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# Del. Bankruptcy Court Reclaims Control Of Article III Suits

By **Matthew Kelsey and Matthew Porcelli** (March 14, 2019, 4:26 PM EDT)

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The Supreme Court's watershed Stern v. Marshall decision altered the division of labor between bankruptcy courts and district courts, establishing that bankruptcy courts lacked authority under Article III of the United States Constitution to enter final orders resolving certain "core" claims notwithstanding Congress's grant of such authority in the Bankruptcy Code.[1]

A recent decision by the Bankruptcy Court for the District of Delaware in the bankruptcy case of offshore drilling company Paragon Offshore represents the latest chapter in Stern's ongoing aftermath.[2] While Stern focused on a state law tortious interference counterclaim, Paragon involves quintessential bankruptcy causes of action: fraudulent transfer claims held by the debtor's estate.

In Paragon Litigation Trust v. Noble Corp. plc, the court determined that under Stern v. Marshall and related case law, Article III does not preclude bankruptcy courts from entering final orders to resolve fraudulent transfer claims brought by a debtor's successor-in-interest against a defendant that has not asserted a claim against the debtor's estate.

In so holding, the bankruptcy court disagreed with prior decisions by the U.S. Court of Appeals for the Ninth Circuit and district courts in the Southern District of New York, setting the stage for a continuing battle on appeal and creating the potential for an eventual circuit split on the issue. The decision also provides guidance on the related issue of implied consent to bankruptcy court authority under Stern.

**Background And Procedural Context**

The Paragon decision arose in an adversary proceeding brought by a post-confirmation litigation trust against Noble Corp. plc, a former parent entity that spun off Paragon Offshore plc and certain of its debtor affiliates in an August 2014 transaction. The litigation trust brought certain causes of action, including five fraudulent transfer claims, against Noble, alleging that the spinoff defrauded Paragon's creditors.

Specifically, the complaint alleged that Noble used the spinoff to isolate a fleet of aged offshore drilling rigs in a newly created group of subsidiaries named Paragon Offshore, caused Paragon to incur $1.73

billion of indebtedness, transferred the proceeds to Noble and distributed Paragon equity to Noble shareholders, leaving limited value behind for Paragon's creditors.

Paragon commenced voluntary Chapter 11 proceedings on Feb. 14, 2016. Shortly after the petition date, the debtors proposed an ultimately unsuccessful plan that incorporated a settlement agreement between Noble and Paragon. The settlement agreement provided broad releases for Noble and affiliated parties in connection with claims arising out of the spinoff, including fraudulent transfer or similar claims.[3] The releases' effectiveness was conditioned on bankruptcy court approval of the settlement agreement and effectiveness of the failed plan.

In November 2016, the bankruptcy court denied confirmation of the failed plan on feasibility grounds.[4] The debtors then proposed a new plan that did not incorporate the settlement agreement, which the bankruptcy court confirmed on June 7, 2017. The confirmed plan created the litigation trust as a successor to the debtors and distributed interests in the litigation trust to Paragon's creditors.[5] Noble provided input into the drafting of the confirmed plan, but did not object at any point to its inclusion of language granting the bankruptcy court exclusive jurisdiction to adjudicate claims held by the litigation trust "to the fullest extent permitted by law."[6]

On Dec. 15, 2017, the litigation trust commenced the adversary proceeding against Noble and other defendants. The defendants responded by filing a motion to determine, arguing that the bankruptcy court lacked constitutional authority to adjudicate the fraudulent transfer claims (among other claims), and seeking a determination that the bankruptcy court could only enter proposed findings of fact and conclusions of law with respect to such claims.[7] The defendants argued that the Supreme Court's decisions in Stern and Granfinanciera SA v. Nordberg compelled the conclusion that the bankruptcy court lacked the constitutional authority to issue final orders when a debtor or its successor-in-interest files a fraudulent transfer claim against a party that has not filed a claim in the underlying bankruptcy case.[8]

**Threshold Issue of Consent**

As a threshold matter, the bankruptcy court considered whether Noble had implicitly consented to the bankruptcy court's entry of final orders with respect to the fraudulent transfer claims. Under Wellness Int'l Network Ltd. v. Sharif, the court would not need to reach the Article III issues raised by the defendants if it found such consent.[9] The litigation trust argued that defendants had implicitly consented by entering into the settlement agreement, and by failing to object to the confirmed plan's providing the bankruptcy court with exclusive jurisdiction over the claims against Noble, despite Noble's active participation in the negotiation of the plan.

The court rejected both arguments, first concluding that Noble's agreement to allow the court to approve the settlement agreement did not necessarily constitute consent to its eventual adjudication of then-unasserted underlying claims.[10] Second, the court held that a failure to object to a plan provision providing a bankruptcy court with ongoing jurisdiction does not constitute waiver of a party's rights to have claims heard by an Article III court, because Stern drew an express distinction between subject matter jurisdiction and the allocation of constitutional authority.[11]

**The Court's Stern Analysis**

Turning to the Article III issue, the bankruptcy court initially noted that, by challenging its authority, the defendants sought a determination that a federal statute was unconstitutional because the 1984 amendments to the Bankruptcy Code directed bankruptcy courts to enter final orders in core proceedings.[12] Core proceedings expressly include “proceedings to determine, avoid, or recover fraudulent conveyances.”[13] With this in mind, the court observed that the general principle of judicial restraint “weighs heavily against such a declaration,” because “federal statutes are presumed constitutional.”[14] The defendants argued that the Supreme Court had already ruled on the constitutionality of fraudulent transfer actions against non-claimants in Granfinanciera and Stern. Accordingly, the bankruptcy court’s decision turned on whether the two precedents controlled, based on a close analysis of each case.

Similar to the circumstances in Paragon, Granfinanciera involved a party with no claim against a bankruptcy estate being hauled into bankruptcy court to defend against a fraudulent transfer claim. The Supreme Court held that such a party “has a right to a jury trial when sued by the trustee in bankruptcy to recover an allegedly fraudulent monetary transfer.”[15] However, the Paragon court distinguished Granfinanciera because the issue before the court was not Article III authority, but rather the right to a jury trial under the Seventh Amendment, and whether the so-called “public rights exception” could limit that right.

While the Supreme Court did cite Article III case law to bolster its ultimate conclusion, the bankruptcy court observed that Granfinanciera specifically avoided addressing the constitutionality of the division of labor between bankruptcy courts and district courts established by Congress through the 1984 amendments.[16] Thus, while observing that it was “a difficult question,” the court concluded that Granfinanciera did not control the Article III issue before it.[17]

Turning to Stern, the bankruptcy court acknowledged that it “was very much an Article III case, and it discusses the Granfinanciera holding at length.”[18] Nevertheless, citing the Supreme Court’s admonition in Stern that the decision should be read narrowly and its “crystal clear statement” that Congress had exceeded its Article III power only “in one isolated respect,” the court concluded that Stern did not control because that isolated issue — a bankruptcy court’s constitutional authority to finally resolve a state law counterclaim that is not necessarily resolved in the proof of claim process — was not before the bankruptcy court.[19]

Notably, the bankruptcy court acknowledged that other courts, including the Ninth Circuit and three judges in the Southern District of New York, reached the opposite conclusion and held that Stern extended Granfinanciera to the Article III context. But the court observed that in Executive Benefits Insurance Agency v. Arkison, the Supreme Court indicated ambiguity on the issue by expressly assuming, without deciding, that fraudulent transfer claims were Stern claims.[20] Having concluded that neither Granfinanciera nor Stern controlled, the bankruptcy court declined to extend their holdings to deem bankruptcy courts’ final adjudication of fraudulent transfer claims unconstitutional and denied the motion to determine.[21]

**Practical Implications**

Paragon provides bankruptcy court litigants with several points of guidance for forum-determinative Stern issues. First, a party’s entry into a settlement agreement submitted to a bankruptcy court for approval does not necessarily constitute that party’s implicit consent to the bankruptcy court’s authority to finally adjudicate such claims.[22] Second, a party’s failure to object to an exclusive jurisdiction provision in a plan during that party’s active participation in plan development does not constitute consent to the bankruptcy court’s constitutional authority, indicating that parties may negotiate plan provisions without thereby waiving their entitlement to an Article III tribunal. Third, the Paragon decision makes it more likely that fraudulent transfer claims can be finally adjudicated by bankruptcy courts — at least in the U.S. Court of Appeals for the Third Circuit. Given that the decision creates a split in authority, and in light of the court's statement that the Stern issue was "a difficult question," it appears likely that the result will be tested on appeal.

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[1] Stern v. Marshall, 564 U.S. 462, 503 (2011).

[2] Paragon Litigation Trust v. Noble Corp. plc (In re Paragon Offshore, plc), Ch. 11 Case No. 16-10386 (CSS), Dkt. No. 2178 (Bankr. D. Del. Mar. 11, 2019) ("Paragon"); Adv. Proc. No. 17-51882 (CSS). For our prior discussion of Stern-related developments in connection with the permissibility of third-party non-debtor releases, see https://www.law360.com/newsroom/articles/5a0f3ae89127550fee01a607.

[3] Paragon at 7.

[4] Id. at 7-8.

[5] Id. at 8.

[6] Id.

[7] Id. at 8-9.

[8] Granfinanciera v. Nordberg, 492 U.S. 33, 109 S. Ct. 2782 (1989).

[9] Wellness Int'l Network Ltd. v. Sharif, 135 S. Ct. 1932, 1947-48 (2015).

[10] Paragon at 13-14.

[11] Id. at 14-15.

[12] 28 U.S.C. Sections 157 and 158.

[13] 28 U.S.C. Section 158(b)(2)(H).

[14] Paragon at 16 (citing Koslow v. Commonwealth of Pennsylvania, 302 F.3d 161, 175 (3d Cir. 2002); Union Pac. R.R. Co. v. United States, 99 U.S. (9 Otto) 700, 718 (1878)).

[15] Granfinanciera, 492 U.S. at 36.

[16] Paragon at 20 (quoting Granfinanciera at 64) ("[The Supreme] Court took pains to declare that it did not 'express any view as to whether . . . Article III allows jury trials in fraudulent conveyance actions to be held before non-Article III bankruptcy judges subject to the oversight provided by the district courts

pursuant to the 1984 Amendments.'").

[17] Id. at 19-21.

[18] Id. at 21.

[19] Id. at 21-23.

[20] 573 U.S. 25, 37 (2014).

[21] Paragon at 23-24.

[22] Because the Paragon settlement agreement never became effective, parties negotiating settlement agreements with debtors should also include carefully drafted language addressing this point to avoid any argument that the Paragon holding is distinguishable.