought in the state courts as well as in the bankruptcy courts" (citation omitted)).

37. *See Stern*, 131 S. Ct. at 2605.

38. *Id.* at 2614 (quoting *Murray v. Hoboken Land and Improvement Co.* (*In re Murray's Lessee*), 59 U.S. 272, 284 (1855)) (internal citations omitted).

39. *Id.* (quoting *Commodity Futures Trading Comm'n v. Schor*, 478 U.S. 833, 856 (1986))(internal citations omitted).

Stern used preferences to illustrate the distinction between such "public rights" types of cases and the "private right" case at issue.[40]

In addition, and unlike fraudulent conveyance actions addressed in *Granfinanciera*, preference actions are particular to bankruptcy, and have no ties to state law.[41] Preferences are defined by and accordingly exclusive to bankruptcy cases, a step beyond causes of action that arise in or out of the bankruptcy filing.[42] Like the causes of action in *Atlas Roofing* and *Thomas*, preference laws "do[] not depend on or replace a right . . . under state law."[43]

Further, preference actions are a "'particularized area of law'"[44] dealing with a specific set of requirements under a strict liability statute. The Court previously rejected the assertion that counterclaims of the type asserted by the debtor in *Stern* fell within the category of public rights because the authority to determine such counterclaims was "not limited to a 'particularized area of the law,' as in *Crowell, Thomas,* and *Schor*."[45] In contrast, Congress has drafted law regarding preference actions to create a specific cause of action arising only when the particularized standards are satisfied.[46] Analysis of a preference action involves a simple application of the standard to the facts; resolution of preference actions before bankruptcy judges familiar with the standards and accustomed to their application could well be described as an "'expert and

40. *Id.* at 2618. In acknowledging that the Court's language here goes against his argument, Brubaker suggests that this is a "head fake" by the Court. Ralph Brubaker, *A "Summary" Statutory and Constitutional Theory of Bankruptcy Judges' Core Jurisdiction after* Stern v. Marshall, 86 AM. BANKR. L.J. 121, 183 (2012). My concerns regarding this attitude of refusing to take the Court at face value are expressed *supra* Part II.E.

41. *See* McCoid, *Right to Jury Trial*, *supra* note 31, at 41 ("The contours of avoidable preferences are peculiarly the subject of bankruptcy law.").

42. *See In re Ortiz*, 665 F.3d 906, 911–12 (7th Cir. 2011) (finding the proceedings at issue to be outside the public rights doctrine despite the fact that they "would have 'no existence outside of the bankruptcy'" and are "'predicated on the defendants' participation'" in the bankruptcy (quoting *In re Repository Techs., Inc.*, 601 F.3d 710, 719–20 (2010))).

43. *Thomas v. Union Carbide Agric. Prods. Co.*, 473 U.S. 568, 584 (1985); *see also Atlas Roofing v. Occupational Safety & Health Review Comm'n*, 430 U.S. 442, 461 (1977).

44. *Stern*, 131 S. Ct. at 2613 (quoting *Schor*, 478 U.S. at 852).

45. *Id.* at 2615 (quoting *N. Pipeline Constr. Co. v. Marathon Pipe Line Co.*, 458 U.S. 50, 85 (1982)).

46. *See generally* 11 U.S.C. § 547 (2012).

inexpensive method for dealing with a class of questions of fact which are particularly suited to examination and determination by an administrative agency specially assigned to that task.'"[47]

Preference actions are distinct to bankruptcy—created by virtue of Congress's authority to enact laws of bankruptcy—and are sufficiently particularized to justify adjudication by a specialized tribunal. Preference actions stem from the bankruptcy itself; accordingly, they are public rights. As a public right, it is appropriate and constitutional for Congress to assign the final adjudication of a preference action to non-Article III bankruptcy courts.[48] . . .

[*Prong Two: Preferences Actions are Necessarily Resolved in the Claims Allowance Process*]

It is generally agreed among commentators and jurists alike that a preference action may be finally adjudicated by a bankruptcy judge when the creditor-defendant has filed a proof of claim in the bankruptcy action, because it is necessary to determine the preference action to make a final determination on the proof of claim. This position is well-supported in the Court's jurisprudence. . . . Unfortunately, many commentators have also been misled or even seduced by the ease of the proof of claim analysis, arguing that the presence of a filed proof of claim is a necessary element to non-Article III final adjudication, rather than just a factor in the broader public rights analysis.[49] This flawed application of *Stern* stems in part from language found in *Langenkamp*. In dicta, the Court had proposed that "[i]f a party does *not* submit a claim against

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47. *Stern*, 131 S. Ct. at 2615 (quoting *Crowell v. Benson*, 285 U.S. 22, 46 (1932)); *see also* Rafael I. Pardo & Kathryn A. Watts, *The Structural Exceptionalism of Bankruptcy Administration*, 60 UCLA L. REV. 384, 389 (2012) (arguing that bankruptcy policymaking should be shifted from courts to an administrative agency). *But see* McCoid, *Right to Jury Trial*, *supra* note 31, at 41 (arguing that neither preferences nor fraudulent conveyances are sufficiently specialized to warrant an "extension of the realm of legislative courts").

48. In ruling on *Stern* challenges, lower courts have followed a similar rationale for other types of bankruptcy proceedings. *See Miller v. Greenwich Capital Fin. Prods.*, *Inc.* (*In re Am. Bus. Fin. Servs., Inc.*), 457 B.R. 314, 319–20 (Bankr. D. Del. 2011) ("If not for the bankruptcy, these [equitable subordination] claims would never exist. Therefore, this Court concludes that is has [constitutional authority to hear and enter a final judgment on] this adversary proceeding as it directly stems from the bankruptcy case.").

49. *See, e.g.*, Crist, *supra* note 4, at 633; Alec. P. Ostrow, *Constitutionality of Core Jurisdiction*, 68 AM. BANKR. L.J. 91, 112 (1994).

the bankruptcy estate, [. . . that party] is entitled to a jury trial,"[50] suggesting that the real issue is not the public rights doctrine at all, but merely whether or not the creditor filed a claim.[51] The Court has previously held as much in the context of another Seventh Amendment challenge.[52]

In light of the similarities between the jury trial and Article III analyses, some have concluded that *unless* a creditor has filed a proof of claim, preference actions fall outside the category of actions appropriate for a non-Article III court's final adjudication.[53] . . . This reasoning is flawed in at least four respects. First, it relies heavily on the idea that fraudulent conveyance actions and preference actions are indistinguishable for purposes of the public rights analysis, and second, that the analysis regarding jury trials can be overlaid on questions regarding Article III, making *Granfinanciera* controlling precedent. For reasons explained above, the first assertion is simply incorrect[54] and the second lacks a strong justification.[55] Third, it places undue emphasis on the proof of claim, using this approach as an alternative to the public rights doctrine.[56] Rather than conducting a full analysis of the public rights doctrine, this approach relies instead on a quick factual determination—was there a claim filed by the creditor? Fourth, it misunderstands the nature of preference proceedings and claims determination, supposing that there is a temporal requirement that the claim must be filed before the preference

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50. *Langenkamp*, 498 U.S. at 45.

51. *West v. Freedom Med., Inc.* (*In re Apex Long Term Acute Care—Katy LP*), 465 B.R. 452, 455–56 (Bankr. S.D. Tex. 2011) ("If the Seventh Amendment question requires the same answer as the Article III question, the *Schoenthal*/*Katchen*/*Langenkamp* line of cases implies that preference actions may not be public rights disputes.").

52. *Granfinanciera, S.A. v. Nordberg*, 492 U.S. 33, 58 (1989) ("We read *Schoenthal* and *Katchen* as holding that, under the Seventh Amendment, a creditor's right to a jury trial on a bankruptcy trustee's preference claim depends upon whether the creditor has submitted a claim against the estate . . . .").

53. Ostrow, *supra* note 10, at 117; *see also Tabor v. Kelly* (*In re Davis*), No. 05-15794-GWE, Adv. No. 07-05181-L, 2011 WL 5429095, at *12 (Bankr. W.D. Tenn. Oct. 5, 2011) (finding that the court could not issue a final ruling in the debtor's preference and fraudulent conveyance actions because the defendant had not filed a proof of claim).

54. [Footnote omitted.]

55. [Footnote omitted.]

56. [Footnote omitted.]

action is heard in order for the preference action to have an impact on the claim.[57] Bankruptcy practice suggests that no such temporal requirement exists. . . .

In conclusion, the appropriate test for preference actions is the public rights test laid out in *Stern*, a two pronged approach, with each prong intended to reach cases consistent with the justification for the public rights exception to Article III determination. Under this two-pronged approach, preference actions are decidedly matters of public rights—both because they stem from bankruptcy law itself as the creation of exclusively federal law,[58] and because they are necessary to resolve claims of creditors against the estate.[59] Concerns that preferences do not fall under this category appear to be rooted in the mistaken belief that preferences and fraudulent conveyances are indistinguishable, or should be treated as such for the purposes of analysis under the public rights exception, and a corresponding misinterpretation of Supreme Court jurisprudence.[60]

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57. [Footnote omitted.]

58. *See Stern v. Marshall*, 131 S. Ct. 2594, 2612 ("The point of *Murray's Lessee* was simply that Congress may set the terms of adjudicating a suit when the suit could not otherwise proceed at all.").

59. *See In re Apex*, 465 B.R. at 463 (Bankr. S.D. Tex. 2011) ("The Court concludes that preference actions both stem from the bankruptcy itself and are decided primarily pursuant to *in rem* jurisdiction. The cause of action for preferential transfers is established by the Bankruptcy Code.") The majority of courts who have considered the matter appear to have reached a similar conclusion. *See* Crist, *supra* note 4, at 663–66.

60. [Footnote omitted for space.]

Constitutional/Jurisdictional/Standing Issues

HON. ROBERT H. JACOBVITZ, *US BANKRUPTCY COURT (D. NM); ALBUQUERQUE*
G. ERIC BRUNSTAD, JR., *DECHERT LLP; HARTFORD, CONN.*
WILLIAM C. HEUER, *DUANE MORRIS LLP; NEW YORK*
PROF. BROOK E. GOTBERG, *BRIGHAM YOUNG UNIVERSITY SCHOOL OF LAW, PROVO, UT*
DUANE H. GILLMAN, *DURHAM JONES & PINEGAR, SALT LAKE CITY*

Preference Litigation
Presented by Brook E. Gotberg

Key Players:
- West America Credit – an uninsured and unregulated financial institution doing business in Oklahoma
- R. Dobie Lang – Chapter 7 Trustee

Key Information:
- Chapter 11 filed September 24, 2014.
- Converted to Chapter 7 on December 31, 2014.
- 90 days prior to filing $713,919.00 was paid out to depositors.

Case Citations:
- *Langenkamp v. Culp*, 498 U.S. 42 (1990) and *Langenkamp v. Hackler (In re Republic Trust & Savs. Co)*, 897 F.2d 1041 (10th Cir. 1990)

Ponzi Scheme Litigation

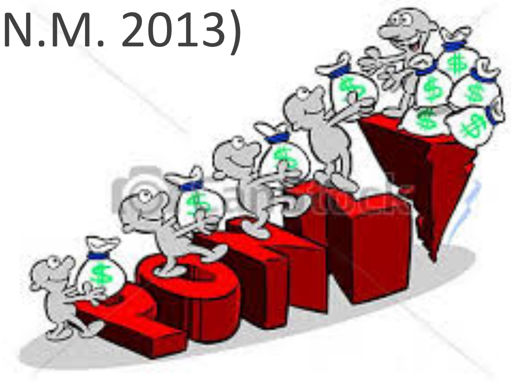
Presented by Duane H. Gillman

Key Players:

- KC Tebbs – Owner of Tebbs Company Realtors ("TCR")
- Judith A. Wing – Chapter 11 Trustee
- Gil Miller – Forensic accountant expert

Case Citations

- *Wagner v. Oliva (In re Vaughan Co. Realtors),* 500 B.R. 778 (Bankr. D.N.M. 2013)



Ponzi Scheme Litigation
Presented by Duane H. Gillman

Key Information:

- In 2007 a Promissory Note Program was started by TCR.
- Terms of program were 6 months to 1 year.
- Interest rates on the promissory notes were 15% to 35% annually.
- Investors could earn a 10% increase if old note was rolled over to new note.
- On December 24, 2014 KC Tebbs pled guilty to federal security fraud charges including running a Ponzi scheme in TCR.
- Report submitted showing profits in the hands of various potential defendants' who invested in the TCR Promissory Note Program that totaled approximately $10,000,000.

Fraudulent Conveyance and State Law Claims
Presented by William C. Heuer

Key Players:

- Rocky Excavating Inc. ("Rocky") – excavating company from Fort Collins, CO and Debtor in Chapter 7 bankruptcy.
- Associated Environment Care Inc. ("Associated") – purchaser of Rocky Excavating's assets.
- Tom Connelly – Chapter 7 Trustee

Case Citations:

- *Miller v. Enviro Care, Inc. (In re Rock Structures Excavating, Inc.),* No. 2:12-CV-856, 2013 WL 1284969 (Bankr. D. Utah Mar. 27, 2013)

Fraudulent Conveyance and State Law Claims

Presented by William C. Heuer

Key Information:

- On August 2013 Rocky entered into an agreement to sell all assets of Rocky to Associated.
- Associated gave a job to Rocky's president (he was later fired).
- After all the assets were transferred, Rocky was left owing $1,000,000 was left in unpaid debt.
- Rocky filed Chapter 7 on July 10, 2014.

- Chapter 7 Trustee wanted to pursue the following:
  - Matured debt owed under purchase agreement;
  - Unauthorized use of debtor's banking relationship;
  - Avoidance and recovery under Colorado statutes and 11 U.S.C. § 548;
  - Declaratory judgment and avoidance and recovery of unjust enrichments;
  - Breach of contract; and
  - Successor liability under securities laws.