Bankruptcy judges see authority sapped

By Kevin Lee

In a decision closely followed by lawyers involved in major law firm bankruptcies, the 9th U.S. Circuit Court of Appeals ruled last week that only an Article III tribunal, such as a district court judge, can enter final judgments in fraudulent transfer actions.

The decision chips away at the power of bankruptcy courts, but also held that bankruptcy judges have legal standing to hear such suits and submit recommended rulings to district courts. Executive Benefits Insurance Agency v. Peter H. Arkinson, 11-35162.

Bingham McCutchen LLP counsel Jeffrey Rosenfeld, who penned an analysis of the decision for his clients this week, said the decision builds on a related U.S. Supreme Court ruling, Stern v. Marshall, 131 S. Ct. 2504 (2011). That ruling determined bankruptcy judges do not have final jurisdiction over state law counterclaims, which are considered core to bankruptcy proceedings. In Executive Benefits, the 9th Circuit said fraudulent transfer claims should also be considered core.

Previously, "the 9th Circuit had held that bankruptcy judges could enter final judgments on fraudulent transfer cases without violating Article III," Rosenfeld said.

Fraudulent transfer suits target parties who allegedly receive a wrongful transfer of assets, such as property or money, from an insolvent entity without exchanging something of reasonably equivalent value for it.

Such lawsuits provide a source of monetary recovery for large law firm estates such as Brobeck, Phleger & Harrison LLP and Heller Ehrman LLP.

Those estates have sued law firms that recruited away their partners, alleging those firms committed fraudulent transfers by keeping the fees from the work those partners brought along.

Bankruptcy practitioners on opposing sides in the Heller bankruptcy claimed victory for their respective sides following the circuit decision.

Jones Day, which is a defendant in a fraudulent transfer suit brought by the Heller estate, had asserted in an amicus brief to the 9th Circuit that district judges should have the final say over such suits.

"It makes sense for the district court to take these [fraudulent transfer] cases up because it's going to have them anyway," said Jones Day associate Nathaniel Garrett, who helped prepare the amicus brief and is preparing the firm's defense against the Heller estate. "There is a lot of merit to the idea that district courts take these matters up as quickly as possible."

But Christopher D. Sullivan, special litigation counsel to the Heller estate, said the ruling reinforces the notion that bankruptcy judges should have a hand in substantive analysis, a notion supported by a district court judge earlier in the Heller bankruptcy. Last year, defendant law firms in fraudulent transfer suits brought by the Heller estate requested to move those suits from bankruptcy court to district court.


"The appellate court ruling provides further clarity and solidifies what Judge Breyer decided in Heller," Sullivan said. "The questions going forward are the nature of the process by which the district judge reviews the bankruptcy judge's findings."
Several lawyers noted that other circuit courts have come to different conclusions over what authority the bankruptcy judge has over fraudulent transfer suits and other proceedings deemed core to a bankruptcy.

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