DID I DO THAT?

CONSENT TO LITIGATION IN BANKRUPTCY COURT FOLLOWING *WELLNESS INTERNATIONAL*

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"To hear the principal dissent tell it, the world will end not in fire, or ice, but in a bankruptcy court."

— Justice Sonia Sotomayor

For those of us who practice bankruptcy law, it's oddly comforting to imagine that we might spend our final moments in a familiar courtroom surrounded by our colleagues instead of fighting a natural disaster. We realize, though, that for many of our fellow attorneys and clients, being forced to litigate in bankruptcy court is a fate to be avoided at all costs. If you're in that camp, allow me to console you – a little.

If you normally stay as far away from bankruptcy as you can and think the Supreme Court's recent ruling won't affect you, think again. Here's one example of how the issue can arise from a non-bankruptcy corporate transaction, although the possible ways this issue can arise run the gamut from product and premises liability cases to trusts and estates and domestic disputes. Say your company was the buyer in an asset purchase agreement with an unrelated company. Both companies appear to be solvent, and the deal is considered a success. Eleven months later, your company is served with a complaint filed in bankruptcy court (a.k.a. an "adversary proceeding") by the plaintiff, the newly appointed bankruptcy trustee for the seller, which filed a chapter 7 bankruptcy petition. The trustee alleges claims for fraudulent transfer and civil conspiracy. Your company now realizes that it has claims against the seller (debtor) for breach of representations and warranties in the asset purchase agreement. Can and should all of these claims be tried in bankruptcy court? What if there is a jury demand on certain claims?

In *Wellness International Network, Ltd. v. Sharif*, 135 S. Ct. 1932 (2015), the Supreme Court continued to outline the contours of judicial power that can be exercised by bankruptcy judges. The debate arises because bankruptcy judges are appointed under Article I of the United States Constitution rather than Article III, which controls appointment of federal district court judges. Bankruptcy judges, like federal magistrate judges, are judicial officers of the United States district courts under which they serve. District courts have original jurisdiction over bankruptcy cases and related proceedings, and universally enter standing orders referring all such cases and proceedings to the bankruptcy courts in their district. 28 U.S.C. § 1334. The reference is automatic, so debtors file their bankruptcy petitions directly in the bankruptcy court. Subsequently, the district court can withdraw from bankruptcy court the reference of the entire case or a single matter in controversy. Such withdrawal can happen at the court's initiative or upon the request of a party. You can bet, though, that it would be a rare district court judge who would want to preside over an entire bankruptcy case from start to finish.

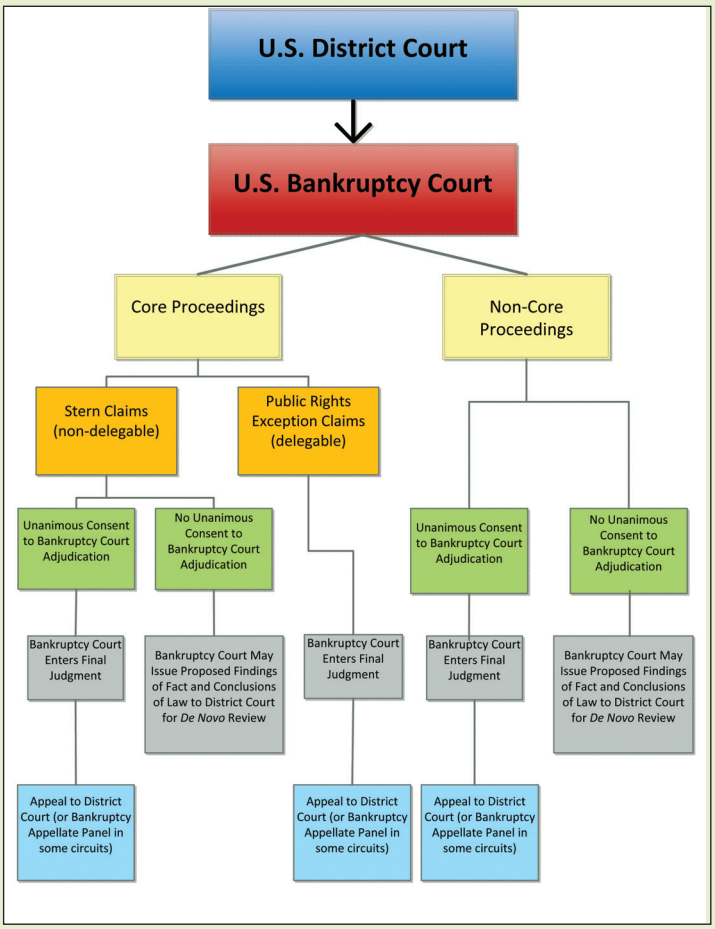
Once a matter is in bankruptcy court, the Bankruptcy Code provides that a bankruptcy judge's authority depends on whether the matter is a "core proceeding" or a "non-core proceeding." In a core proceeding, the Code provides that a bankruptcy judge can enter final orders and judgments subject to ordinarily appellate review by the district court. 28 U.S.C. § 157(b). In a non-core proceeding, a bankruptcy judge's authority is limited to hearing the matter and submitting proposed findings of fact and conclusions of law to the district court for de novo review. 28 U.S.C. § 157(c)(1); Rule 9033, Fed. R. Bankr. P. However, if all the parties to a non-

core proceeding consent, the bankruptcy court can enter a final judgment subject to ordinary appellate review by the district court. 28 U.S.C. § 157(c)(2).

This is where it starts getting complicated. There is a non-exclusive statutory list of matters that are classified as core proceedings. 28 U.S.C. § 157(b)(2). Core proceedings generally involve management, identification and distribution of property of the bankruptcy estate. The line between core and non-core proceedings is often blurry, though, and subject to dispute. Before you even get to that distinction, here's what you should know.

In *Stern v. Marshall*, 131 S. Ct. 2594 (2011) (Marshall being better known as Anna Nicole Smith), the Supreme Court told us that a bankruptcy court's authority is limited even in core proceedings. Specifically, the Court held that the bankruptcy court could not enter final judgment on the debtor's counterclaim for tortious interference with a gift, even though it was a core proceeding, because the parties had not consented to adjudication in bankruptcy court and the counterclaim did not fall within the "public rights exception" category of cases that the Constitution allows to be delegated to an Article I tribunal. However, the Court did little to explain which claims come within the public rights exception. As a result, the core versus non-core proceeding distinction is no longer as reliable an indicator of a bankruptcy court's authority as it once was.

Not long after *Stern*, in *Executive Benefits Insurance Agency v. Arkinson*, 134 S.Ct. 2165 (2014), the Supreme Court answered one unresolved question. When faced with a non-delegable core proceeding as in *Stern*, it is constitutional for a bankruptcy court to treat the proceeding like a non-core proceeding and submit proposed findings of fact and conclusions of law to the district court for *de novo* review, regardless of whether the parties consented to adjudication in bankruptcy court. Although the bankruptcy court may not enter a final judgment in such cases, its authority does extend to pre-trial proceedings including disposition of motions to dismiss and motions for summary judgment. *See Forman v. Kelly Capital, LLC*, 2015 Bankr. LEXIS 2029 at *7 (Bankr. D. Del. June 18, 2015).



Another critical issue not reached by the Court in *Stern* was whether the Constitution permits a bankruptcy court to issue final judgments on core but non-delegable *Stern*-type claims if all parties consent. The Court answered affirmatively in *Wellness*. Writing for the majority, Justice Sotomayor explained that the Constitution permits parties to a Stern claim to consent to have a bankruptcy judge issue final judgment. This ruling preserves not only much of the existing division of labor between district courts and bankruptcy courts, but also the federal magistrate judge system, which also relies on the consent of the parties to avoid constitutional challenges. This practical consequence was not lost on Justice Sotomayor as a former district court judge. Surely it contributed to her urge to poke fun at the dissent, which expressed a very protective view of the dangers presented by chipping away at the judicial power reserved for Article III courts.

The Court also held in *Wellness* that a party's consent can be express or implied, as long as it is "knowing and voluntary." Unfortunately, the Court remanded the case to the Seventh Circuit to address the "deeply factbound analysis" of whether implied consent occurred in the case. Thus, what constitutes consent to adjudication in bankruptcy court is still being defined.

While we wait for lower courts to develop the law on these issues, parties must proceed with caution when they have a matter in bankruptcy court that they want adjudicated elsewhere. Consent to adjudication of certain types of counterclaims may be implied from such routine actions as filing a proof of claim in the bankruptcy case. If bankruptcy court is not your preferred forum, object early and on the record to adjudication there. Promptly file the appropriate motion requesting another forum. In some circumstances, a motion asking the bankruptcy court to abstain from hearing the matter will be the most appropriate strategy. 28 U.S.C. § 1334(c). Alternatively, you may have grounds to support a motion to withdraw the automatic reference to the bankruptcy court so the matter returns (theoretically) to the district court. Rule 5011, Fed. R. Bankr. P.; 28 U.S.C. § 157(d). Waiting a while to file a motion to withdraw the reference may support an argument that you consented by implication to final adjudication in bankruptcy court.

The flowchart accompanying this article attempts to distill the current law regarding bankruptcy court authority into shorthand format. With many legal questions unresolved, the flowchart provides only minimal consolation. However, until these questions are answered, remember that comfort can be found in the hands of an experienced bankruptcy practitioner who isn't afraid of the dangers lurking in these Article I waters.

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