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Feature

By Dennis Connolly[1]

Wellness: Is Consent the Cure?

Editor's Note: *For ABI media teleconferences on Supreme Court decisions entered this term, including* Wellness*, visit abi.org/newsroom/supreme-court-opinions.*

In *Wellness Int'l Network Ltd. v. Sharif*, the U.S. Supreme Court has added another piece of the puzzle needed to resolve the long-discussed issue of bankruptcy court authority.[2] This issue stems from the structure of the Constitution, which provides in Article I that Congress can establish "uniform bankruptcy laws." However, Article I does not provide specific guidance on what courts will interpret and enforce those laws. Article III then addresses the "judicial power of the United States," but does not refer to the "uniform bankruptcy laws" provided for in Article I.

As a result, the Constitution places bankruptcy law under the province of Congress and the "judicial power" under the province of the judiciary. This structural division in the Constitution has led to tension, causing some jurists to view the authority of bankruptcy courts, as passed by Congress, as encroaching upon the "judicial power" reserved for the judiciary in Article III. As a result, from the recent decision of *Wellness* back through the Supreme Court's 1982 decision in *Northern Pipeline Constr. Co. v. Marathon Pipe Line Co.*,[3] courts have struggled to define the extent to which Article III limits the authority of bankruptcy courts.[4]

Litigants in bankruptcy court today must understand this tension between Article I and Article III, and how this tension may affect their rights. But first, a brief historical overview helps frame the questions to be answered.

The U.S. inherited its bankruptcy jurisprudence from England, where "bankruptcy commissioners," supervised by the Lord Chancellor in Equity, handled bankruptcy cases through *in rem* jurisdiction.[5] These commissioners were empowered by statute "to collect a debtor's property, resolve claims by creditors, order the distribution of assets in the estate, and ultimately discharge the debts."[6] However, reclaiming assets of the estate from third parties required a suit at common law (*i.e.*, in courts with juries).[7] In the Bankruptcy Act of 1898, the U.S. continued this dichotomy of power, allowing bankruptcy "referees" to exercise what was called "summary" jurisdiction over certain bankruptcy claims and requiring a "plenary" proceeding in an Article III court for other common law claims.[8]

In the Bankruptcy Reform Act of 1978, Congress supplanted the referee system with bankruptcy courts and eliminated the summary-plenary jurisdictional dichotomy, but the Supreme Court responded with the *Marathon* decision, which placed the jurisdictional aspects of the 1978 Act in jeopardy.[9] In *Marathon*, a debtor sued a third party for breach of contract, a common law claim.[10] The Court's plurality decided that the grant of judicial authority in the 1978 Act violated Article III by vesting bankruptcy judges with the judicial power of the U.S. to decide such common law claims.[11] Congress sought to remedy this issue with the Bankruptcy Amendments and Federal Judgeship Act of 1984, which distinguished between core proceedings, in which bankruptcy courts could

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1 The author currently represents parties that involve bankruptcy or related litigation, and some of these matters may involve the issues (or related issues) discussed in this article. The opinions expressed herein do not necessarily constitute the opinions of Alston & Bird LLP or any of its clients. Nothing contained herein shall be construed as legal advice.
2 135 S. Ct. 1932, 2015 U.S. LEXIS 3405 (2015).
3 458 U.S. 50 (1982).
4 This includes, of course, the discussion of the scope of the Seventh Amendment right to a jury trial in *Granfinanciera v. Nordberg*, 492 U.S. 33, 58-59 (1989), and the scope of consent where a proof of claim has been filed in *Katchen v. Landy*, 382 U.S. 323 (1966), as well as *Langenkamp v. Culp*, 498 U.S. 42 (1990), and *Stern v. Marshall*, 131 S. Ct. 2594, 2620 (2011).
5 Ralph Brubaker, "A 'Summary' Statutory and Constitutional Theory of Bankruptcy Judges' Core Jurisdiction After *Stern v. Marshall*," 86 *Am. Bankr. L.J.* 121, 123 (Winter 2012).
6 *Wellness*, 2015 U.S. LEXIS 3405, at *40 (Roberts, C.J., dissenting).
7 *Id.* at *46-47.
8 *Id.* at *44-45.
9 *Marathon*, 458 U.S. at 52-53.
10 *Id.* at 56.
11 *Id.* at 63-65.

enter final orders, and non-core proceedings, in which they could not.[12] Core proceedings were presumably those referenced in *Marathon* as involving "the restructuring of debtor/creditor relations [that] is at the core of the federal bankruptcy power."[13]

However, in *Stern*, the Supreme Court held that the statutory authority of bankruptcy courts — as provided by Congress — to decide certain "core proceedings" still violated Article III.[14] In that case, a creditor filed a proof of claim based on a defamation claim, and the debtor asserted a counterclaim against the creditor for tortuous interference.[15] Counterclaims by the estate against claimants constitute a core proceeding under 28 U.S.C. § 157, the jurisdictional statute applicable to bankruptcy courts. The Court held that the statute violated Article III by allowing an Article I judge to enter final judgment on a common law counterclaim that did not require joint resolution with the creditor's proof of claim.[16]

Stern left many questions unanswered, including what a bankruptcy court should do upon encountering a "*Stern* claim" — a claim that the bankruptcy court has statutory authority, but not constitutional authority, on which to enter final judgment. In *Executive Benefits Insurance Agency v. Arkison*,[17] the Supreme Court answered this question by holding that on a *Stern* claim, the Constitution permits a bankruptcy court to issue proposed findings of fact and conclusions of law for *de novo* review by the district court by deeming the *Stern* claim to be non-core.[18] Following *Arkison*, the Court next took up the question of consent in *Wellness*, holding that litigants in bankruptcy court could give "knowing and voluntary" consent — expressly or impliedly — to the bankruptcy court's final adjudication of *Stern* claims.[19]

While recognizing the legal consequence of consent, *Wellness* creates opportunities and risks for litigants in deciding whether to consent to the bankruptcy court's final adjudication of *Stern* claims. It bears emphasizing that the decision of whether to consent in an adversary proceeding is a decision that must be made early in the case. It remains possible that Fed. R. Bankr. P. 7012 may be amended in the near future to require litigants to expressly consent or not consent in responsive pleadings in bankruptcy court litigation.[20] These amendments would be similar to the provisions in the current Federal Rules of Bankruptcy Procedure that address this same question in the context of non-core proceedings.

Several factors can affect a party's decision on whether to consent to the entry of final orders by a bankruptcy judge. On the one hand, consent potentially leads to a more expeditious resolution and the benefit of a final decision, setting a clear standard for appellate review based on whether findings of fact are clearly erroneous. Moreover, since bankruptcy judges are generally and justifiably perceived to have a commercial law specialization, a litigant may appreciate the commercial sophistication of litigating before a bankruptcy judge in the same way that parties often appreciate being before the Delaware Court of Chancery (or the many business courts created in the last few years). Conversely, the facts underlying the dispute may prompt a litigant to protect its Seventh Amendment right to a jury if the litigant believes that it will provide the best outcome. A litigant may also prefer the decision of an Article III judge, especially if an area of the law rarely touched upon in bankruptcy courts is central to the dispute.

Another significant consideration for bankruptcy court litigants relates to appellate standards. A litigant may prefer to preserve the appellate standard applicable to *Stern* claims, requiring the district court to review the bankruptcy court's factual findings under a *de novo* review standard rather than a clearly erroneous standard.[21] For example, the district court in *TOUSA* reversed the bankruptcy court's holding that certain lenders had received fraudulent transfers as part of a restructuring transaction that was carried out through payments and support by the debtor's affiliates.[22] On further appeal, the Eleventh Circuit reviewed the bankruptcy court's — rather than the district court's — factual findings on a clearly erroneous standard: Based on the bankruptcy court's factual findings, the Eleventh Circuit reversed the district court.[23]

The defendants in *TOUSA could have* objected to the bankruptcy court's entry of final orders, thereby causing the bankruptcy court to issue proposed findings of fact and conclusions of law. The district court, performing a *de novo* review of the facts, *would then have created* the final factual record that went up on appeal to the Eleventh Circuit. In addition, the Eleventh Circuit *would have* applied the clearly erroneous standard to the factual findings of the district court, not the bankruptcy court.[24] Thus, *TOUSA* demonstrates the consequence of consent in bankruptcy courts, and litigants are well advised to consider the impact of their decisions at the outset of litigation.

Still, the *Stern*, *Arkison* and *Wellness* decisions have left unanswered questions. For example, these cases have not addressed the way that *Stern* claims affect non-final orders, such as orders denying motions to dismiss or for summary judgments. Are these types of rulings in a legal no man's land, or are they subject to review under Fed. R. Bankr. P. 9033 based on the language in the rule and the same Article III concerns that led to the rulings in *Stern*? An answer to this question must also take into account the way the Article III concerns in *Stern* have evolved and been expressed in *Wellness*, where Chief Justice John Roberts, as the author of the majority decision in *Stern*, was in the dis-

12 Under the Bankruptcy Code, "[b]ankruptcy judges may hear and determine all cases under title 11 and all *core proceedings* arising under title 11, or arising in a case under title 11 ... and may enter appropriate orders and judgments." 28 U.S.C. § 157(b) (emphasis added).

13 *Marathon*, 458 U.S. at 71.

14 *Stern v. Marshall*, 131 S. Ct. 2594 (2011).

15 *Id.* at 2601.

16 *Id.* Central to this holding was the lack of overlap between the debtor's counterclaim for tortuous interference and the creditor's claim for defamation. *Id.* at 2617. The Court concluded that "there was never any reason to believe that the process of adjudicating Pierce [Marshall]'s proof of claim would necessarily resolve Vickie [Lynn Marshall]'s counterclaim." *Id.* The Court did not say if the standard for determining whether the bankruptcy court must resolve the debtor's counterclaim as part of the creditor's proof of claim should mirror the standard under Fed. R. Civ. P. 13, even though Fed. R. Civ. P. 13 appears to provide a well-established standard for such a determination.

17 134 S. Ct. 2165 (2014).

18 *Id.* at 2173.

19 *Wellness*, 2015 U.S. LEXIS 3405, at *8.

20 *See, e.g.*, Report of the Judicial Conference, Committee on Rules of Practice and Procedure, pp. 6, 7, 9 (September 2013). The proposed amendments were ultimately not submitted to the Supreme Court for final approval because the *Arkison* decision was pending at the time. *See* Report of the Advisory Committee on Bankruptcy Rules, p. 122 (Dec. 12, 2013).

21 *See, e.g., Senior Transeastern Lenders v. Official Comm. of Unsecured Creditors (In re TOUSA Inc.)*, 680 F.3d 1298, 1298 (11th Cir. 2012).

22 *Id.* at 1298-1313.

23 *Id.* at 1310, 1312-13.

24 Litigants should be mindful that different deadlines apply for an appeal of a final order vs. an objection to proposed findings of fact and conclusions of law. *Compare* Fed. R. Bankr. P. 8002(a) (allowing 14 days to file notice of appeal after final order) *with* Fed. R. Bankr. P. 9033(a)(c) (allowing court to extend 14-day period to file objection to proposed findings of fact and conclusions of law to 21 days).

sent. Further, litigants should consider the different doctrines and rationales underlying finality of orders for purposes of Article III[25] and finality of orders for purposes of appeals.[26] This distinction appears to have been largely ignored in case law to date, but it could hold significant consequences in the constitutional analysis.

While *Wellness* may offer clarity on the issue of consent, the longstanding tension between Article I and Article III will continue to play out in bankruptcy courts. Litigants in bankruptcy courts must carefully consider their strategies in deciding whether to consent to entry of final rulings by the bankruptcy court judge. Consent may have significant consequences for, among other things, the speed of resolution and the standards on appeal, and the full consequences of the rulings discussed herein remain to be decided. abi

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25 *See Stern*, 131 S. Ct. at 2615.

26 *See, e.g., In re Texas Extrusion Corp.*, 844 F.2d 1142, 1154-56 (5th Cir. 1988) (discussing concept of finality for purposes of appeal in bankruptcy context).