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Determining Party Consent To a Bankruptcy Judge's Authority To Decide 'Stern' Claims

Five elements factor into the analysis.

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In *Wellness International Network v. Sharif*, 135 S. Ct. 1932 (2015), the U.S. Supreme Court addressed an unresolved question from its decision in *Stern v. Marshall*, 131 S. Ct. 2594 (2011): whether parties' consent permits a bankruptcy judge to enter a final order or judgment on a claim otherwise requiring Article III adjudication. The court answered in the affirmative, explaining that non-Article III tribunals may enter final judgments on so-called "*Stern* claims" when litigants provide consent—either express or implied—that is "knowing and voluntary." Id. at 1948. Although the decision answered the constitutional consent question, it provided limited guidance on how to evaluate consent in practice. This article summarizes the decision in *Wellness*, surveys subsequent lower court decisions and proposed amendments to the Federal Rules of Bankruptcy Procedure that will require parties in adversary proceedings to affirmatively express their consent or nonconsent, and identifies five factors that bear on consent analysis in practice.

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Background

Bankruptcy courts' adjudicative authority has been in question since Congress created the modern bankruptcy court system in Bankruptcy Act of 1978 (1978 Act), Pub. L. 95-598, 92 Stat. 2549, granting bankruptcy courts final adjudicative authority over all matters "arising under [the Bankruptcy Code] or arising in or related to a case" under the Bankruptcy Code. 28 U.S.C. §1471(b) (repealed). Within a few years of 1978 Act's enactment, the Supreme Court struck down the grant of authority as unconstitutional and limited bankruptcy courts' authority to enter final orders to matters involving "the restructuring of debtor/creditor relations [that] is at the core of the federal bankruptcy power." *Northern Pipeline Constr. Co. v. Marathon Pipe Line Co.*, 458 U.S. 50, 71, 76 (1982). In the wake of *Marathon*, Congress enacted the Bankruptcy Amendments and Federal Judgeship Act of 1984 (BAFJA), Pub. L. 98-353, 98 Stat. 333,

which distinguished between "core" proceedings—in which bankruptcy courts could enter final orders and judgment—and "non-core" proceedings—in which they could not.

Almost three decades later, the Supreme Court revisited the constitutionality of BAFJA's grant to bankruptcy judges of full adjudicatory authority over "core proceedings," as statutorily

defined in 28 U.S.C. §157(b), and held that the authority of bankruptcy judges to decide certain of these "core proceedings" violated Article III. *Stern*, 131 S. Ct. at 2620. In so doing, the court created the so-called *Stern* claim: "a claim that is 'core' under 28 U.S.C. §157 but yet 'prohibited from proceeding in that way as a constitutional matter.'" *Wellness*, 135 S. Ct. at 1941-42 (quoting *Executive Benefits Ins. Agency v. Arkison*, 134 S. Ct. 2165, 2170 (2014)).

After *Stern*, the circuits were split on whether the parties' consent permitted a bankruptcy judge to enter final orders or judgments on *Stern* claims. After declining to address the issue in *Arkison*, the court granted certiorari on the consent issue in *Wellness*.

The 'Wellness' Consent Standard

The court in *Wellness* began its consent analysis by recognizing that "[a]djudication by consent is nothing new," and citing a line of cases beginning in 1813. 135 S. Ct. at 1942 (citing *Thornton v. Carson*, 7 Cranch 596, 597 (1813); *Heckers v. Fowler*, 2 Wall. 123, 131 (1865); *Newcomb v. Wood*, 97 U.S. 581, 583 (1878)).

The court explained that the "foundational case in the modern era" is *Commodity Futures Trading Commission v. Schor*, 478 U.S. 833 (1986), which held that Congress can empower a non-Article III tribunal (the Commodity Futures Trading Commission (CFTC)) to enter a final judgment.[1] In *Schor*, the court held that "'Article III's guarantee of an impartial and independent federal adjudication is subject to waiver, just as are other personal constitutional rights'—such as the right to a jury—'that dictate the procedures by which civil and criminal matters must be tried.'" *Wellness*, 135 S. Ct. at 1943 (quoting *Schor*, 478 U.S. at 848-49). In *Wellness*, the court explained that the same reasoning applied to bankruptcy court authority. Id. at 1944.

After holding that bankruptcy courts could issue final orders or judgments on Article III claims with litigant consent, the court rejected the argument that such consent must be express. The court relied on *Roell v. Withrow*, 538 U.S. 580 (2003), which addressed whether consent to a magistrate judge's adjudicative authority must be express under 28 U.S.C. §636(c).[2] The *Roell* majority concluded that it did not and provided that Article III rights are "'substantially honored' by permitting waiver based on 'actions rather than words.'" *Wellness*, 135 S. Ct. at 1948 (quoting *Roell*, 538 U.S. at 589, 590). Under *Roell*, "the key inquiry is whether 'the litigant or counsel was made aware of the need for consent and the right to refuse it, and still voluntarily appeared to try the case' before the non-Article III adjudicator." Id. (quoting *Roell*, 538 U.S. at 590). *Wellness* extended *Roell*'s rule for implied consent to bankruptcy courts, holding that consent, whether express or implied, need only be "knowing and voluntary." Id.

Although implied consent will suffice, the court suggested that it was a "good practice" for courts to seek express statements regarding litigant consent "both to ensure irrefutably that any waiver of the right to Article III adjudication is knowing and voluntary and to limit subsequent litigation over the consent issue. Statutes or judicial rules may require express consent where the Constitution does not." Id. at 1948 n.13.

The court did not determine whether the respondent had impliedly consented to bankruptcy court authority, which would require a "deeply factbound analysis of the procedural history" in the litigation and "would provide little guidance to litigants or the lower courts." Id. at 1949. Instead, it directed the Seventh Circuit to decide on remand "whether Sharif's actions evinced the requisite knowing and voluntary consent, and also whether, as Wellness contends, Sharif forfeited his *Stern* argument below." Id.[3]

Post-'Wellness' application

Express Consent.

To date, several lower courts have followed the court's suggestion to seek express statements of litigant consent. See, e.g., *In re Cowin*, No. CIV.A. H-13-1767, 2015 WL 5714614, at *8 (S.D. Tex. Sept. 29, 2015); *In re Bridgeview Aerosol*, 538 B.R. 477, 484-85 (Bankr. N.D. Ill. 2015); *In re Chi. Mgmt. Consulting Grp.*, No. 12-18139, 2015 WL 5177969, at *1 (Bankr. N.D. Ill. Sept. 3, 2015). These courts have not required the consent to take any particular form; oral consent has sufficed. As the court predicted, these express statements of consent appear to have limited subsequent litigation on the consent issue.

Similarly, a litigant's express non-consent has precluded the bankruptcy court from entering final judgment on an Article III claim. See *In re Labgold*, 532 B.R. 276, 285 (Bankr. E.D. Va. 2015) (finding abstention appropriate when Defendant unequivocally indicated lack of consent to the bankruptcy court's entry of final money judgment). A litigant cannot shift a dispute to the district court if it does not otherwise require an Article III adjudicator, however. See *Wiscovitch-Rentas v. Glaxosmithkline Puerto Rico*, No. 13-1509 (GAG), 2015 WL 5692784, at *5 (D.P.R. Sept. 28, 2015) (declining to withdraw reference of matter "entirely composed

of bankruptcy-related issues"; by itself, defendant's refusal to consent is insufficient basis for withdrawal).

Taking a cue from *Wellness*, the Advisory Committee on Bankruptcy Rules has proposed amendments to the Bankruptcy Rules that would revise the requirement of express statements of consent to conform more closely to *Wellness*'s taxonomy. Proposed Bankruptcy Rules 7008 and 7012(b).[4] Several bankruptcy courts have already amended their local rules to require similar express statements of consent from the litigants. See, e.g., S.D.N.Y. Local Bankr. Rules 7008-1 and 7012-1; D. Nev. Local Bankr. Rules 7008.1(a) and 9014.2(a); S.D. Tex. Local Bankr. Rules 7008-1 and 7012-1.

The proposed amendments raise two related questions. *First*, will failure to provide an express statement of consent or nonconsent under the amended Rules 7008 and 7012 forfeit a litigant's challenge to the bankruptcy court's authority?[5] In all likelihood, a court will find such a challenge forfeited; otherwise, a litigant could "sandbag" her adversary—withholding any challenge until the bankruptcy court issued an unfavorable ruling. At least one post-*Wellness* decision has found that a litigant's failure to object to the bankruptcy court's adjudicative authority under the applicable local rule indicated implied consent. *Perkins v. LVNV Funding, LLC (In re Perkins)*, 533 B.R. 242, 249 (Bankr. W.D. Mich. 2015).

Second, may a bankruptcy judge enter a default judgment based on the failure to respond to an adversary complaint? In *Executive Sounding Board Association v. Advanced Machines & Engineering Co. (In re Oldco M Corp.)*, 484 B.R. 598 (Bankr. S.D.N.Y. 2012), the court concluded that a bankruptcy judge may enter a final default judgment based on implied consent, since the official form of the summons states:

> IF YOU FAIL TO RESPOND TO THIS SUMMONS, YOUR FAILURE WILL BE DEEMED TO BE YOUR CONSENT TO ENTRY OF A JUDGMENT BY THE BANKRUPTCY COURT AND JUDGMENT BY DEFAULT MAY BE TAKEN AGAINST YOU FOR THE RELIEF DEMANDED IN THE COMPLAINT.

See id. at 601-02 (quoting Bankruptcy Forms B 250A and B 250B (emphasis in original)); Hon. Martin Glenn, "*Stern v. Marshall* and Its Progeny," Nat'l Conf. of Bankr. Judges, Educational Materials at 1247-48 & n.4 (September 2015). It is unclear whether this notice is sufficient for a court to find that "the litigant or counsel was made aware of the need for consent and the right to refuse it, and still voluntarily appeared to try the case before the non-Article III adjudicator." *Wellness*, 135 S. Ct. at 1948. A court might determine that a litigant who suffers a default by failing to respond to a summons effectively consents to not trying the case at all.

Implied Consent.

Wellness clarifies that consent may be implied when a party fails to make an express statement. The courts have not yet clearly defined what might constitute implied consent, but initiating certain kinds of litigation in the bankruptcy court might suffice.[6]

Courts have been divided as to whether initiating a proceeding in the bankruptcy court implies consent. Compare *Perkins*, 533 B.R. at 249 ("Plaintiff decided to file her Complaint in this court, as opposed to the District Court. … Plaintiff has implicitly, if not expressly, consented to the jurisdiction of this court to enter a final judgment or order in this adversary proceeding.") with *In re Nortel Networks*, No. 09-10138(KG), 2015 WL 3506697, at *3 (Bankr. D. Del. June 2, 2015) ("The Court is not willing to base a finding of implied consent on the filing of the Complaints in this Court when, as here, SNMP expressly gave notice in the Complaints that it was reserving its rights and, indeed, that it intended to seek the withdrawal of the reference because it was not submitting itself to the Court's authority to enter final orders. SNMP made its intention known and reserved its rights clearly." (internal citation omitted)).

Taking inconsistent positions on consent throughout the course of the proceedings might waive a litigant's challenge to the bankruptcy judge's adjudicative authority. In *True Traditions, LC v. Wu*, No. 14-CV-03605-BLF, 2015 WL 5261138 (N.D. Cal. Sept. 8, 2015), the District Court for the Northern District of California explained:

> [T]he right to seek Article III adjudication can … invite litigation hijinks. Courts confronted with the thorny issue of implied consent to enter final judgment are finely attuned to the concerns of litigation misconduct and sandbagging identified in *Stern*. This concern is particularly acute where, as here, a party seeks affirmative relief from the bankruptcy court believing it might win and then cries foul over the court's entry of final judgment when it loses.

Id. at *8 (internal citation omitted).[7] The court explained actions the Appellant could have taken to maintain its objection to the court's authority: It could have withdrawn its motion for summary judgment, or, after the summary judgment order was issued, it could have filed a motion to withdraw its consent. Id. at *9. Instead, it remained silent through trial and post-trial briefing without raising the issue of consent again until its appeal. Id. As such, Appellant's reliance on colloquy

from the summary judgment hearing to demonstrate an absence of consent was unavailing. Id.

Consent was also found to be implied in contradiction to express statements of nonconsent in *In re Prof'l Facilities Mgmt.*, No. 14-31095-WRS, 2015 WL 6501231 (Bankr. M.D. Ala. Oct. 27, 2015), which involved the question of whether filing a compulsory counterclaim constituted implied consent to a bankruptcy court's adjudicative authority. The counterclaimant unequivocally stated in its affirmative defenses that it did not consent to the bankruptcy court's adjudication and demanded a jury trial and that it did not consent to the bankruptcy judge presiding over the trial. Id. at *4. The court nevertheless found that the counterclaimant had impliedly consented to its adjudicative authority, relying heavily on the fact that the counterclaimant demanded in its counterclaim nearly twice as much money as the claimant in her complaint for damages. Id. at *5. "Regardless of the ultimate characterization of the counterclaim, … the courts' chief concern has been whether the counterclaimant was seeking to achieve an affirmative recovery from the estate by circumventing the bankruptcy court's formal claims allowance procedure." Id. (quoting *Container Recycling Alliance v. Lassman*, 359 B.R. 358, 362 (D. Mass. 2007)). The court surmised that the counterclaimant likely would not have waived its right to a jury trial had it limited its counterclaim to the amount of the claim, but it did not do so. Id. at *6.

Conclusion

Although *Wellness* resolved the constitutional question of consent, determining party consent in a given case remains a factbound exercise. The following factors will bear on a court's analysis of a party's consent to a bankruptcy judge's adjudicative authority:

1. Did the party expressly consent to bankruptcy judge's adjudicative authority?

2. Did the party forfeit its right to challenge the bankruptcy judge's adjudicative authority by failing to provide an express statement as required by applicable rules or court order?

3. Did the party institute an action in the bankruptcy court?

4. Were there indicia of "sandbagging" or other gamesmanship?

5. Did the party file a counterclaim greater than the value of the initial claim?

Courts give these factors varying weight, and none are necessarily dispositive. However, parties should provide express consent or nonconsent early in the case to prevent litigation on the issue and thus make clear to the factfinder that if consent is given, it is knowing and voluntary, and if withheld, the lack of consent is clear.

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1. In *Schor*, the CFTC issued a regulation allowing itself to hear state-law counterclaims. Plaintiff filed a complaint with the CFTC against his broker, and the broker, which had previously filed claims in federal court, refiled them as counterclaims in the CFTC proceeding. The CFTC ruled against plaintiff on the counterclaims, and the court upheld the CFTC's ruling, holding that Schor had waived his right to an Article III court. 478 U.S. 833.

2. Section 636(c) authorizes magistrate judges to "'conduct any or all proceedings in a jury or nonjury civil matter and order the entry of judgment in the case,' with "the consent of the parties.'" *Wellness*, 135 S. Ct. at 1948 (quoting 28 U.S.C. §636(c)).

3. Sharif had not raised his *Stern* objection until he filed his reply brief before the Seventh Circuit. The Seventh Circuit initially concluded under *Stern* that it could not enforce the forfeiture, even though it determined Sharif had waited too long to raise the objection. *Wellness Int'l Network v. Sharif*, 727 F.3d 751, 767 (7th Cir. 2013). On remand from the Supreme Court, the Seventh Circuit recognized that it had the enforcement power and held that the claim was forfeited. *Wellness Int'l Network v. Sharif*, No. 12-1349, 2015 WL 6456296, at *1 (7th Cir. Aug. 4, 2015).

4. Proposed Bankruptcy Rule 7008 provides:

> [Fed. R. Civ. P. 8] applies in adversary proceedings. The allegation of jurisdiction required by Rule 8(a) shall also contain a reference to the name, number, and chapter of the case under the Code to which the adversary proceeding relates and to the district and division where the case under the Code is pending. In an adversary proceeding before a bankruptcy ~~judge~~ court, the complaint, counterclaim, cross-claim, or third-party complaint shall contain a statement ~~that the proceeding is core or non-core and, if non-core~~ that the pleader does or does not consent to entry of final orders or judgment by the bankruptcy ~~judge~~ court.

Fed. R. Bankr. P. 7008 (proposed Oct. 29, 2015) (new material is underlined; omitted material is in strikethrough).

Proposed Bankruptcy Rule 7012(b) provides:

> [Fed. R. Civ. P. 12(b)-(i)] applies in adversary proceedings. A responsive pleading ~~shall admit or deny an allegation that the proceeding is core or non-core. If the response is that the proceeding is non-core, it~~ shall include a statement that the party does or does not consent to entry of final orders or judgment by the bankruptcy ~~judge~~ court. ~~In non-core proceedings final orders and judgments shall not be entered on the bankruptcy's judge's order except with express consent of the parties~~.

Proposed Fed. R. Bankr. P. 7012(b) (proposed Oct. 29, 2015) (new material is underlined; omitted material is in strikethrough).

5. "Waiver is different from forfeiture. Whereas forfeiture is the failure to make the timely assertion of a right, waiver is the intentional relinquishment or abandonment of a known right." *United States v. Olano*, 507 U.S. 725, 733 (1993) (internal citation and quotation marks omitted).

6. Filing a proof of claim does not constitute consent to a bankruptcy judge's authority to enter final orders and judgments on a *Stern* claim against the creditor. But if the estate's counterclaim against the creditor would necessarily be resolved in the claims allowance process, then the claim or counterclaim against that creditor is not a *Stern* claim. 131 S. Ct. at 2618. The claim in *Stern* involved a "state tort action that exists without regard to any bankruptcy proceeding." Id. The court distinguished *Katchen v. Landy,* 382 U.S. 323 (1966), and *Langenkamp v. Culp*, 498 U.S. 42 (1990), both of which involved claims asserting rights of recovery created by federal bankruptcy law that would necessarily be resolved in the claims allowance process, 131 S. Ct. at 2616-18, and so did not involve *Stern* claims that entitle a party to a final adjudication by an Article III tribunal. Sec. *Inv'r Prot. v. Bernard L. Madoff Inv. Sec.*, 490 B.R. 46, 54-55 (S.D.N.Y. 2013) ("Whenever a bankruptcy court must resolve a §502(d) claim brought by a trustee, it may also finally decide avoidance actions to the extent that those actions raise the same issues as the §502(d) claim and thus would 'necessarily' be resolved by it."). Similarly, implied consent is not relevant in actions seeking to disallow or equitably subordinate claims because these matters "go to the heart of the claims allowance process" and are thus subject to final adjudication by the bankruptcy court. *In re TMST, Inc.*, No. 09-17787 NVA, 2015 WL 4080077, at *7 (D. Md. July 6, 2015).

7. In *True Traditions*, the district court upheld the bankruptcy court's conclusion that appellant's actions constituted implied consent to the bankruptcy court's authority to enter final judgment. The court found the appellant was aware of the need to consent—indeed, after initially admitting the bankruptcy judge's jurisdiction early in the proceeding, it later challenged the bankruptcy judge's authority. And at summary judgment, Appellant sought final judgment in its favor without ever mentioning consent, which led the court to the "unmistakable implication" that it sought an entry of final judgment in its favor from the bankruptcy judge. 2015 WL 5261138, at *9.