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Bankruptcy & Financial Restructuring ADVISORY ■

JUNE 1, 2015

Wellness Raises a $920 Million Question

The U.S. Supreme Court's decision in *Wellness International Network Ltd. v. Sharif* confirms the long-held and common sense belief that "knowing and voluntary consent" is the key to the exercise of judicial authority by a bankruptcy court judge.[1] In short, the Supreme Court held that a litigant in a bankruptcy court can consent—expressly or impliedly through waiver—to the bankruptcy court's final adjudication of claims that the bankruptcy court otherwise lacks constitutional authority to finally decide. In so ruling, the Court has added clarity to the scope and effect of its rulings in *Stern v. Marshall*[2] and *Executive Benefits Insurance Agency v. Arkison*.[3] Wellness also requires parties to make significant decisions that have substantive impact that can be the difference in winning or losing $920 million, which therefore should be carefully considered, and must be made at the very start of the procedural path facing bankruptcy litigants.

Previously, in *Stern*, the Supreme Court held that a bankruptcy court lacks constitutional authority to enter a final judgment on a state law counterclaim by the bankruptcy estate against a creditor where the estate's counterclaim was not "necessary" to decide as part of allowance of a filed proof of claim. The counterclaim asserted in *Stern*, like other state law claims traditionally decided in courts of law, could not be finally decided by an Article I bankruptcy judge. *Arkison* then held that upon encountering such a claim (commonly referred to now as a "*Stern* claim"), the bankruptcy court should treat it as a *non-core related to* proceeding and therefore could issue proposed findings of fact and conclusions of law for the district court's de novo review; and in making such a determination, the Court closed the "statutory gap" that could have precluded the issuance of even such a limited report and recommendation. But neither *Stern* (where there was not consent) nor *Arkison* (where the consent issue was not resolved) answered the simple but important question of whether litigants can consent to entry of final orders by the bankruptcy court in *Stern* claims. *Wellness* has provided that answer, and in confirming that consent is a precondition to entry of a final order by the bankruptcy judge, brings renewed emphasis to several material considerations at the start of a case.

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[1] No. 13-935 (S. Ct.), U.S. (May 26, 2015).

[2] 131 S. Ct. 2594 (2011).

[3] 134 S. Ct. 2165 (2014).

After *Wellness*, the question for litigants is whether they *should* consent to the entry of final orders by the bankruptcy judge and what is the consequence if they don't. Consent potentially leads to speed of resolution and finality of decision and sets a standard for appellate review based on whether findings of fact are clearly erroneous. A litigant understandably may appreciate the commercial sophistication of being before a bankruptcy judge, who is generally perceived to have a commercial law specialization. Conversely, a litigant may want to protect its Seventh Amendment right to have a jury decide the issues raised in its case, or prefer the decision of an Article III judge to which it is constitutionally entitled. The benefits and costs to each strategy will change depending on the nature of the claims and liabilities at issue. A classic example of the immediate and material impact of these types of decisions is the well-known *Tousa* case.[4] The trial decision in *Tousa* had a $920 million consequence based on the amounts at issue that were avoided. As the bankruptcy court explained, "Aligned as defendants in the fraudulent transfer claims are the holders of a first lien term loan (in the original amount of roughly $200 million), the holders of a second lien term loan (in the original amount of roughly $300 million), and the lenders who were paid some $420 million in the financing transaction which forms the basis for the lawsuit."[5, 6]

In *Tousa*, the creditors' committee, derivatively acting for the bankruptcy estate, sued lenders for alleged fraudulent transfers related to a restructuring transaction that involved the assets of affiliates being used to pay and support the debt being restructured. The bankruptcy court ruled against the lenders and avoided the transfers and ordered the funds paid to be disgorged, but the district court reversed in a 113-page opinion.[7] The amount of the transfers avoided had a value of approximately $920 million, according to the trial decision by the bankruptcy court. Reviewing the bankruptcy court's factual findings under a clearly erroneous standard, the Eleventh Circuit reversed the district court because the factual record supported the bankruptcy court's decision even though the district court, in reviewing that identical factual record, reached a different factual conclusion.[8] If *Tousa* had been decided after *Wellness*, or if the parties in that case had objected and not consented to the entry of final orders by the bankruptcy court as contemplated by the applicable statutes, the result would have been entirely different. In that circumstance, the bankruptcy court's factual findings would not have been final but instead would have been subject to de novo review, enabling the district court to retry the case in its entirety, receive additional evidence on any issue or accept the record as it was, but weigh the evidence differently. *See* Bankruptcy Rule 9033. The consequence would have been that the district court's factual findings would have been the final ruling, and the bankruptcy court's determinations mere recommendations subject to being rejected or modified in whole or in part. *Tousa* therefore demonstrates the importance consent could have on bankruptcy litigation.

Another area impacted by the consent question is the level of review applicable to decisions of the bankruptcy court. If, in a non-core related to or *Stern* matter (with *Stern* being "core" but deemed to be "related to" under *Arkison*), the parties do not consent to the entry of final orders by the bankruptcy judge under existing or

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[4] *Senior Transeastern Lenders v. Official Comm. of Unsecured Creditors (In re TOUSA, Inc.)*, 680 F.3d 1298 (11th Cir. 2012).

[5] *Official Comm. of Unsecured Creditors v. Citicorp North American, Inc., et. al. (In re TOUSA, Inc.)*, 400 B.R. 783, 786 (Bankr. S.D. Fla. 2009).

[6] The following discussion evolved out of comments made by a bankruptcy judge about Stern and jurisdictional issues during the course of a continuing legal educational program.

[7] *Id*. at 1301, 1309-10.

[8] *Id*. at 1310, 1312-13.

future Bankruptcy Rules 7008 and 7012[9] and 28 U.S.C. § 157(c)(2), what happens if a motion to dismiss or for summary judgment is filed and denied by the bankruptcy court? The bankruptcy court has authority under *Arkison* to submit proposed findings of fact and conclusions of law. Bankruptcy Rule 9033, which is the procedural mechanism for objecting to proposed findings and recommendations, does not distinguish between orders granting or denying a motion in entitling the parties to de novo review in the district court. Certainly, any order (proposed findings and recommendations) granting a motion is entitled to such review, and an order (proposed findings and recommendations) denying such a motion should presumptively be entitled to such review. What about discovery motions which are not dispositive? Bankruptcy Rule 9033 does not differentiate between substantive final rulings and interim rulings in entitling the party to review by an Article III judge, and its incorporation by reference of 28 U.S.C. § 157(c)(1) only requires that a final order be entered by the district court, not that the order being reviewed itself be a final order.

One other point to note is that a bankruptcy judge has extensive judicial authority in non-*Stern* settings, such as dealing with requests for relief from the automatic stay, valuation of property, use of cash collateral, post-petition lending, discharge, dischargeability, exemptions, plan confirmation and assumption or rejection of union contracts and component issues, under 11 U.S.C. §§ 362, 363, 364, 506, 522, 523, 727, 1113, 1114, 1129, 1225 and 1325. In *Wellness*, the issue presented was one dealing with whether property was property of the estate under 11 U.S.C. §541 which, ordinarily, one might think would have clearly been within the judicial authority of the bankruptcy judge, but which under deeper scrutiny presented constitutional questions under *Stern* because of the competing claims to ownership of the asset at issue by a non-debtor trust.

In summary, the question answered by *Wellness* of knowing and voluntary consent is significant, but the playing field and the complicated determinations where litigants do not consent is daunting, and these decisions have to be made in the very earliest stages of a case. And so, while some may say that we have simply returned to a slight modification of the summary/plenary days, the issues that remain to be factored in are actually more complex than the bright line that existed before the Bankruptcy Reform Act of 1978 became effective in October 1979, and could be questions with $920 million consequences.

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[9] The proposed new Bankruptcy Rules, as discussed in *Wellness*, will require a statement of whether a party does or does not consent to entry of a final order by the bankruptcy judge whether or not a matter is "core" or "non-core."

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