

Supreme Court Clarifies Scope of Bankruptcy Courts' Jurisdiction

On May 26, 2015, in [Wellness International Network Ltd. v. Sharif](#), No. 13-935, 575 U.S. __ (2015) (the "Opinion"), the Supreme Court of the United States (the "Court") clarified bankruptcy courts' ability to hear and decide issues related to bankruptcy cases, holding that (1) bankruptcy courts possess constitutional authority to adjudicate matters with the parties' consent; and (2) such consent may be express or implied, so long as it is knowing and voluntary.

The Opinion aids bankruptcy courts and litigators by clarifying and further refining the Court's recent procedural bankruptcy and jurisdictional jurisprudence, which somewhat limited bankruptcy courts' constitutional authority to enter final orders in core bankruptcy matters, [Stern v. Marshall](#), 131 S. Ct. 2594 (2011) ("Stern"), yet enabled them to hear such matters and propose findings of fact and conclusions of law, subject to fresh Article III court review, [Exec. Benefits Ins. Agency v. Arkison](#), 134 S. Ct. 2165 (2014). In affirming bankruptcy courts' ability to decide matters with the parties' consent, the Opinion acknowledged the key role that bankruptcy judges play in the administration of the federal courts and the fact that without their service, the federal court system would "grind nearly to a halt."

The Opinion

A. Facts & Procedural Background

Wellness International Network ("Wellness"), a manufacturer of health and nutrition products, entered into a contract with Richard Sharif under which Sharif would distribute Wellness' products. Not long after, in 2005, Sharif sued Wellness and repeatedly ignored his discovery obligations during the course of the ensuing litigation. So much so, that the federal district court overseeing the litigation sanctioned Sharif and awarded Wellness over \$650,000 in attorney's fees. Thereafter, Sharif filed for Chapter 7 bankruptcy protection and listed Wellness as a creditor. Wellness sought information about Sharif's assets and eventually obtained a copy of a loan application of Sharif, dated from 2002, which listed over \$5 million in assets. Questioned about these assets, Sharif claimed he had lied on this application and these assets were not his but a trust's (the "Trust"), purportedly administered by Sharif on behalf of his mother, for the benefit of his sister.

Unsatisfied, and denied additional information regarding the Trust by Sharif, Wellness filed a five-count adversary complaint in Sharif's bankruptcy. Four counts objected to the discharge of Sharif's debts and alleged Sharif had concealed his property in the Trust, while the fifth sought a declaratory judgment that the Trust was Sharif's alter ego and should be

treated as property of Sharif's bankruptcy estate.¹ Sharif answered the adversary complaint and requested that the bankruptcy court rule in his favor on all five counts and find that the Trust was not property of his estate. When Sharif again repeatedly evaded his discovery obligations, the bankruptcy court entered a judgment against him on all five counts, including the alter-ego claim.

Sharif appealed to the district court, and before his opening brief was due, the Supreme Court issued its Stern decision. In relevant part, Stern held that certain claims statutorily designated by Congress for final adjudication in the bankruptcy court could not be finally decided by the bankruptcy court as a constitutional matter (each such claim, a "Stern Claim").² Only after the district court briefing concluded did Sharif ask to raise his objection to the bankruptcy court's ability to enter a final judgment on Wellness' alter-ego, Stern Claim. The district court denied the request as untimely and affirmed the bankruptcy court's judgment.

On appeal, the U.S. Court of Appeals for the Seventh Circuit held that a constitutional Stern objection like the one Sharif raised belatedly could not be waived because it implicated separation of powers concerns. The Seventh Circuit held that the bankruptcy court lacked constitutional authority to enter final judgment on the alter-ego claim. Wellness appealed to the Supreme Court.

B. The Holding

Although the Supreme Court did not answer whether Sharif's Claim was a Stern Claim, it resolved two questions regarding a bankruptcy court's ability to decide such Stern Claims: First, can litigants consent to the adjudication by a bankruptcy court (an Article I court) of a Stern Claim that otherwise merits adjudication by an Article III court? Second, if so, what type of consent suffices?

The Court answered "yes" to the first question—parties may consent to a bankruptcy court's resolution of a Stern Claim. To get there, the Court resolved whether a litigant's right to Article III adjudication was a personal right capable of being waived, or a whether those non-waivable, separation of powers issues controlled. The Court held that the "entitlement to an Article III adjudicator is 'a personal right' and thus ordinarily 'subject to waiver.'" Opinion at 11-12 (quoting Commodity Futures Trading Comm'n v. Schor, 478 U.S. 833, 848 (1986)). The Court dismissed the separation of powers concerns, holding that "allowing Article I adjudicators to decide claims submitted to them by consent does not offend the separation of powers so long as Article III courts retain supervisory authority over the process." Opinion at 12. The Court credited the district courts' supervisory authority over

¹ "Core" claims include, but are not limited to, those actions at the heart of a bankruptcy court's adjudication and adjustment of debtor-creditor relations, set forth in 28 U.S.C. § 157(b). Bankruptcy courts may enter final orders and judgments on core claims. By contrast, "non-core" claims include claims that are not core but nevertheless relate to a bankruptcy case. Ordinarily, a bankruptcy court may only issue proposed findings of fact and conclusions of law with respect to non-core claims, but with "the consent of all the parties to the proceeding" a bankruptcy judge may enter final orders and judgments. 28 U.S.C. § 157(c).

² See Exec. Benefits, 134 S. Ct. at 2170.

bankruptcy courts, noting that bankruptcy judges are appointed and subject to removal by Article III judges, constitute a unit of the district court and may hear matters only upon reference from the district court. Opinion at 13. As such, the “[s]eparation of powers concerns are diminished” when, as here, ‘the decision to invoke [a non-Article III] forum is left entirely to the parties and the power of the federal judiciary to take the jurisdiction’ remains in place.” Opinion at 13 (quoting Schor, 478 U.S. at 855). The Court also held that its recent decision in Stern did not mandate otherwise, as Stern was premised on the bankruptcy court’s inability to issue certain binding orders *without* the consent of the litigants, and had no occasion to determine whether a litigant could validly consent to bankruptcy court adjudication. Opinion at 15-17.

While the dissenting justices would have held that the bankruptcy court possessed the constitutional authority to decide Sharif’s alter-ego claim, the primary dissent, penned by Chief Justice Roberts, balked at allowing litigants entitled to Article III adjudication to consent to final adjudication before the Article I bankruptcy courts. Pointing to the same separation of powers concerns dismissed by the majority, the Chief Justice warned that the majority opinion had unconstitutionally ceded the power of Article III courts to Article I bankruptcy judges, “impermissibly threaten[ing] the institutional integrity of the Judicial Branch.” Dissenting Opinion at 13 (Roberts, C.J.).

Turning to the second question, the Court held that a litigant’s consent to bankruptcy court adjudication can be implied by a litigant’s conduct: “Nothing in the Constitution requires that consent to adjudication be express.” Opinion at 18. The Court likened the consent required to proceed before a bankruptcy judge with a similar decision holding that consent to proceedings before a magistrate judge need not be express,³ reiterating that “‘the Article III right is substantially honored’ by permitting waiver based on ‘actions rather than words.’” Opinion at 19 (quoting Roell, 538 U.S. at 589, 590). Such a result, the Opinion holds, has the effect of “increasing judicial efficiency and checking gamesmanship.” Id.

The Court then elaborated on how a litigant could consent to non-Article III adjudication of a Stern Claim. It held that such consent, “whether express or implied—must still be knowing and voluntary.” Id. That is, 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.” Id. (quoting Roell, 538 U.S. at 590). When such knowing and voluntary consent is present, litigants will have waived their right to adjudicate Stern Claims before an Article III court. Rather than elaborate on whether Sharif’s conduct demonstrated such knowing and voluntary consent, the Court remanded to the Seventh Circuit to determine that question in the first instance.

The Opinion’s Importance

The Opinion puts to rest some of the procedural wrangling among litigants in the wake of the prior Stern ruling, and clears the path for bankruptcy judges, with the knowing and voluntary consent of the parties, to resolve important bankruptcy questions subject only to

³ See Roell v. Withrow, 538 U.S. 580 (2003).

deferential review by the district court. Rather than restricting bankruptcy courts to suggesting only proposed findings of fact and conclusions of law to the district court, the Opinion gives bankruptcy courts and the parties before them more flexibility to resolve issues quickly and efficiently, while respecting Congress' choice to "supplement the capacity of district courts through the able assistance of bankruptcy judges."

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