Keeping Up with the Supremes: Supreme Court Update

James E. Van Horn, Moderator
McGuireWoods LLP; Baltimore

Stuart M. Brown
DLA Piper; Wilmington, Del.

Christopher J. Giaimo
BakerHostetler; Washington, D.C.

Hon. Martin Glenn
U.S. Bankruptcy Court (S.D.N.Y.); New York

Jeffrey N. Rothleder
Arent Fox LLP; Washington, D.C.

Lisa A. Tracy
Executive Office for U.S. Trustees; Washington, D.C.

Stern v. Marshall and Its Progeny

Hon. Martin Glenn
U.S. Bankruptcy Judge
Southern District of New York

Stern v. Marshall and Its Progeny[1]

By Hon. Martin Glenn
U.S. Bankruptcy Judge
Southern District of New York

Supreme Court decisions strongly shape what bankruptcy judges can and can't do, particularly the decisions in *Murray's Lessee*, 59 U.S. 272 (1855); *Katchen v. Landy*, 382 U.S. 323 (1966); *Northern Pipeline v. Marathon Pipeline Co.*, 458 U.S. 50 (1982); *Commodity Futures Trading Comm'n v. Schor*, 478 U.S. 833 (1986); *Granfinanciera, S.A. v. Nordberg*, 492 U.S. 33 (1989); *Langenkamp v. Culp*, 498 U.S. 42 (1990); *Stern v. Marshall*, 131 S. Ct. 2594 (2011); *Executive Benefits Ins. Agency v. Arkison*, 134 S. Ct. 2165 (2014); and, most recently, *Wellness Int'l Network, Ltd. v. Sharif*, 135 S. Ct. 1932 (2015) .

A. Cases Imposing Limitations on the Authority of Bankruptcy Judges

Courts have grappled with constitutional and statutory limits on bankruptcy jurisdiction even before the current bankruptcy court system was created in the Bankruptcy Act of 1978 (the "1978 Act"). The inquiry commonly focused on whether a bankruptcy estate's affirmative claim against a third party involved the claims allowance process. For example, in *Katchen v. Landy*, 382 U.S. 323 (1966), the Supreme Court held that a bankruptcy judge had authority to enter judgment on a bankruptcy estate's preference action against a creditor that filed a proof of claim in the bankruptcy case, *and* to enter judgment against the creditor for an amount in excess of its proof of claim. The Court held that the preference action in question was, like any other claims objection, "part and parcel" of the claims allowance process, and therefore subject to adjudication by a bankruptcy court. *Id.* at 330. The Court explained: "he who invokes the aid of the bankruptcy court by offering a proof of claim and demanding its allowance must abide the consequences of that procedure." *Id.* at 333 n.9. "[O]ne of those consequences was resolution of the preference issue as part of the process of allowing or disallowing claims . . . ." *Stern*, 131 S. Ct. at 2616 (explaining *Katchen*).

The contours of bankruptcy jurisdiction remained unclear after enactment of the 1978 Act. In the landmark *Marathon* decision, the Supreme Court struck down as unconstitutional the provisions of the 1978 Act that granted bankruptcy courts final adjudicative authority over certain state law claims brought against third parties who were not otherwise part of the bankruptcy case. The Court explained that Article III of the Constitution requires those matters to be adjudicated by an Article III court, not an Article I bankruptcy court. 458 U.S. at 71–72. Notably, the defendant in *Marathon* had not filed a proof of claim in the bankruptcy case—an important distinction from *Katchen*. *See Stern*, 131 S. Ct. at 2615–18 (discussing *Katchen* and *Marathon*).

In 1984, after the delayed congressional response to the 1982 decision in *Marathon*, Congress adopted the Bankruptcy Amendments and Federal Judgeship Act of

[1]

1984 (BAFJA), Pub. L. No. 98-353, 98 Stat. 333 (codified in sections of titles 11 and 28). BAFJA amended the 1978 Bankruptcy Act, effectively repealing sections that the Court found unconstitutional in the *Marathon* decision. That enactment set the structure for our bankruptcy courts today. It codified the "core," "non-core" division that, until *Stern v. Marshall*, largely defined how bankruptcy judges determined their authority to act in the specific matters before them. On the basis of *Marathon*, Congress thought that the "core," "non-core" distinction was workable. Congress provided a non-exhaustive list of core proceedings in 28 U.S.C. § 157(b)(2). Non-core proceedings are those that are not core "but that [are] otherwise related to a case under title 11." *Id.* at § 157(c)(1). Bankruptcy judges were given statutory authority to enter final judgments in core proceedings, *id.* § 157(b)(1), but were limited in non-core proceedings to submitting proposed findings of fact and conclusions of law to the district court for de novo review. *Id.* § 157(c)(1).

Proceedings involving the "allowance or disallowance of claims" are listed as core proceedings under section 157(b)(2)(B). Even after *Marathon*, it remained clear—as it has been since *Katchen*—that bankruptcy courts could constitutionally determine matters that were part of the claims allowance process. *See, e.g.*, *Langenkamp*, 498 U.S. at 44 ("[B]y filing a claim against a bankruptcy estate the creditor triggers the process of 'allowance and disallowance of claims,' thereby subjecting himself to the bankruptcy court's equitable power.") (citing *Granfinanciera, S.A. v. Nordberg*, 492 U.S. at 58–59). This authority is codified in section 157(b)(2)(B). But it was unclear whether Congress, by listing counterclaims as core in section 157(b)(2)(C), had provided that the filing of a proof of claim subjected a creditor to final adjudication by the bankruptcy court of *all* counterclaims by the estate (regardless of the connection to the proof of claim), and, if so, whether that act was constitutional. *See* 1 COLLIER ON BANKRUPTCY ¶ 3.02[d][i] (16th ed. rev. 2014). Indeed, in the 2009 edition of their casebook, Professors Warren and Westbrook concluded that after *Granfinanciera*, "many in the bankruptcy world are waiting for another jurisdictional shoe to drop, but it has become the wait for Godot." ELIZABETH WARREN & JAY LAWRENCE WESTBOOK, THE LAW OF DEBTORS AND CREDITORS, at 108 (6th ed. 2009). With the decision in *Stern v. Marshall*, the wait was over.

In *Stern*, a creditor filed a proof of claim for defamation in the debtor's bankruptcy case, and the debtor defended the complaint and filed a counterclaim for tortious interference. *See Stern*, 131 S. Ct. at 2601. The bankruptcy court treated the counterclaim as core and entered judgment in favor of the debtor. *See id.* at 2601–02. The district court disagreed that the counterclaim was core and conducted a de novo review of the record as if the claim was non-core. *See id.* at 2602. On further appeal, the Ninth Circuit held that the debtor's counterclaim, although compulsory, was not a core proceeding under section 157(b)(2)(C). *Marshall v. Stern (In re Marshall)*, 600 F.3d 1037, 1057–58 (9th Cir. 2010).

On appeal to the Supreme Court, one of the questions presented was "[w]hether the Ninth Circuit opinion, which render[ed] § 157(b)(2)(C) surplusage in light of § 157(b)(2)(B), contravene[d] Congress' intent in enacting § 157(b)(2)(C)." Petition for Writ of Certiorari at ii, *Stern*, 131 S. Ct. 2594 (No. 05-1631), 2010 WL 3068082. The

Supreme Court answered this question in the affirmative, rejecting the Ninth Circuit's reasoning. The Court held that the counterclaim at issue was indeed statutorily core under section 157(b)(2)(C) as a "counterclaim by the estate against persons filing claims against the estate." *Stern*, 131 S. Ct. at 2604. *See also* 1 COLLIER ON BANKRUPTCY ¶ 3.02[d][i]. But even though the counterclaim was statutorily core, the Court concluded that Congress could not constitutionally authorize bankruptcy courts to finally determine the counterclaim, since the bankruptcy court "lacked the constitutional authority to enter a final judgment on a state law counterclaim that is not resolved in the process of ruling on a creditor's proof of claim." *Stern*, 131 S. Ct. at 2620. Thus, "*Stern* made clear that some claims labeled by Congress as 'core' may not be adjudicated by a bankruptcy court in the manner designated by § 157(b)." *Arkison*, 134 S. Ct. at 2172. *Stern* explicitly held that the debtor's counterclaim was "core" under section 157(b)(2)(C). *See Stern*, 131 S. Ct. at 2605 ("[W]e agree with [the creditor] that designating all counterclaims as 'core' proceedings raises serious constitutional concerns. . . . We would have to 'rewrit[e]' the statute, not interpret it, to bypass the constitutional issue § 157(b)(2)(C) presents. That we may not do.") (alteration in original) (quoting *Schor*, 478 U.S. at 841). Importantly, *Stern* did not alter the subject matter jurisdiction of the bankruptcy courts. As the Supreme Court stated, "[s]ection 157 allocates the authority to enter final judgment between the bankruptcy court and the district court. That allocation does not implicate questions of subject matter jurisdiction." *Stern*, 131 S. Ct. at 2607.

As discussed above, the core/non-core distinction generally does not bear on the question of federal subject matter jurisdiction—federal courts have jurisdiction to hear *both* core matters *and* non-core matters. *See* 28 U.S.C. § 1334(b). If a proceeding qualifies as one of the core proceedings enumerated in section 157(b)(2), the court has subject matter jurisdiction over the action as one "arising under" or "arising in" a bankruptcy case. The applicable test for determining whether the court may exercise related-to jurisdiction over non-core claims may depend on whether the claim is asserted before or after confirmation of a chapter 11 plan and whether the confirmed plan provides for reorganization or liquidation of the debtor.

After the 2011 decision in *Stern v. Marshall*, the distinction between core and non-core issues no longer completely determines the authority of bankruptcy judges to act, particularly for what the Court in *Arkison* described as "*Stern* claims"—statutorily core claims for which Article I bankruptcy judges may not enter final orders or judgment, at least absent the consent of the parties. *Stern* left great uncertainty whether or how bankruptcy judges could resolve *Stern* claims. Section 157(b)(1) provides that bankruptcy judges may "hear and determine"—understood to mean enter final orders or judgment—on all statutorily core proceedings, but after the *Stern* decision that was no longer true. Section 157(c) provides that for none core proceedings, bankruptcy judges shall submit proposed findings of fact and conclusions of law to the district court, with the district court entering final orders or judgment after de novo review. The statute left a gap—what should or could the bankruptcy judge do with core claims for which the bankruptcy judge lacked constitutional authority to enter final orders or judgment?

Stern made clear that the jurisdiction of the bankruptcy court was not affected by the ruling; rather, the issue was the authority of the bankruptcy judge in deciding *Stern* claims. The applicable jurisdictional statute, 28 U.S.C. § 1334, provides that the district courts have original and exclusive jurisdiction of bankruptcy cases, and original but not exclusive jurisdiction of civil proceedings arising under title 11, or arising in or related to cases under title 11. Section 157(a) provides that the district courts may provide that bankruptcy cases and proceedings shall be referred to bankruptcy judges in the same district. Every district court in the country has acted on this authority by adopting an order of reference automatically referring all bankruptcy cases and proceedings to the bankruptcy court. But section 157(d) provides that the district court, on motion or *sua sponte*, may withdraw the reference, in whole or in part, of any case or proceeding referred to the bankruptcy court. Therefore, the bankruptcy court's jurisdiction over cases and proceedings is derivative of the district court's jurisdiction, and the district court may withdraw the reference of cases or proceedings in the bankruptcy court, effectively taking those matters back for decision by Article III district judges. As discussed below, this authority of the district court to withdraw the reference of cases or proceedings was important to the decision in *Wellness*, permitting bankruptcy judges to enter final orders or judgment with the consent of the parties.

Many district courts responded to the decision in *Stern* by amending their orders of reference.[2] These amendments clarified that not only statutorily noncore matters, but also *Stern* claims are referred to the bankruptcy courts for resolution. Absent consent (assuming consent was valid), these changes to the orders of reference directed the bankruptcy judge to resolve *Stern* claims by issuing proposed findings of fact and conclusions of law. The Supreme Court's decision in *Arkison*, 134 S. Ct. 2165, decided in 2014 after many of these amended orders of reference were issued, validates the approach taken by these district courts. Some bankruptcy courts have also adopted local rules changes to accommodate the procedures for dealing with core and non-core claims, and the issue of consent.

---

[2] At least 16 districts amended their orders of reference in light of *Stern*. For example, the U.S. District Court for the Southern District of New York adopted an amended standing order of reference on February 1, 2012, continuing to refer all bankruptcy cases or proceedings to the bankruptcy court, and specifying how the bankruptcy court or district court may deal with rulings in matters impacted by *Stern*. The order provides as follows:

> Pursuant to 28 U.S.C. Section 157(a) any or all cases under title 11 and any or all proceedings arising under title 11 or arising in or related to a case under title 11 are referred to the bankruptcy judges for this district.
>
> If a bankruptcy judge or district judge determines that entry of a final order or judgment by a bankruptcy judge would not be consistent with Article III of the United States Constitution in a particular proceeding referred under this order and determined to be a core matter, the bankruptcy judge shall, unless otherwise ordered by the district court, hear the proceeding and submit proposed findings of fact and conclusions of law to the district court. The district court may treat any order of the bankruptcy court as proposed findings of fact and conclusions of law in the event the district court concludes that the bankruptcy judge could not have entered a final order or judgment consistent with Article III of the United States Constitution.

M-431 (Bankr. S.D.N.Y. Feb. 1, 2012).

Until the recent Supreme Court decision in *Wellness*, 135 S. Ct. 1932, post-*Stern* decisions from lower federal courts added to the uncertainty whether a bankruptcy judge could enter final orders or judgment with respect to core and non-core claims with the consent of the parties. Section 157(c)(2) specifically permits bankruptcy judges to "hear and determine"—enter final orders or judgment—in related to (*i.e.*, non-core proceedings) with the consent of all of the parties, but that subsection does not by its terms apply to statutorily core proceedings. As discussed below, *Wellness* has now resolved that issue, concluding that express or implied consent by the parties is sufficient to permit a bankruptcy judge to enter final orders or judgment with respect to both core and non-core claims. This resolution of the consent issue is important for both bankruptcy judges and magistrate judges.

B. The Authority of Article I Judges to Decide Disputes

Marathon, Stern v. Marshall, Arkison and *Wellness* deal with the constitutional limitations placed on Article I judges. Article III, section 1 of the Constitution provides that the "judicial power of the United States shall be vested in one Supreme Court, and in such inferior courts as the Congress may from time to time ordain and establish." It also protects Article III judges (but not bankruptcy or magistrate judges) by providing life tenure and protections against diminution in salary.

In 1856, the Supreme Court in *Murray's Lessee*, 59 U.S. 272, 284 (1855), concluded that Article III does not permit Congress to "withdraw from [Article III] judicial cognizance any matter which, from its nature, is the subject of a suit at the common law, or in equity, or admiralty . . . ." The Supreme Court applied this principle in *Marathon*, where it struck down as unconstitutional the 1978 Bankruptcy Act's provisions vesting final adjudicative authority in the bankruptcy court—an Article I court—over certain state-law claims asserted by the debtor against a third party. The Court held that Article III required final adjudicative authority over matters within the competence of the Article III judiciary to be vested in an Article III court. The cases must not be removed to tribunals where judges lack the Article III protections of life tenure and non-diminution of salary. The Court stated:

> Article III bars Congress from establishing under its Art. I powers legislative courts to exercise jurisdiction over all matters arising under the bankruptcy laws. The establishment of such courts does not fall within any of the historically recognized situations—non-Art. III courts of the Territories or of the District of Columbia, courts-martial, and resolution of "public rights" issues—in which the principle of independent adjudication commanded by Art. III does not apply.

Marathon, 458 U.S. at 51.

The Court explained the public rights doctrine as follows:

> The [public rights] doctrine extends only to matters arising between the Government and persons subject to its authority in connection with the performance of the constitutional functions of the executive or legislative departments, and only to matters that historically could have been determined exclusively by those departments. The understanding of these cases is that the Framers expected that Congress would be free to commit such matters completely to nonjudicial executive determination, and that as a result there can be no constitutional objection to Congress' employing the less drastic expedient of committing their determination to a legislative court or an administrative agency.

Marathon, 458 U.S. at 67–68 (internal quotation marks and citations omitted).

Bankruptcy judges may hear and determine (enter final judgment) on any issue that is "part and parcel" of the claims-allowance process. For example, in *Katchen v. Landy*, 382 U.S. 323 (1966), the Supreme Court upheld the authority of a bankruptcy judge, as part of the claims allowance process, to adjudicate and enter final judgment on a bankruptcy estate's claim to avoid and recover a preference against a creditor that filed a proof of claim in the bankruptcy case, *and* to enter judgment against the creditor for an amount in excess of the proof of claim the creditor filed. Bankruptcy judges may also enter final judgments on discharge matters. *See Cent. Va. Cmty. College v. Katz*, 546 U.S. 356, 363–64 (2006) ("Critical features of every bankruptcy proceeding are the exercise of exclusive jurisdiction over all of the debtor's property, the equitable distribution of that property among the debtor's creditors, and the ultimate discharge that gives the debtor a 'fresh start' by releasing him, her, or it from further liability for old debts."); *Tenn. Student Assistance Corp. v. Hood*, 541 U.S. 440, 447 (2004) ("The discharge of a debt by a bankruptcy court is similarly an in rem proceeding."); *Local Loan Co. v. Hunt*, 292 U.S. 234, 244–45 (1934) ("This purpose of the act has been again and again emphasized by the courts as being of public as well as private interest, in that it gives to the honest but unfortunate debtor who surrenders for distribution the property which he owns at the time of bankruptcy, a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of preexisting debt.").

This focus on what is necessarily part of the claims-allowance process is one of the crucial factors in understanding the implications of *Stern v. Marshall* for the authority of bankruptcy judges to enter final orders and judgments. The claims allowance process—including preference avoidance and recovery against a creditor that filed a proof of claim—is integral to the restructuring of the debtor-creditor relationship and invokes the bankruptcy court's equity jurisdiction. Therefore, there is no right to trial by jury.

Section 157(b)(2)(A)–(P) provides a non-exhaustive list of examples of core matters, including avoidance actions (§ 157(b)(2)(F) & (G)) and counterclaims by the estate against persons filing claims against the estate (§ 157(b)(2)(C)).

The statute provides that bankruptcy courts may hear core matters and non-core matters that are "otherwise related" to a case under title 11. But bankruptcy judges only have statutory authority to enter final judgments in core proceedings (§ 157(b)(1) ("hear and determine all cases . . . and all core proceedings"); in non-core proceedings, absent consent, bankruptcy judges may only enter proposed findings of fact and conclusions of law, with final orders or judgments entered by the district courts (§ 157 (c)(1) ("the bankruptcy judge shall submit proposed findings of fact and conclusions of law to the district court, and any final order or judgment shall be entered by the district judge")). The district court enters a final order or judgment after reviewing de novo any matters to which a party objects following the procedure set forth in Bankruptcy Rule 9033.

In *Arkison*, the Supreme Court decided that for "*Stern* claims"—for which section 157(b)(1) provides that bankruptcy judges may hear and determine all core proceedings and enter final orders and judgment but Article III does not permit a bankruptcy judge to do so—bankruptcy judges may enter proposed findings of fact and conclusions of law under section 157(c)(1), with final judgment entered by the district court after de novo review to the extent of any objections to the bankruptcy judge's proposed disposition following the procedure in Fed. R. Bankr. P. 9033. *Arkison* resolved the issue of the "statutory gap," since the statute only provides for proposed findings and conclusions for non-core, related-to claims, and not for core claims—in effect, after *Arkison*, the *Stern* claims are channeled to the procedure applicable for non-core claims. *See Wellness*, 135 S. Ct. at 1942 n. 6 ("The Seventh Circuit concluded its opinion by considering the remedy for the Bankruptcy Court's purportedly unconstitutional issuance of a final judgment. The court determined that if count V of Wellness' complaint raised a core claim, the only statutorily authorized remedy would be for the District Court to withdraw the reference to the Bankruptcy Court and set a new discovery schedule. The Seventh Circuit's reasoning on this point was rejected by the decision last Term in *Arkison*, which held that district courts may treat *Stern* claims like non-core claims and thus are not required to restart proceedings entirely when a bankruptcy court improperly enters final judgment."); *see also Residential Funding Co., LLC v. UBS Real Estate Securities, Inc. (In re Residential Capital, LLC)*, 515 B.R. 52, 66 (Bankr. S.D.N.Y. 2014) ("[A]djudication of *Stern* claims is channeled to section 157(c), permitting the bankruptcy court to submit proposed findings of fact and conclusions of law, *as if* the claim was non-core. The Court does not read *Arkison* to re-write the statute such that *Stern* claims are no longer statutorily core under 157(b)(2)—something the *Stern* court itself explicitly did not do.") (citation omitted).

Section 157(c)(2) provides that the parties may consent to a bankruptcy court's final adjudication of non-core matters. 28 U.S.C. § 157(c)(2) ("Notwithstanding the provisions of paragraph (1) of this subsection, the district court, with the consent of all the parties to the proceeding, may refer a proceeding related to a case under title 11 to a bankruptcy judge to hear and determine and to enter appropriate orders and judgments, subject to review under section 158 of this title."). The Supreme Court granted *certiorari* on the consent issue in *Arkison*, but found it unnecessary to resolve it. Less than one week after deciding *Arkison*, however, the Supreme Court granted *certiorari* in *Wellness*

on the consent issue and its decision resolved the circuit split in post-*Stern* cases, concluding that express or implied consent is sufficient to provide authority for bankruptcy judges to enter final orders or judgments on *Stern* claims or non-core matters. The question of what may constitute implied consent was not fully resolved, however, with the Court remanding the case to the Seventh Circuit to address the question. Implied consent is discussed further below.

C. *Wellness* and the Framework for Analyzing the Consent Issue

After *Stern*, the circuits were split whether the parties' consent permitted a bankruptcy judge to enter final orders or judgment.[3] While the Supreme Court granted *certiorari* in *Arkison* on the consent issue, the Court found it unnecessary to resolve the issue. But the Court promptly thereafter granted *certiorari* in *Wellness* on the consent issue. This time, the Court resolved the issue hanging over bankruptcy judges, and magistrate judges as well since 28 U.S.C. § 636, applicable to magistrate judges, likewise includes a consent procedure permitting magistrate judges with the consent of the parties to enter final orders or judgment (including conducting of jury trials).

---

[3] Circuit court decisions had reached conflicting results on the consent issue. In *Arkison*, the Ninth Circuit concluded that, based on express or implied consent, a bankruptcy judge may enter a final order or judgment in a core proceeding that would otherwise require that the district court enter final orders or judgment. *See Executive Benefits Ins. Agency v. Arkison (In re Bellingham Ins. Agency, Inc.)*, 702 F.3d 553, 567 (9th Cir. 2012). In *Mastro v. Rigsby*, 764 F.3d 1090 (9th Cir. 2014), decided after the Supreme Court decision in *Arkison*, the Ninth Circuit concluded that its earlier decision in *Arkison*, remained controlling law in the circuit.

In a pre-*Stern* case that addressed the Article III issue based on the Supreme Court *Marathon* decision, the Second Circuit had held that a bankruptcy judge may enter a final order or judgment based on express or implied consent in core or non-core proceedings. *Men's Sportswear, Inc. v. Sasson Jeans, Inc. (In re Men's Sportswear, Inc.)*, 834 F.2d 1134, 1137–38 (2d Cir. 1987).

The Fifth and Sixth Circuits reached the opposite result. In *BP RE, L.P. v. RML Waxahachie Dodge, L.L.C. (In re BP RE, L.P.)*, 735 F.3d 279, 285–86 (5th Cir. 2013), the Fifth Circuit concluded, based on *Stern*, that the bankruptcy court did not have the constitutional authority to enter a final judgment on claims that are not necessarily resolved as part of the claims allowance process. *See also Frazin v. Haynes & Boone, L.L.P. (In re Frazin)*, 732 F.3d 313, 319 (5th Cir. 2013).

The Sixth Circuit reached a similar conclusion in *Waldman v. Stone*, 698 F.3d 910, 918–19 (6th Cir. 2012), *cert. denied*, 133 S. Ct. 1604 (2013) ("Article III could neither serve its purpose in the system of checks and balances nor preserve the integrity of judicial decisionmaking if the other branches of the Federal Government could confer the Government's judicial Power on entities outside Article III. Article III envisions—indeed it mandates—that the judicial Power will be vested in judges whose tenure and salary are protected as set forth in that Article. To the extent that Congress can shift the judicial Power to judges without those protections, the Judicial Branch is weaker and less independent than it is supposed to be.")

Despite the Seventh Circuit's *Wellness* decision, the outcome on the consent issue remained unclear in the Seventh Circuit. The decision in *Wellness Int'l Network, Ltd. v. Sharif*, 727 F.3d 751, 771 (7th Cir. 2013), dealt with a S*tern* claim and was primarily based on the statutory gap that provided no statutory authority for a bankruptcy judge to dispose of statutorily core claims that required an Article III judge to enter final orders or judgment, a position that was thereafter rejected by the Supreme Court in *Arkison.* Indeed, the Seventh Circuit panel in *Wellness* reserved judgment on the constitutionality of 28 U.S.C. § 157(c)(2), which authorizes the parties to consent to adjudication by a bankruptcy judge for related to proceedings; in dicta, the panel explained that the argument supporting the constitutionality of the consent procedure for related to proceedings was strong. *See also Peterson v. Somers Dublin Ltd.*, 729 F.3d 741, 747 (7th Cir. 2013) (concluding that the effect of an express waiver is open in the circuit).

Writing for the majority in *Wellness*, Justice Sotomayor concluded that "We hold that Article III is not violated when the parties knowingly and voluntarily consent to adjudication by a bankruptcy judge." 135 S. Ct. at 1939. In analyzing the consent issue, the Court stated that "[t]he foundational case in the modern era is *Commodity Futures Trading Comm'n v. Schor*, 478 U.S. 833 (1986)." *Id.* at 1942. In *Schor*, the Court found two components inherent in the constitutional right to an Article III judge: (1) the individual constitutional right of litigants to insist on an Article III decision-maker; and (2) the structural constitutional right, stemming from the separation of powers doctrine which requires an Article III decision-maker. *Schor*, 478 U.S. at 847–49. The individual constitutional right to an Article III decision-maker may be lost through waiver or express or implied consent by the parties. The structural right, however, assures that the executive and legislative branches will not encroach on the authority to enter a final judgment in certain matters; it is derived from the core separation of powers principle, and it may not be waived by the parties.

> The lesson of *Schor*, *Peretz* [*v. U.S.*, 501 U.S. 923 (1991)], and the history that preceded them is plain: The entitlement to an Article III adjudicator is a personal right and thus ordinarily subject to waiver. Article III also serves a structural purpose, barring congressional attempts to transfer jurisdiction [to non-Article III tribunals] for the purpose of emasculating constitutional courts and thereby prevent[ing] the encroachment or aggrandizement of one branch at the expense of the other. But 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.

Wellness, 135 S. Ct. at 1944 (internal quotation marks and citations omitted).

The last point—the supervisory authority of Article III judges over the process—was likewise important to the decision. As already discussed, bankruptcy cases and proceedings are referred to the bankruptcy courts by the district courts, which continue to have the authority, on motion or *sua sponte*, to withdraw the reference. 28 U.S.C. § 157(d). Because the entire process of adjudication in the bankruptcy court "takes place under the district court's total control and jurisdiction, there is no danger that use of the bankruptcy court involves a congressional attempt to transfer jurisdiction to non-Article III tribunals for the purpose of emasculating constitutional courts." *Id.* at 1945 (internal quotation marks and brackets omitted).

Giving effect to the decisions in *Stern*, *Arkison* and *Wellness*, the Bankruptcy Code does not withdraw from Article III judicial cognizance, for final decision by Article I bankruptcy judges, cases in which the parties are entitled to an Article III decision-maker. While the parties may waive their individual rights to an Article III judge, opting instead to have a bankruptcy judge enter final orders or judgment, the district court retains the authority to withdraw the reference despite the parties' consent.

Indeed, one can argue that in providing a consent procedure in section 157(c)(2), by its terms limited to related-to cases but now applied to *Stern* claims as well, Congress

has only codified what was the historical practice in bankruptcy cases and proceedings, sanctioned by decisions of the Supreme Court under the former Bankruptcy Act. Bankruptcy jurisdiction was previously divided between summary and plenary jurisdiction, with referees authorized to finally resolve summary proceedings, but with district judges required to resolve plenary proceedings. But even in the absence of statutory provisions authorizing referees to do so, Supreme Court cases permitted referees to finally resolve plenary proceedings with the express or implied consent of the parties. Indeed, in *Wellness*, Justice Sotomayor explained:

> Before 1978, district courts typically delegated bankruptcy proceedings to "referees." Under the Bankruptcy Act of 1898, bankruptcy referees had "[s]ummary jurisdiction" over "claims involving 'property in the actual or constructive possession of the bankruptcy court' "—that is, over the apportionment of the bankruptcy estate among creditors. They could preside over other proceedings—matters implicating the court's "plenary jurisdiction"—by consent.

Wellness, 135 S. Ct. at 1939 (citations omitted).

In support of her conclusion regarding consent to referees deciding plenary proceedings, Justice Sotomayor cited *MacDonald v. Plymouth County Trust Co.,* 286 U.S. 263 (1932). The Court in that case concluded as follows:

> While under the provisions of the Bankruptcy Act the exercise of his jurisdiction by the referee is ordinarily restricted to those matters which may be dealt with summarily by the method of procedure available to referees in bankruptcy, the restriction may be removed, as it was here, by the consent of the parties to a summary trial of the issue presented. The referee therefore had power to decide the issues . . . .

Id. at 268. The *MacDonald* decision was not unique. For example, Justice Frankfurter explained in *Cline v. Kaplan,* 323 U.S. 97 (1944), that based on consent a referee may decide matters otherwise entitling the defendant to a plenary action before a district judge. And the consent may be formally expressed or waived by failing to make a timely objection.

> Consent to proceed summarily may be formally expressed, or the right to litigate the disputed claim by the ordinary procedure in a plenary suit, like the right to a jury trial, may be waived by failure to make timely objection. Consent is wanting where the claimant has throughout resisted the petition for a turnover order and where he has made formal protest against the exercise of summary jurisdiction by the bankruptcy court before that court has made a final order.

Id. at 99. *See generally* KENNETH M. KLEE, BANKRUPTCY AND THE SUPREME COURT, chpt. 4, at 199–217 (2008).

Chief Justice Roberts and Justices Scalia and Thomas dissented in *Wellness*. The Chief Justice wrote the principal dissent. The Chief Justice would have resolved the case without reaching the consent issue, concluding that the Seventh Circuit incorrectly decided that one of the plaintiff's claims was a *Stern* claim. But assuming the case raised a *Stern* claim, the Chief Justice concluded that consent to adjudication of *Stern* claims by an Article I bankruptcy judge trenches upon the structural protection of Article III that cannot be waived. The Chief Justice laments the Court opening the door to congressional action that would encroach on the powers of Article III judges. *Id.* at 1950–51. The expressed concern is not fanciful. There is long history of legislative efforts—some well-intentioned, expanding the range of administrative agency decision-making, *see, e.g., Thomas v. Union Carbide Agric. Prod. Co.*, 473 U.S. 568, 582–83 (1985)—and some seemingly punitive, for example, attempting to restrict the Supreme Court's appellate jurisdiction over legislative apportionment, or review of the voluntariness of confessions. *See, e.g.*, Hart, The Power of Congress to Limit the Jurisdiction of Federal Courts: An Exercise in Dialectic, 66 Harv. L. Rev. 1362 (1953), reprinted in P. Bator, P. Mishkin, D. Shapiro, & H. Wechsler, Hart and Wechsler's The Federal Courts and the Federal System 330 (2d ed. 1973).

The concern expressed by the dissent seems overblown in the circumstances. Well-settled historical practice under the Bankruptcy Act permitted referees (the predecessors to bankruptcy judges) to adjudicate plenary disputes on consent. The statutory consent procedure under section 157(c)(2), combined with the authority of district judges to withdraw the reference under section 157(d), leaves Article III judges with control. In short, with the judicial gloss imposed on the statutes by *Stern*, *Arkison* and *Wellness*, Congress has not withdrawn from Article III judicial cognizance any cases that were tried at Westminster in 1789.

D. Express and Implied Consent

Five of the six justices in the majority in *Wellness* agreed that nothing in the Constitution or in the relevant statute (28 U.S.C. § 157) requires express consent. 135 S. Ct. at 1947. Justice Alito, in a separate concurring opinion, said that he "would not decide whether consent may be implied." *Id.* at 1949. In discussing implied consent, Justice Sotomayor's opinion for the Court focused on the Court's earlier decision in *Roell v.Withrow*, 538 U.S. 580 (2003), which construed the consent provision in 28 U.S.C. § 636(c)(1) ("Upon the consent of the parties, a full-time United State magistrate judge . . . may conduct any or all proceedings in a jury or nonjury civil matter and order the entry of judgment in the case . . . ."), and concluded that implied consent sufficed for a magistrate judge to decide and enter final judgment in matters otherwise requiring an Article III judge. *Id.* ("But the majority [in *Roell*]—thus placed on notice of the constitutional concern—was untroubled by it, opining that 'the Article III right is substantially honored' by permitting waiver based on 'actions rather than words.'") (internal citation omitted).

The majority opinion explained:

> The implied consent standard articulated in *Roell* supplies the appropriate rule for adjudications by bankruptcy courts under section 157. Applied in the bankruptcy context, that standard possesses the same pragmatic virtues—increasing judicial efficiency and checking gamesmanship—that motivated our adoption of it for consent-based adjudication by magistrate judges. It bears emphasizing, however, that a litigant's consent—whether express or implied—must still be knowing and voluntary. *Roell* makes clear that 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. at 1948. In a footnote, the opinion then explains that while the Constitution does not require that consent be express,

> it is good practice for courts to seek express statements of consent or nonconsent, 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 and judicial rules may require express consent where the Constitution does not. Indeed, the Federal rules of Bankruptcy Procedure already require that pleadings in adversary proceedings before a bankruptcy court "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."

Id. at 1948 n.13 (citing FED. R. BANKR. P. 7008 and 7012). The Court then remanded the case back to the Seventh Circuit to determine on remand whether the defendant "evinced the requisite knowing and voluntary consent . . . ." *Id.* at 1949.

The requirement of knowing and voluntary waiver or consent before permitting a bankruptcy judge to enter final orders or judgment seems unexceptional, but the comparison of the applicable procedures for magistrate judges and bankruptcy judges presents some difficulties. *See O'Toole v. McTaggart (In re Trinsum Group, Inc.)*, 467 B.R. 734, 740 n.13 (explaining the differences in the referral procedures and scope of the referral for magistrate judges and bankruptcy judges). "A referral to a magistrate judge under the applicable statute and rule [Fed. R. Civ. P. 72] is narrower than the referral of cases to the bankruptcy court." *Id.* All bankruptcy cases and proceedings are referred to the bankruptcy court. Bankruptcy judges may enter final orders or judgment on statutorily-core, non-*Stern* claims without the parties' consent; for *Stern* claims and non-core claims, final orders or judgment may only be entered by the bankruptcy judge with express or implied consent. Section 157(b)(3) provides that the "bankruptcy judge shall determine, on the judge's own motion or on timely motion of a party, whether a proceeding is a core proceeding . . . or is a proceeding that is otherwise related to a case

under title 11. A determination that a proceeding is not a core proceeding shall not be made solely on the basis that its resolution may be affected by state law." 28 U.S.C. § 157(b)(3). Of course, after *Stern*, the determination required by the statute is not enough; the court must also decide what is a *Stern* claim. The statute does not direct when the determination must or should be made. It is not always an easy determination, and it may never need to be made—most cases settle. Sometimes, too, parties that initially withhold consent change their minds and provide consent before pretrial proceedings are complete.

Adversary proceedings (like many civil complaints in district court) may contain multiple causes of action—core claims that allow the bankruptcy judge to enter final orders or judgment without consent; *Stern* claims that require consent to enter final orders or judgment; and non-core claims that require consent to enter final orders or judgment. But absent consent, the determination needs to be made on a claim-by-claim basis. The procedure for parties' consent to magistrate judge adjudication is designed to prevent the magistrate judge from knowing which party has withheld consent; but Bankruptcy Rules 7008 and 7012 (discussed further in Section F *infra)* require statements agreeing to or withholding consent to be included in the complaint and answer.

Among the questions that remain after *Wellness* are the following:

1. Should the Federal Rules of Bankruptcy Procedure be amended to better reflect the state of the law on consent? (An earlier proposed amendment was withdrawn by the Rules Committee after *certiorari* was granted in *Wellness*.)
2. Should local bankruptcy rules be amended to better reflect the state of the law on consent? May the rules provide a time limit for the parties to disclose whether they consent, and provide that failure to object by the deadline shall be deemed consent?
3. May a bankruptcy judge presiding over an adversary proceeding enter a case management and scheduling order setting a time limit for the parties to disclose whether they consent, and provide that failure to object by the deadline shall be deemed consent?
4. Consistent with the decision in *Wellness*, may a bankruptcy judge enter a default judgment based on the failure to respond to an adversary complaint?

E. Many Issues Remain Regarding What Are "*Stern* Claims"

Many issues remain about which statutorily core claims are *Stern* claims. The *Stern* Court held that the bankruptcy court "lacked the constitutional authority to enter a final judgment on a state law counterclaim that is not resolved in the process of ruling on a creditor's proof of claim." *Stern*, 131 S. Ct. at 2620.

The lower federal courts have split on what are *Stern* claims. For example, absent consent or the filing of a proof of claim by a creditor, courts are split whether bankruptcy

judges may enter final orders or judgment on preference[4] and fraudulent conveyance claims.[5] Cases have generally upheld the authority of bankruptcy judges to enter final

[4] For cases upholding the authority of bankruptcy judges to enter final judgments on preference avoidance claims, *see, e.g., In re MCK Millennium Centre Parking, LLC*, Adv. No. 14–00392 (JPC), 2015 WL 1951036 , at *2 (Bankr. N.D. Ill. April 30, 2015) (applying *Apex Long Term Acute Care* (summarized below) and concluding that "the Court determines that it has both constitutional and statutory authority to enter a final judgment order on Plaintiff's preference claims"); *Post–Confirmation Comm. v. Tomball Forest, Ltd. (In re Bison Bldg. Holdings, Inc.),* 473 B.R. 168, 171 (Bankr. S.D. Tex. 2012) (Isgur, J.) ("This Court may not issue a final order or judgment in matters that are within the exclusive authority of Article III courts. The Court may, however, exercise authority over essential bankruptcy matters under the 'public rights exception.' Actions to recover preferential transfers under § 547 fall within the Bankruptcy Court's constitutional authority.") (citations omitted); *Burtch v. Seaport Capital, LLC (In re Direct Response Media, Inc.),* 466 B.R. 626, 644 (Bankr. D. Del. 2012) (Gross, J.) ("This Court disagrees that the *Stern* decision stands for the . . . proposition that a non-Article III court does not have authority to enter a final judgment on a preference . . . claim brought by the Debtor to augment the estate, or any other core claim (as defined in 28 U.S.C. § 157(b)(2)) that is not a state law counterclaim. . . . By extension, the Court concludes that *Stern* does not remove the bankruptcy courts' authority to enter final judgments on other core matters, including the authority to finally adjudicate preference . . . actions like those at issue before this Court."); *West v. Freedom Med., Inc. (In re Apex Long Term Acute Care–Katy, L.P.),* 465 B.R. 452, 463 (Bankr. S.D. Tex. 2011) (Isgur, J.) ("The Court concludes that preference actions both stem from the bankruptcy itself and are decided primarily pursuant to *in rem* jurisdiction. The cause of action for preferential transfers is established by the Bankruptcy Code. The provision for recovering preferences is integrally bound up in the overall scheme for ensuring equitable distribution among creditors. Preferential transfers are payments for legitimate debts. Preferences are avoidable precisely because they enable some creditors to receive more than their fair distribution under the Bankruptcy Code. The entire purpose of the cause of action, then, is to enforce the Bankruptcy Code's equality of distribution. In this respect, preferential transfer actions are fundamentally different from fraudulent transfer actions, although the two causes of action superficially resemble.").

For cases rejecting the authority of bankruptcy judges to enter final judgments on preference avoidance claims, *see, e.g., Penson Fin. Servs. Inc. v. O'Connell (In re Arbco Capital Mgmt., LLP),* 479 B.R. 254, 264–66 (S.D.N.Y. 2012) (Oetken, J.) ("Most recently the Supreme Court concluded that the public rights exception is limited to 'cases in which the claim at issue derives from a federal regulatory scheme, or in which resolution of the claim by an expert government agency is deemed essential to a limited regulatory objective within the agency's authority.' . . . The Court . . . concludes that claims for avoidance of preferential transfers, where the creditor has filed no proof of claim, are not subject to the public right[s] exception. . . . While the Supreme Court has not expressly held that actions to avoid preferential transfers are matters of private right, the Supreme Court has examined the authority of the bankruptcy court to adjudicate preferential transfer claims in the Seventh Amendment context and determined that preference defendants are entitled to a trial by jury. . . . *Stern's dicta* similarly support the conclusion that where a creditor has not submitted a proof of claim, preference actions may be finally adjudicated only by an Article III court. . . . Accordingly, this Court concludes that preferential transfer claims, where, as here, the preference defendant has filed no proof of claim against the bankruptcy estate, are matters of private right.") (citations omitted); *Tabor v. Kelly (In re Davis),* 2011 WL 5429095, at *12 (Bankr. W.D. Tenn. Oct. 5, 2011) (Latta, J.) ("Using this test, when a creditor who has not filed a proof of claim is sued by the bankruptcy trustee to recover a preferential transfer, it is a matter of private right, which, as we have seen, requires the exercise of the judicial power of the United States, a power that cannot be exercised by a non-Article III judge.").

[5] With respect to fraudulent conveyance claims, because such claims seek to augment the bankruptcy estate, and such claims existed at common law outside of bankruptcy proceedings, courts have concluded that unless the defendant filed a proof of claim or consented to the entry of final orders or judgment, a bankruptcy judge may not enter final orders or judgment. While circuit, district and bankruptcy courts have concluded that fraudulent conveyance claims are *Stern* claims, the Supreme Court has not actually decided the issue. *See Wellness*, 135 S. Ct. at 1952 (citing *Arkison* with a parenthetical explaining that the case assumed without deciding that a fraudulent conveyance claim is a

judgments on dischargeability of debts and objections to discharge; determinations of the validity, extent, and priority of liens; confirmation of plans; orders approving the use, sale, or leasing of property; turnover of property of the estate (so long as it is not a disguised breach of contract action); approval of settlements; assumption and rejection of contracts; distribution of property of the estate; and many others.

Additionally, some proceedings are treated as non-core solely as a matter of congressional policy, not constitutional law. For example, wrongful death and personal injury claims against the estate are subject to mandatory withdrawal to the district court *for trial* under 28 U.S.C. § 157(b)(5). But even answering the question of what is a personal injury or wrongful death action may not be simple. Courts apply different standards in making this determination. *See, e.g., Stranz v. Ice Cream Liquidation, Inc. (In re Ice Cream Liquidation, Inc.),* 281 B.R. 154 (Bankr. D. Conn. 2002) (discussing the different approaches courts apply in resolving the question whether the claim is for personal injury or wrongful death). One of the overlooked portions of the decision in *Stern v. Marshall* is its holding that section 157(b)(5) is *not* jurisdictional and the parties may consent to the trial of personal injury and wrongful death claims in bankruptcy court. *Stern*, 131 S. Ct. at 2606 ("We need not determine what constitutes a 'personal injury tort' in this case because we agree with Vickie that § 157(b)(5) is not jurisdictional, and that Pierce consented to the Bankruptcy Court's resolution of his defamation claim.").

F. The Bankruptcy Rules Require Parties to Identify "Core" and "Non-Core" Claims

Bankruptcy Rule 7008 makes Federal Rule of Civil Procedure 8 applicable in adversary proceedings. It also requires that "in an adversary proceeding before a bankruptcy judge, 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." FED. R. BANKR. P. 7008(b). After *Stern v. Marshall*, the core vs. non-core division does not accurately determine a bankruptcy judge' authority to act without consent of the parties.

Bankruptcy Rule 7012 makes Federal Rule of Civil Procedure 12 applicable in adversary proceedings. But it also requires that "[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 the entry of final orders or judgment by the bankruptcy judge. In non-core proceedings final orders and judgments shall not be entered on the bankruptcy judge's order except

---

Stern claim); *see, e.g., In re MCK Millennium Centre Parking, LLC*, Adv. No. 14–00392 (JPC), 2015 WL 1951036 , at *2 (Bankr. N.D. Ill. April 30, 2015) ("However, the fraudulent transfer claims . . . may not be constitutionally core under the precedent set by *Stern v. Marshall* and its progeny.") (citing *Arkison*, 134 S. Ct. at 2174 ("The Court of Appeals held, and we assume without deciding, that fraudulent conveyance claims in this case are *Stern* claims."). The Supreme Court in *Granfinanciera, S.A. v. Nordberg*, 492 U.S. 33 (1989), analogized the Seventh Amendment right to a jury trial to the Article III right to have an Article III judge, and concluded that a fraudulent conveyance defendant that did not file a proof of claim was entitled to demand a jury.

with the *express* consent of the parties." FED. R. BANKR. P. 7012(b) (emphasis added). The rule requires a party to disclose whether it consents to entry of final orders or judgment by a bankruptcy judge in non-core matters; the rule does not address consent in core matters, because section 157 provides that a bankruptcy judge may enter final orders or judgment in all core matters. Absent consent of the parties in non-core matters, the statute requires the bankruptcy judge to submit proposed findings of fact and conclusions of law, and then requires that final orders or judgment only be entered by the district court. After *Stern v. Marshall*, absent consent the bankruptcy judge may not enter final orders or judgment in core matters unless the issues will be resolved as part of the claims-allowance process or unless the matter determines the debtor's right to a discharge.

The issue whether bankruptcy judges may enter proposed findings of fact and conclusions of law in the absence of statutory authority for bankruptcy judges to enter proposed findings of fact and conclusions of law in core matters was resolved in *Arkison*. This issue was often referred to as the statutory gap—Congress in drafting section 157 of the Judicial Code assumed (incorrectly, as it turned out) that bankruptcy judges could enter final orders or judgments in all core matters, so there was no need to provide for entry of proposed findings of fact and conclusions of law, as Congress provided for non-core matters, where absent consent, only the district court may enter final orders or judgments.

A number of bankruptcy courts, including my court in the Southern District of New York, have amended the local rules to require a statement whether the party filing the pleading consents to the entry of final orders or judgments "if it is determined that the bankruptcy judge, absent consent of the parties, cannot enter final orders or judgment consistent with Article III of the United States Constitution." *See* N.Y.S.B. Local Rules 7008-1 and 7012-1.

Two further observations: First, counsel frequently ignore the requirements in Bankruptcy Rules 7008 and 7012, and in my court's amended local rules, requiring a statement about consent. Second, adversary complaints frequently contain a statement that "this complaint is a core proceeding," without focusing on separate causes of action within the complaint. But consider, for example, an adversary complaint filed by a debtor that contains two causes of action: one for recovery of a preference under Bankruptcy Code sections 547 and 550 that is statutorily "core" under section 157(b)(2)(F)); and the other for breach of contract for an alleged prepetition breach that is a non-core "related to" claim. The bankruptcy judge may enter final orders or judgment on preference avoidance claim if the creditor also filed a proof of claim (and, perhaps, even without a proof of claim). But the bankruptcy judge may not enter final orders or judgment absent consent on a breach of contract claim (which was essentially the issue decided in *Marathon*) unless the resolution is part and parcel of the claim determination. Therefore, absent consent, the questions need to be addressed on a claim-by-claim basis.

G. Does *Stern* Lead to Withdrawal of the Reference?

Section 157(d) provides that "[t]he district court may withdraw, in whole or in part, any case or proceeding referred under this section, on its own motion or on timely motion of any party, for cause shown. The district court shall, on timely motion of a party, so withdraw a proceeding if the court determines that resolution of the proceeding requires consideration of both title 11 and other laws of the United States regulating organizations or activities affecting interstate commerce." 28 U.S.C. § 157(d).

The first sentence provides for withdrawal of the reference "for cause shown" and is permissive. The second sentence provides for mandatory withdrawal of the reference, but it is only mandatory if one of the parties moves to withdraw the reference.

After *Stern v. Marshall* was decided, there was a flood of motions to withdraw the reference in some districts. The motions generally argued that because the bankruptcy judge couldn't finally resolve the proceeding, judicial efficiency supported moving the case to the district court promptly. An almost unbroken line of district court cases all across the country now deny such motions to withdraw the reference without prejudice to renewing the motion when the case is trial ready. Bankruptcy judges may handle all pretrial proceedings and enter interlocutory orders on all motions before the reference is withdrawn and the proceeding is returned to the district court for trial if a jury is properly demanded.

In core and non-core cases in which consent is required but has not been given, absent a timely jury demand in a case triable to a jury, the bankruptcy judge may try the case and submit proposed findings of fact and conclusions of law under Bankruptcy Rule 9033. Rule 9033 sets forth the procedure for objections to the proposed findings of fact and conclusions of law. The district court enters final orders or judgment.

With respect to motions to withdraw the reference, the motions are filed in the bankruptcy court, which then transmits them to the district court. Only the district court can decide the motion. Some district courts have local rules permitting or even requiring the bankruptcy judge to make a recommendation to the district court about the appropriate disposition of the motion.

Section 157(b)(3) provides that "the bankruptcy judge shall determine, on the judge's own motion or on timely motion of a party, whether a proceeding is a core proceeding under this subsection or is a proceeding that is otherwise related to a case under title 11." 28 U.S.C. § 157(b)(3). Bankruptcy Rule 5011(c) specifically provides that a motion to withdraw the reference or to abstain shall not stay the administration of the case or proceeding. Thus, the bankruptcy court may continue to administer the case while the motion to withdraw the reference is pending in the district court. Often, the district court is in no hurry to decide the withdrawal motion.

M.G.

Wellness International Network, Ltd., et al. v. Sharif

Jeffrey N. Rothleder
Arent Fox LLP
Washington, D.C.

***Wellness International Network Ltd., et al. v. Sharif*, 575 U.S. __ (2015)**
By Jeffrey N. Rothleder[1]

Precedential Background

In 2011, the Supreme Court created a wave of confusion when it issued the *Stern* decision, which found that bankruptcy judges lacked constitutional authority to enter final judgments or orders on matters that Congress designated as "core" for bankruptcy court jurisdictional purposes but for which the Constitution guaranteed adjudication by an Article III tribunal. Meaning, that if a claim or cause of action was designated as "core" but is prohibited from proceeding due to a constitutional bar (*i.e.*, a claim that arose under common law, in equity or admiralty) (a "Stern Claim"), a bankruptcy court did not have jurisdiction to decide those claims notwithstanding the provisions of 28 U.S.C. § 157 and related statutes.

Thereafter, in 2014, the Supreme Court in *Bellingham* attempted to clarify some confusion created by *Stern*. In that case, the Supreme Court held that a bankruptcy court could issue proposed findings of fact and conclusions of law for review by a district court when presented with a Stern Claim. Bellingham, however, did not end the discussion regarding the bankruptcy court's power to adjudicate Stern Claims.

Wellness Case Background

The *Wellness* case arises out the attempts by Wellness Internal Network ("Wellness") to enforce a judgment against Sharif. After Wellness obtained the judgment, Sharif commenced a chapter 7 bankruptcy case. In the bankruptcy case, Wellness sought to enforce and collect its judgment; however Sharif stymied those efforts by refusing to turn over documents and comply with discovery orders. Eventually Wellness discovered the existence of Soad Wattar Living Trust (the "Trust") that held $5 million in assets, which Sharif claimed he administered on behalf

[1] Jeffrey is a partner in the Bankruptcy and Financial Restructuring Group in the Washington, DC office of Arent Fox LLP.

of his mother. After discovering the existence of the Trust, Wellness commenced an adversary proceeding in the bankruptcy court objecting to the discharge of Sharif and requesting entry of a declaratory judgment that the Trust is property of the Sharif's bankruptcy estate because Sharif used the assets of the Trust and the Trust was Sharif's alter ego. Sharif responded to the complaint and admitted that the adversary proceeding was a "core" matter under 28 U.S.C. § 158.

Due to failure to comply with discovery orders and other factors, the Bankruptcy Court entered a default judgment against Sharif. Pursuant to this default judgment, the Trust was declared to be property of the Sharif's bankruptcy estate such that its assets were available for administration and distribution to creditors.

Sharif appealed to the district court. After Sharif filed his appeal to the district court, the *Stern* decision was issued. Sharif, however, failed to cite or discuss *Stern* until after briefing had closed. The district court therefore did not consider the *Stern* issues and affirmed the bankruptcy court.

Sharif again appealed, this time to the Seventh Circuit. The Seventh Circuit affirmed the district court's decision in part and reversed in part. The Seventh Circuit affirmed that the judgment against Sharif with respect to the claim asserted by Wellness as non-dischargeable; however, the Seventh Circuit reversed the ruling declaring that the Trust was property of the bankruptcy estate. The Seventh Circuit ruled that a litigant, such as Sharif, cannot waive a *Stern* argument and since the determination of whether the Trust is an alter ego of Sharif was a claim prohibited from proceeding before the bankruptcy court by the Constitution, the bankruptcy court lacked constitutional authority to declare the Trust property of the bankruptcy estate.

The Supreme Court Decision

In a 6-3 decision, the Supreme Court reversed the Seventh Circuit and held that litigants may validly consent to the adjudication of Stern Claims (and other claims) by the bankruptcy court. The majority began the decision discussing the fact that since the founding of the Republic, parties have been permitted to consent to adjudication before non-Article III tribunals and those judgments are binding. The Supreme Court found, relying on precedent, that litigation before an Article III judge is a personal right that can waived so long as the waiver does not implicate a structural challenge to the constitutionally mandated separate of powers. Meaning, parties can consent to trial before a non-Article III court, such as a bankruptcy court, so long as the claims at issues do not result in a challenge to the separation of powers mandated by the Constitution. The Supreme Court further stated that separation of powers is not challenged so long as Article III courts retain supervisory authority over the process. Indeed, the Supreme Court stated that "[a]djudication based on litigant consent has been a consistent feature of the federal court system since its inception. Reaffirming that unremarkable fact, we are confident, poses no great threat to anyone's birthrights, constitutional or otherwise."

The crux of the *Wellness* decision is the fact that when a party consents to adjudication by a non-Article III tribunal, the party knowingly and voluntarily does so and, therefore, waives that constitutional protection. The Supreme Court distinguished the situation in *Wellness* from the one in *Stern* because, in *Stern*, the litigant had no choice at the time but to litigate in bankruptcy court. The litigant in *Stern* was "forced" to litigate before a non-Article III court due to existing rules and jurisprudence at the time. Whereas in *Wellness*, Sharif likely consented to adjudication before the non-Article III bankruptcy court and, therefore, since the bankruptcy court is a division of and under the supervision of the Article III district court, the litigants could consent

to trial before the bankruptcy court without offending the separation of powers mandated that doomed the jurisdiction of the bankruptcy court under *Stern*.

The *Wellness* decision does not address what is required to determine if a litigant consents to non-Article III adjudication. Sharif argued that such consent must be expressed. The Supreme Court disagreed, stating that consent can be implied but such consent must be knowing and voluntary. The Supreme Court did not, however, go any further and did not decide if Sharif's consent, by admitting that the adversary proceeding was "core", was sufficient.

The Dissenting Opinions

Chief Justice Roberts (the author of *Stern*) and Justice Thomas dissented in the decision. Justice Scalia joined in the dissent filed by the Chief Justice.

Chief Justice Roberts dissented on the grounds that parties cannot cure constitutional defects, such as a violation of separation of powers, by consent. The Chief Justice argues that Congress cannot vest Article III powers in Article I judges; however, the Chief Justice does find that the bankruptcy court could have had jurisdiction over the alter ego claims asserted by Wellness because that claim focused on what is properly property of the bankruptcy estate, which is within a narrow historical class of claims that Congress can delegate for resolution by non-Article III courts. Notwithstanding, since the majority found that under the Constitution, parties can consent to can cure this jurisdictional defect, the Chief Justice dissents because one party "has no authority to compromise the structural separation of powers or agree to an exercise of judicial power outside Article III." According to this dissent, to allow a party to consent to a cure of a constitutional/jurisdictional defect would threaten the "institutional integrity of the Judicial Branch", which is something that the Chief Justice cannot stand for.

Justice Thomas filed a separate dissent. He agreed with the Chief Justice's reasoning and proposed disposition of the underlying case; however, he asserted that the majority overlooked the complexity of the consent issue. Justice Thomas asserted that the consent to jurisdiction implicated significant separation of powers issues and that, ultimately, the Constitution limits the activity of non-Article III courts to certain specific matters, including "public rights."

Harris v. Viegelahn, Chapter 13 Trustee

Jeffrey N. Rothleder
Arent Fox LLP
Washington, D.C.

***Harris v. Viegelahn, Chapter 13 Trustee*, 575 U.S. __ (2015)**

By Jeffrey N. Rothleder[1]

In *Harris v. Viegelahn, Chapter 13 Trustee* ("*Harris*"), the Supreme Court held that a Chapter 13 trustee is required to turnover wages earned by a debtor and held in the trustee's possession to a debtor who converts to Chapter 7 absent bad-faith conversion.

Background

In this case, the debtor, Charles Harris III, filed a Chapter 13 bankruptcy petition and the bankruptcy court confirmed a Chapter 13 plan. Under that plan, Harris would resume making mortgage payments and that $530 per month would be withheld from Harris' post-petition wages, which funds would be paid to Mary Viegelahn, the Chapter 13 Trustee (the "Trustee"). The Trustee would then use those funds to pay creditors pursuant to the confirmed plan. Shortly after confirmation of the Plan, Harris fell behind again and the bank foreclosed on his home. Nevertheless, the Trustee continued to receive the $530 per month, which funds accumulated in the Trustee's account. Eventually, Harris exercised his statutory right to convert the Chapter 13 case to Chapter 7.

At the time of conversion, the Trustee held $5,519.22. Ten days after the conversion, the Trustee disposed of those funds to creditors including Harris' counsel and herself. Harris challenged the disbursement asserting that the Trustee lacked authority to disburse the funds once the case converted. The Bankruptcy Court agreed with Harris and that decision was affirmed by the District Court. The Fifth Circuit, however, reversed and found that Harris' creditors had a superior claim to the funds held by the Trustee and disbursement was appropriate. The Fifth Circuit's decision conflicted with a Third Circuit decision on the same issue. The Supreme Court reversed the Fifth Circuit.

---

[1] Jeffrey is a partner in the Bankruptcy and Financial Restructuring Group in the Washington, DC office of Arent Fox LLP.

The Supreme Court Holding

In rendering its decision, the Supreme Court addressed the history of the treatment of post-petition wages in individual bankruptcy cases. The Court found that the 1994 amendments to the Bankruptcy Code resolved the issue by adding Section 348(f)(1)(A), which provides that in a case converted from Chapter 13, a debtor's post-petition earnings and acquisitions do not become part of the Chapter 7 estate. 11 U.S.C. § 348(f)(1)(A). The one exception is that if the case was converted for bad faith. *See* 11 U.S.C. § 348(f)(2). Consequently, under this section, on conversion to a Chapter 7 case, only property held by a debtor on the original petition date becomes property of the Chapter 7 estate. Thus, any wages or properties acquired after the original petition date are not property of the estate.

With this background, the Supreme Court concluded that because Congress excluded post-petition wages from estate property upon conversion to Chapter 7, permitting a Chapter 13 trustee to distribute the very same earnings to the very same creditors is incompatible with statutory design. To find otherwise, the Supreme Court stated, would be contrary to Congressional intent in revising the Section 348(f).

Further, the Supreme Court analyzed Section 348(e), which provides that upon conversion from Chapter 13, the services of the Chapter 13 trustee are terminated. *See* 11 U.S.C. § 348(e). The Court held that since a core service of the Chapter 13 trustee is making distributions to creditors, upon conversion, the Chapter 13 trustee no longer has authority to make such distributions and, as a result, any distributions made after conversion are improper. Rather, pursuant to the *Harris* decision and the statute, the Chapter 13 trustee must return any funds it is holding to the debtor. Thus, the Trustee had no authority to provide the service of

making distributions to creditors after Harris' case converted and the funds she held should have been returned to Harris.

The Trustee argued that since a confirmed Chapter 13 plan is binding on a debtor and creditors, she had the right to distribute funds under that plan. The Court disregarded that argument by, again, citing the fact that once conversion takes places the trustee's services are terminated and the provisions of Chapter 13 no longer are applicable. Moreover, the distribution of funds is not part of the "wind up" of affairs required by the Bankruptcy Code as the Trustee asserted. Further, the Court rejected the argument that a confirmed Chapter 13 plan gives creditors a vested right in the funds held by the trustee because there is no provision in the Bankruptcy Code to support that proposition.

In sum, the *Harris* court stands for the proposition that undistributed post-petition wages earned by a debtor revert to the debtor's possession upon conversion from a Chapter 13 case to a Chapter 7 case.

Baker Botts LLP, et al. v. ASARCO LLC

Christopher J. Giaimo
BakerHostetler
Washington, D.C.

***Baker Botts LLP et al. v. ASARCO LLC*, 135 S. Ct. 2158 (2015)**

Factual Background

In 2005, ASARCO LLC retained Baker Botts, along with local law firm, as debtor's counsel in their Chapter 11 bankruptcy. After several years, Baker Botts was able to successfully prosecute fraudulent-transfer claims against ASARCO's parent company relating to the transfer of a controlling interest in an affiliate to the parent. All told, the "wildly successful" judgment amounted to between $7 and $10 billion. The result also led to a reorganization in which all of the company's creditors were paid in full.

Having incurred approximately $113 million in attorney's fees and another $6 million in expenses over the course of the proceedings, Baker Botts sought compensation for its services under §330(a)(1). This provision states that a bankruptcy court may award "reasonable compensation for actual, necessary services rendered" by professionals hired under §327(a). After Baker Botts filed its fee application seeking payment for its legal services and a 20% fee enhancement, ASARCO, now controlled by its parent company (the defendant in the fraudulent-transfer proceeding) objected to both the compensation and the enhancement.

Procedural Posture

After protracted litigation and a six day trial on the fees, the Bankruptcy Court rejected ASARCO's arguments and awarded the firms approximately $120 million for core fees and expenses and a $4.1 million enhancement only for work performed on the fraudulent-transfer litigation. Critically, it also awarded the firms $5 million for the time spent defending their fee applications. ASARCO then appealed that portion of the award relating solely to the fee enhancement and the award for the fees defending their fee application. The District Court affirmed the Bankruptcy Court's holding that the firms were entitled to a fee enhancement based and the results of the bankruptcy and could be compensated for the defense of their fee applications.

On appeal to the Fifth Circuit, however, the ruling was overturned. The Fifth Circuit based its decision primarily on the "American Rule"—which holds that each side must pay its own attorney's fees—"applies absent explicit statutory authority" to the contrary. It also noted that the Bankruptcy Code does not have a provision addressing recovery of fees for time spent defending fee applications. *In re ASARCO, L.L.C.*, 751 F.3d 291, 301 (2014). Additionally, the Fifth Circuit reasoned that, because the defense of fee applications does not benefit the debtor's estate or the overall case, compensation does not count as a "service" described in §330(a)(1). *Id.* at 299. The firms appealed.

The United States supported the law firms as *amicus curiae* in the present case.

Question Presented

While the Fifth Circuit had held that the defense-fees were *not* recoverable, the Ninth Circuit held that they could be awarded according to the judge's discretion. *In re Smith*, 317 F.3d 918 (9th Cir. 2002). The Supreme Court granted certiorari to the Fifth Circuit to resolve the split over the question of compensation for defense-fees.

Holding

The Supreme Court ultimately sided with ASARCO and affirmed the Fifth Circuit's holding that time spent defending fee applications was not compensable under §330(a)(1). *Baker Botts L.L.P. v. ASARCO LLC*, 135 S. Ct. 2158, 2169 (2015). As such, bankruptcy courts may not award compensation for litigation over fee applications. Justice Thomas wrote for the majority, and was joined by Chief Justice Roberts and Justices Scalia, Kennedy, and Alito. Justice Sotomayor concurred, in part.

Reasoning

Mirroring the Fifth Circuit, the Court relied on the principle of the American Rule as its "basic point of reference." Absent a statute or contract that directs otherwise, it said, parties are to pay their own attorney's fees regardless of the outcome. The Court began with a brief overview of the significance of this rule, noting that its roots in common law reach back to the 18th century. Additionally, it noted that deviations from the rule have only occurred when a statute contains specific and explicit provisions that allow compensation for "a reasonable attorney's fee," "fees," or "litigation costs," and typically refer to a "prevailing party" in the context of an adversarial "action." *Id.* at 2161. The Equal Access to Justice Act, the Court stated, through its unambiguous fee-shifting language, is a good example of the clarity required. *Id*.

With the American Rule established as a baseline, the rest of the Court's opinion focused largely on statutory interpretation. Turning to the text of §330(a)(1), it found that the language did not reflect any congressional intent to deviate from the default rule. *Id*. at 2169. Under §327(a), it reasoned, disinterested professionals may be hired to assist the trustee in carrying out the estate's duties. §330(a)(1) provides compensation for these professionals, then, when they do work *in service of* the trustee or administrator. Because "services" are defined as "labor performed for another"—and because time spent defending a fee application is neither "disinterested service" nor "labor performed for" someone else—the Court concluded that fee defense is not compensable under the statute. This conclusion, it stated, is further supported by the fact that other portions of the Bankruptcy Code explicitly shift litigation costs from one party to another.

In the course of the majority opinion, the Court also rejected the theories advanced by the law firms and the United States as *amicus*. First, it disagreed with the firms' proposition that the fee-defense litigation was included in the "services rendered" described in §330(a)(1). In addition to its reasoning described above, it found that such an understanding could end up compensating attorneys for *unsuccessful* fee defenses as well. This would also be odd, it said, because normally only prevailing parties receive awards for attorney's fees.

Next, it rejected the Government's more nuanced contention that while the defense of a fee application on its own does not qualify as part of the services rendered, it is nonetheless part of the compensation for the *underlying* services in the proceeding. Not compensating an attorney for these efforts, the Government argued, would "dilute" the compensation for the actual services rendered, and would therefore thwart Congress' goal of ensuring that bankruptcy attorneys are paid similarly to attorneys in other practices. Here, the Court found the "*actual, necessary*

services" language persuasive, saying it reflects the fact that bankruptcy courts do not have carte blanche to grant reimbursements for any and all work done by professionals and that the Government's position would read such language out of the statute. *Id*. at 2169. The Government also argued that §330(a)(6) allows for compensation for work beyond "service" to the estate and that since time spent *preparing* a fee application is compensable, time spent *defending* it must be too. In rejecting this argument, the Court held that the provision in that a professional's preparation of a fee application is actually "services rendered" to the estate administrator under §330(a)(1) but that the professional's defense of that application is not. *Id*. at 2167. The Court likened the process to a car mechanic preparing a bill, saying the mechanic ought to be paid for the time spent preparing the bill, but noting that it would be odd to think he should also be paid for any fees incurred in a subsequent court battle over the bill. *Id*.

The Court also distinguished *Commissioner v. Jean*[1]—a precedent relied on by the dissent. Although the statute there did not explicitly mention compensation for fee defense litigation, the Court dismissed the argument by saying that "everyone agreed" that the provision in question "authorized court-awarded fees for fee-defense litigation."

Finally, the Court concluded by stating that even if it found the system unfair to the bankruptcy bar, it was powerless to rewrite the statute. Because there was no explicit intent to override the American Rule, bankruptcy courts simply could not award compensation for fee-defense litigation. *Id*. at 2169.

Dissent

Justice Breyer wrote for the dissent, and was joined by Justices Ginsburg and Kagan. The dissent's main argument was that, as the Government suggested, the fee defense was not independently a "service," but was nonetheless compensable as part of the underlying services in a bankruptcy proceeding. In essence, the dissent focused more on the complex nature of bankruptcy proceedings and declined to take the majority's black-and-white statutory approach. In so doing, it found more importance in the "reasonable compensation" language of §330(a)(1) than in the "actual, necessary services" phrase.

Noting that the Bankruptcy Code affords bankruptcy courts "broad discretion" to determine reasonable compensation, the dissent argued that courts could and should consider "all relevant factors" as provided by §330(a)(3), including the cost spent on defending fee applications. It also drew attention to the fact that while bankruptcy courts supposedly cannot award compensation for fee-defenses, they still could order enhancements in the case of protracted litigation, indicating the discrepancy in the holding.

Additionally, the dissent relied on *Commissioner v. Jean*, where the Court suggested that fee defense work would be compensable, and that withholding the payment would dilute the value of other service fees owed. It also noted that while the majority distinguished *Jean* in this case, the language in that statute did not explicitly reference fee-shifting either. The dissent also rejected the example of the car mechanic, arguing that the mechanic is not paid separately for the bill preparation, but rather for the services as a whole. Therefore, an attorney's preparation of a

[1] *Commissioner, I.N.S. v. Jean*, 496 U.S. 154 (1990).

bill ought not to be compensable. Because it is unanimously viewed to be so, however, the dissent argued that it is incongruous to compensate for this and not defense of fee applications.

Interestingly, in its discussion of the issue and the majority's position, the dissent seems to have a fundamentally different view on how the American Rule ought to function. Where the majority believes it is the baseline, applying at all times unless there is explicit direction otherwise, the dissent views it as something closer to a "gap filler." In other words, *only when* the statute makes no suggestion of fee shifting does the Rule apply, potentially implying that there is an initial presumption that the Rule does not apply. As is evident in its opinion, the dissent believes that there is sufficient reason to believe §330(a)(1) "provides otherwise."

Public Impact

Aside from the obvious impact of this case—which prevents attorneys from being reimbursed for their time spent litigating or defending fee applications in bankruptcy cases—there are several other ways in which the holding might affect future bankruptcy proceedings. First, many argue that this outcome incentivizes disgruntled parties to make retaliatory objections to fee applications, initiating expensive litigation that the firm will have to cover out of pocket. Bankruptcy attorneys in particular are concerned that this effectively allows any third party to bring needless litigation to lessen or "dilute" net compensation as mere leverage for their position. Moreover, they will be forced to weigh the unreasonable demand against the cost of defending the entire fee application.

Further, some have also speculated that the holding will encourage attorneys and other professionals to include language in contracts or agreements that the debtors will pay the costs of fee-defenses. This, in turn, might mean that courts will have to interpret these agreements and decide if they comport with the outcome in *Baker Botts*.

Bullard v. Blue Hills Bank

P. Matthew Sutko, Associate General Counsel
John Postulka, Trial Attorney
Executive Office for United States Trustees, Washington, DC

In *Bullard v. Blue Hills Bank*, __ U.S. __, 135 S. Ct. 1686 (2015), the United States Supreme Court held that an order denying confirmation of a chapter 13 plan is not a final order that the debtor can immediately appeal.

I. Background

Louis Bullard filed for bankruptcy relief under chapter 13 of the Bankruptcy Code. Alleging that the mortgage on his multi-family house was higher than the value of the property, Mr. Bullard proposed a plan that would allow him to bifurcate the mortgage holder's claim into secured and unsecured portions. The bank holding the mortgage objected to the plan. The bankruptcy judge sustained the objection and rejected the proposal, though the court noted that other bankruptcy courts within the circuit had approved such arrangements. The judge ordered Mr. Bullard to propose a new plan or face dismissal of his case. Mr. Bullard instead moved for leave to appeal to the Bankruptcy Appellate Panel (BAP) for the circuit. After granting leave to appeal, the BAP affirmed the denial of confirmation of the plan. Mr. Bullard then appealed to the United States Court of Appeals for the First Circuit.

The court of appeals considered only whether the denial of confirmation was a final appealable order. The court recognized that there was a circuit split on the issue with the Second, Sixth, Eighth, Ninth, and Tenth Circuits holding that the denial of confirmation was not a final order and the Third, Fourth, and Fifth Circuits holding that it was. Ultimately, the court held that "[a]n order of an intermediate appellate tribunal affirming the bankruptcy court's denial of confirmation of a reorganization plan is not a final order so long as the debtor remains free to propose an amended plan. The rejection of Bullard's plan plainly does not 'finally dispose of all the issues pertaining to a discrete dispute within the larger proceeding.'" *Bullard v. Hyde Park Savings Bank (In re Bullard)*, 752 F.3d 483, 486 (1st Cir. 2014).

Mr. Bullard filed a petition for a writ of certiorari with the United States Supreme Court. The Supreme Court granted the petition to consider the sole issue of whether an order denying confirmation of a chapter 13 bankruptcy plan is appealable. Before the Supreme Court, the United States filed an amicus brief arguing orders denying plan confirmation are final and immediately appealable as of right.

II. Statutory Framework

11 U.S.C. § 158 is the statute dealing with jurisdiction over appeals from bankruptcy court decisions. It provides:

> (a) The district courts of the United States shall have jurisdiction to hear appeals
>
> (1) from final judgments, orders, and decrees;
>
> (2) from interlocutory orders and decrees issued under section 1121(d) of title 11 increasing or reducing the time periods referred to in section 1121 of such title; and
>
> (3) with leave of the court, from other interlocutory orders and decrees;
>
> and, with leave of the court, from interlocutory orders and decrees,[1] of bankruptcy judges entered in cases and proceedings referred to the bankruptcy judges under section 157 of this title. An appeal under this subsection shall be taken only to the district court for the judicial district in which the bankruptcy judge is serving.
>
> * * * * *
>
> (b)(1) The judicial council of a circuit shall establish a bankruptcy appellate panel service composed of bankruptcy judges of the districts in the circuit who are appointed by the judicial council in accordance with paragraph (3), to hear and determine, with the consent of all the parties, appeals under subsection (a)….
>
> * * * * *
>
> (c)(1) Subject to subsections (b) and (d)(2), each appeal under subsection (a) shall

[1] As explained in Collier's Pamphlet Edition of the Bankruptcy Code, the "intent of Congress regarding the eleven words preceding this footnote is unclear. Pub. L. No. 103-394 (1994) stated that Section 158(a) of title 28, United States Code, is amended by striking 'from' the first place it appears and all that follows through 'decrees' and inserting [paragraphs (1) through (3)]. Because 'decrees' appeared twice in the affected sentence, the instance immediately preceding this footnote having been the second of the two, it cannot be determined with certitude that Congress intended for these eleven words to be removed."

be heard by a 3-judge panel of the bankruptcy appellate panel service established under subsection (b)(1) unless--

(A) the appellant elects at the time of filing the appeal; or

(B) any other party elects, not later than 30 days after service of notice of the appeal;

to have such appeal heard by the district court.

* * * * *

(d)(1) The courts of appeals shall have jurisdiction of appeals from all final decisions, judgments, orders, and decrees entered under subsections (a) and (b) of this section.

III. Supreme Court Decision.

The Supreme Court issued its opinion affirming the First Circuit's decision on May 4, 2015. The Court began its analysis by noting that, unlike in ordinary civil litigation, it has long been recognized that parties in a bankruptcy case can appeal orders that "finally dispose of discrete disputes within the larger case." *Bullard*, 135 S. Ct. at 1692. And the Court concluded that the applicable statute, 28 U.S.C. § 158, allows "appeals as of right not only from final judgments in cases but from 'final judgments, orders, and decrees ... in cases and proceedings.'" *Id.*

In applying the statute, the Court found the relevant dispute to be "how to define [what is] the immediately appealable 'proceeding' in the context of the consideration of Chapter 13 plans." *Id.* Mr. Bullard had argued that a bankruptcy court resolves a separate proceeding each time it makes a decision on whether to confirm or deny a proposed plan. *Id.* The Bank argued that the relevant proceeding is the entire plan process, which terminates only when a plan is confirmed or the case is dismissed; it argued plan denial does not terminate a proceeding because denial leaves the debtor free to propose another plan. *Id*. The Court agreed with the Bank "first and foremost, because only plan confirmation—or case dismissal—alters the status quo and fixes

the rights and obligations of the parties." *Id.* Confirmation makes the terms of the plan binding on the parties. *Id.* But denial with leave to amend changes little since the parties' rights and obligations remain unsettled, the stay persists, and the possibility of discharge lives on. *Id.* at 1693.

The Court also noted that several additional factors supported its conclusion. First, 28 U.S.C. § 157 contains a list of "core proceedings." Among the core proceedings listed there is "confirmations of plans." *Id.* at 1693. The Court found this important because there is no corresponding reference to "denials of plans," which indicated to the Court that confirmation of a plan is a proceeding but denial of a plan is not. *Id.* Second, according to the Court, Mr. Bullard's position defines the pertinent proceeding so narrowly "that the requirement of finality would do little work as a meaningful constraint on the availability of appellate review." *Id.* Third, the Court reasoned that knowledge that debtors have no guaranteed right to appeal a plan denial would encourage debtors to work with creditors to develop confirmable plans as promptly as possible, a goal of the bankruptcy system. *Id.* at 1694.

The Court then considered and rejected arguments presented by Mr. Bullard and the United States. It reasoned that any asymmetry that will result from allowing immediate appeals of plan confirmations but not denials "simply reflects the fact that confirmation allows the bankruptcy to go forward and alters the legal relationships among the parties, while denial does not have such significant consequences." *Id.* at 1695. While the result of the decision may be that there is no effective means of obtaining appellate review of the denied proposal, the Court stated that "[t]his prospect is made tolerable in part by our confidence that bankruptcy courts, like trial courts in ordinary litigation, rule correctly most of the time." *Id.* Plus, the Court pointed out that there are several mechanisms for interlocutory review that "'serve as useful

safety valves for promptly correcting serious errors' and addressing important legal questions." *Id.* at 1696.

IV. Practical Effects.

As the Supreme Court recognized, before *Bullard* the general rule applied in deciding whether a bankruptcy order is final is whether the order "finally dispose[s] of discrete disputes within the larger case." *Id.* at 1692. The Supreme Court did not change this rule. Instead, it concluded that the rule flows from the text of the jurisdictional statute governing bankruptcy appeals, 28 U.S.C. § 158.

Although the *Bullard* decision did not change the status quo, it did resolve a circuit split by deciding that orders denying plan confirmation are not final. It also established that an order does not "finally dispose[s] of discrete disputes within the larger case" unless it "alters the status quo and fixes the rights and obligations of the parties." *Id.* It is this point that is likely to have the most effect on the finality of bankruptcy orders issued in other contexts. For example, there is currently a circuit split regarding whether orders approving employment pursuant to 11 U.S.C. § 327 are final orders. *Compare Ekstrom v. S.S. Retail Stores Corp. (In re S.S. Retail Stores Corp.)*, 162 F.3d 1230 (9th Cir. 1998) (holding that order approving employment is not final); *with Lambert v. Coan (In re AroChem Corp.)*, 176 F.3d 610 (2d Cir. 1999) (holding that order approving employment is final). After *Bullard*, it seems that such orders may be viewed as final since the orders alter the status quo and fix the rights and obligations of the parties in five ways, by: **(a)** determining the professional does not labor under a disqualifying conflict of interest or adverse interest, **(b)** authorizing the professional to perform services on behalf of the estate, **(c)** giving the professional a statutory right to seek payment for that work under 11 U.S.C. § 330, **(d)** making the professional's award an administrative expense under 11 U.S.C. § 503, and **(e)** giving

any such administrative expense award priority of payment from the assets of the bankruptcy estate. And *Bullard* is likely to have a similar result in other contexts where the order at issue confers a specific right or obligation.

The Supreme Court Forecloses Lien Stripping in Chapter 7: An Analysis of *Bank of America, N.A. v. Caulkett* and *Bank of America, N.A. v. Toledo-Cardona*

Stuart M. Brown & Kaitlin M. Edelman
DLA Piper LLP (US), Wilmington, Delaware

Introduction

This paper discusses the holding and implications of *Bank of America, N.A. v. Caulkett* and *Bank of America, N.A. v. Toledo-Cardona*, 575 U.S. ___ (2015), in which the Supreme Court, relying on *Dewsnup v. Timm*, 502 U.S. 410 (1992), held that Bankruptcy Code section 506(d) does not permit a chapter 7 debtor to "strip off" a wholly underwater junior lien.

I. Overview of the Supreme Court's Recent Decision in *Bank of America, N.A. v. Caulkett* and *Bank of America, N.A. v. Toledo-Cardona*

The facts of these cases are straightforward and were stipulated to by the parties. In *Bank of America, N.A. v. Caulkett* and *Bank of America, N.A. v. Toledo-Cardona*, 575 U.S. ___ (2015) (slip op.) (hereinafter "*Caulkett*"), chapter 7 debtor-respondents David Caulkett and Edelmiro Toledo-Cardona ("Debtors" or "Respondents") each owned a house encumbered by two mortgage liens: a senior mortgage lien and a junior mortgage lien, the latter in each case held by petitioner Bank of America ("Bank" or "Petitioner"). *Id.*, at ___ (slip op. at 2). The balance remaining on each Debtor's senior mortgage lien exceeds the current market value of each Debtor's house, leaving the Bank's junior mortgage liens completely underwater. *Id.* A lien is "underwater" to the extent that the outstanding balance of the claim secured by the lien exceeds the value of the collateral. In the Debtors' respective bankruptcy cases, each moved to void, or "strip off," the Bank's junior mortgage liens pursuant to section 506(d). *Id.* The Bankruptcy Court granted the Debtors' motions, and the District Court and Court of Appeals for the Eleventh Circuit affirmed the Bankruptcy Court's orders. *Id.* The Bank appealed.

The Supreme Court, relying on *Dewsnup v. Timm*, 502 U.S. 410 (1992), reversed and, in a unanimous decision, held that the Debtors could not "strip off" or void the Bank's underwater junior liens under Bankruptcy Code section 506(d). *Caulkett*, 575 U.S., at 1. In *Dewsnup*, the Supreme Court held that section 506(d) of the Bankruptcy Code does not permit a chapter 7

debtor to "strip down" a partially underwater lien to the current value of the property. *Id.* at 417. The Court in *Dewsnup* determined that the phrase "allowed secured claim" has different meanings in section 506(a) and 506(d). *Id.* at 417. *Caulkett* acknowledged that under a "straightforward reading of [section 506], the debtors would be able to void the Bank's claims;" however, *Dewsnup* "defined the term 'secured claim' in section 506(d) to mean a claim supported by a security interest in property, regardless of whether the value of the property would be sufficient to cover the claim." *Caulkett*, 575 U.S., at 4. Accordingly, the *Caulkett* Court held that section 506(d) does not permit a chapter 7 debtor to void a wholly underwater junior lien if the junior lien holder's claim "has been 'allowed' pursuant to section 502 of the Code and is secured by a lien with recourse to the underlying collateral." *Id.* at 4 (quoting *Dewsnup*, 502 U.S., at 415.)

A. Background

A "claim" in bankruptcy is broadly defined as a "right to repayment." 11 U.S.C. § 101(5). Allowance of claims is governed by section 502, which provides that "[a] claim or interest, proof of which is filed under section 501 of this title, is deemed allowed, unless a party in interest…objects." 11 U.S.C. § 502(a). Section 506 concerns the determination of a claim's secured status. Section 506(a) provides the mechanism for determining the secured status of a claim and bifurcates allowed claims into allowed secured claims and allowed unsecured claims; to wit: "[a]n allowed claim of a creditor secured by a lien on property in which the estate has an interest…is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property…and is an unsecured claim to the extent that the value of such creditor's interest…is less than the amount of such allowed claim." 11 U.S.C. § 506(a). As the Seventh Circuit explained, "[t]he point of section 506(a) is not to wipe out liens but to recognize that if a creditor is owed more than the current value of his lien, he can by filing a claim in

bankruptcy (rather than bypassing bankruptcy and foreclosing his lien) obtain, if he's lucky, some of the debt owed him that he could not obtain by foreclosure because his lien is worth less than the debt." *Palomar v. First Am. Bank*, 722 F.3d 992, 994 (7th Cir. 2013).

Section 506(d), on the other hand, "[voids] a lien whenever a claim secured by the lien itself has not been allowed," *Dewsnup*, 502 U.S., at 416, and provides, in pertinent part, "[t]o the extent that a lien secures a claim against the debtor that is not an allowed secured claim, such lien is void." 11 U.S.C. § 506(d). The *Dewsnup* Court read "allowed secured claim" to mean something different than the plain meaning under section 506(a) with the focus under section 506(d) being on the extent to which the claim is allowed or enforceable. *Dewsnup*, 502 U.S., at 416-17. *Dewsnup* interpreted section 506(d) to prohibit a chapter 7 debtor from "stripping down" a creditor's lien to the judicially determined value of the collateral where the creditor's "claim is secured by a lien and [the claim] has been fully allowed pursuant to section 502." *Id.* at 417. Because the Court found that the meaning of "secured" in section 506(d) was ambiguous due to the parties' disagreement over its meaning, the Court declined to use the definition of "secured claim" set forth in section 506(a). Instead, the Court turned to policy and pre-Bankruptcy Code case law to derive the meaning of "secured" in the context of section 506(d).

Relying upon pre-Code case law for the principle that "a lien on real property passe[s] through bankruptcy unaffected," *id*. at 418, *Dewsnup* noted that with the exception of "reorganization proceedings…no provision of the pre-Code statute permitted involuntary reduction of the amount of a creditor's lien for any reason other than payment on the debt." *Id.* at 418-19 (citing *Long v. Bullard*, 117 U.S. 617, 620-21 (1886) (holding that a discharge in bankruptcy does not release real estate of the debtor from the debtor's pre-bankruptcy mortgage lien); *Louisville Joint Stock Land Bank v. Radford*, 295 U.S. 555, 579, 594 (1935) (invalidating

the Frazier-Lemke Act's additions to the Bankruptcy Act, which additions were intended to "take from the mortgagee rights in the specific property held as security; and to that end 'to scale down the indebtedness' to the present value of the property" and finding "[n]o instance, except under the Frazier-Lemke Act, of either a statute or decision compelling the mortgagee to relinquish the property to the mortgagor free of the lien unless the debt was paid in full.")). These pre-Code principles were codified by section 506(a) and (d). *See Matter of Tarnow*, 749 F.2d 464 (7th Cir. 1984) (Posner, J.) ("A long line of cases, though none above the level of bankruptcy judges since the Bankruptcy Code was overhauled in 1978, allows a creditor with a loan secured by a lien on the assets of a debtor who becomes bankrupt before the loan is repaid to ignore the bankruptcy proceeding and look to the lien for the satisfaction of the debt.") (citing *Long v. Bullard*, 117 U.S. 617, 620-21 (1886); *Louisville Joint Stock Land Bank v. Radford*, 295 U.S. 555, 582-83 (1935); *United States Nat'l Bank v. Chase Nat'l Bank*, 331 U.S. 28, 33 (1947)). Indeed, when the Bankruptcy Code was enacted in 1978, the House Report stated that with respect to section 506, "[s]ubsection (d) permits liens to pass through the bankruptcy case unaffected." H.R.Rep. No. 95-595, p. 357 (1977), U.S.Code Cong. & Admin. News 1978, pp. 5787, 6313 (cited in *Dewsnup*, 502 U.S. 410).

B. The Parties' Positions

The Bank sought certification on the question of whether section 506(d) permits a chapter 7 debtor to "strip off" a junior mortgage lien in its entirety when the outstanding debt owed to a senior lienholder exceeds the current value of the collateral, in light of *Dewsnup*'s holding that section 506(d) does not permit a chapter 7 to "strip down" a mortgage lien to the current value of the collateral. Under the Bank's reading, "'[t]he heart of *Dewsnup*'s reasoning was that section 506(d) applies only when "a *claim* secured by the lien…has not been *allowed*'"—that is, where the underlying debt is invalid under applicable law." Petitioner's Brief, at 24 (quoting *Dewsnup*,

502 U.S. at 416 (emphasis added)). The crux of the Bank's argument is that the Bankruptcy Code distinguishes between the two components of a mortgage: the note or claim, which provides the lender with a right *in personam* (*i.e.*, to seek repayment from the debtor); and the lien, which provides the lender with a right *in rem* (*i.e.*, to foreclose against the property). 11 U.S.C. §§ 101(5), (37); *Johnson v. Home State Bank*, 501 U.S. 78 (1991). Section 506(a) concerns the claim, or the lender's *in personam* right, while section 506(d) refers to the lender's right *in rem*. Significantly, under the Bank's interpretation, the value of the collateral only affects the treatment of the claim under 506(a); it does not affect the status of a lien under 506(d). Petitioner's Brief, at 26-27.

While *Dewsnup* concerned a *single* lien that was *partially* underwater, the Bank argued that *Dewsnup* is controlling precedent here, where a *junior* lien is *completely* underwater, because its "analysis applies with equal force to *any* lien – whether it is junior or senior or partially or wholly underwater." Petitioner's Brief, at 19-20. The Bank further argued that *Dewsnup* was correctly decided, given the "context and structure of section 506 itself—along with its drafting and legislative history—[which] make clear that it is primarily directed to the treatment of secured *claims*, not to the treatment of *liens*." *Id.*, at 20. Indeed, the fact that Congress has undertaken two substantial revisions to the Bankruptcy Code, including an amendment to section 506 itself, without indicating any disagreement with *Dewsnup* shows Congress does not disagree with *Dewsnup*'s holding. The Bank also paid special attention to the doctrine of *stare decisis* and noted that in the years since *Dewsnup*, "millions of mortgage loans have been made based on *Dewsnup*'s holding that liens pass through chapter 7 bankruptcy unaffected." *Id.*, at 21.

Respondents' main argument is that the text of section 506 is clear: "According to ordinary rules of grammar, a claim must be both 'allowed' and 'secured' in order to be an 'allowed secured claim.'" Respondents' Brief, at 12. Therefore, a lien is void if and to the extent its associated claim is not secured. *Id.* The Debtors argued that *Dewsnup* should not be extended to prohibit stripping off a lien securing the Bank's completely unsecured claim. *Id.*, at 14. The Debtors distinguished *Dewsnup*'s holding on the basis that in that case, the mortgage claim had both secured and unsecured components, while in the Debtors' situation here, no component of the Bank's mortgages is secured because both are completely underwater: "A completely 'unsecured claim' under Section 506(a) cannot be 'an allowed secured claim' under Section 506(d)." *Id*.

The second step in Debtors' textual argument is that section 506(d) uses two distinct phrases: "lien secures a claim," which describes nonbankruptcy-law rights, and "secured claim," which is a term of art that describes rights under federal bankruptcy law. *Id.* In support of this argument, Debtors note that the heading of section 506, "Determination of secured status," indicates that the section concerns both liens and claims, contrary to the Bank's position that section 506 is "primarily directed to the treatment of secured *claims*, not to the treatment of *liens*." *Id.*, at 15 (quoting Petitioner's Brief, at 20). In Debtors' view, the purpose of section 506(a) is to classify allowed claims as secured or unsecured based on the Bankruptcy Court's valuation of the underlying collateral, while section 506(d) gives effect to that classification and the bifurcation of the claim under section 506(a). Respondents' Brief, at 15. The Debtors also note that section 506(d)'s phrase "'[t]o the extent that' remains necessary to address 'allowed' claims" even if it has no effect on partially secured claims and their accompanying liens. *Id.*, at 16. "Although *Dewsnup* accorded 'secured' status under Section 506(d) to fully or partially

secured claims, liens associated with partially allowed claims are void only to the extent that they are not allowed." *Id.* The Debtors contend that the Bank's interpretation of section 506 "creates surplusage." *Id.*, at 17. The Debtors argue that according to the Bank's reading of section 506(d), only liens securing disallowed claims can be stripped. The effect of this reading, the Debtors continue, would be to render every "lien that secures a claim" an "allowed secured claim," such that the word "secured" has no meaning whatsoever. *Id.* (quoting 11 U.S.C. § 506(d)).

The Debtors also attack the Bank's interpretation of section 506 as contradicting other provisions of the Bankruptcy Code, including section 1111(b), and point out that lien stripping —both "stripping off" unsecured liens and "stripping down" undersecured liens—is allowed in chapters 11 and 13. One section that explicitly excludes application of section 506(a) is section 1111(b)(2), which provides lienholders in chapter 11 cases the option of treating their undersecured claims as fully secured, in exchange for giving up their unsecured claim. 11 U.S.C. § 1111(b). The effect of this election is to allow nonrecourse lenders a choice between having their claim treated as (i) completely secured but limited to the collateral or (ii) partially unsecured and including an unsecured deficiency claim against the debtor's other assets. Debtors contend that Bank's interpretation of 506 "would automatically treat *all* allowed underwater claims backed by liens as completely secured, regardless of any election." Respondents' Brief, at 21. Moreover, section 1111(b) precludes creditors from electing secured status if their interest in property of the estate is "of inconsequential value." 11 U.S.C. § 1111(b)(1)(B)(i). The Debtors argue that "this provision protects claims with value but not *completely* underwater claims [which] lose their secured status, even if the holders of those claims dissent and even if they receive no distribution of property in return." Respondents'

Brief, at 21-22 (citing 124 CONG. REC. 34,007 (1978) (statement of Sen. DeConcini)). Debtors believe this is another instance of surplusage—the Bank's reading would negate this limitation and "would render superfluous another part of the same statutory scheme." Respondents' Brief, at 22, (quoting *Marx v. Gen. Revenue Corp.*, 133 S.Ct. 1166, 1178 (2013).

In response to Debtors' arguments that "section 506(d) must be read to void wholly underwater liens to avoid a supposed conflict with section 1111(b)," Respondents' Brief, at 20-22, the Bank argued that there is no conflict, because reading section 506(d) to void only liens securing disallowed claims would not affect section 1111(b):

> Section 1111(b) is an express exception to the bifurcation of *claims* under section 506(a). Section 506(d) has no effect on the treatment of creditors' *claims*; it governs only the disposition of *liens*. Accordingly, however section 506(d) is read, section 506(a)'s bifurcation of claims into secured and unsecured portions would still apply in any case in which a creditor does not or cannot make the section 1111(b) election. In that case, chapter 11's cram-down provisions would permit a plan to pay the partially secured creditor only the value of its collateral, as long as the substantive and procedural protections chapter 11 provides in such circumstances are satisfied.

Petitioner's Reply, at 9 (citing 11 U.S.C. § 1129(b)(2)(A)).

Debtors also cited *Nobleman v. American Savings Bank*, 508 U.S. 324 (1993),[1] as support for distinguishing between partially and wholly underwater mortgages, and highlighted the Court's reliance on "the continued existence of value in the collateral to secure the lien."

[1] *Nobleman* held that "section 1322(b)(2) prohibits a Chapter 13 debtor from relying on section 506(a) to reduce an undersecured homestead mortgage to the fair market value of the mortgaged residence," because "to give effect to section 506(a)'s valuation and bifurcation of secured claims through a Chapter 13 plan in the manner petitioners propose would require a modification of the rights of the holder of the security interest. Section 1322(b)(2) prohibits such a modification where, as here, the lender's claim is secured only by a lien on the debtor's principal residence." *Nobleman*, 508 U.S., at 325-26, 332.

Respondents' Brief, at 30 (citing *Nobleman*, 508 U.S., at 329). Debtors argued that "*Nobleman* undermines [the Bank's] reading of Section 506(d)….[and] clarifies *Dewsnup* by confirming that Section 506(a) determines the secured status of 'secured claim[s]' throughout the Code." *Id.* The Bank argued in response that *Nobleman* concerned section 1322(b)(2), not section 506(d), and that *Nobleman* rejected the argument that "because section 1322(b)(2) protects holders of 'claim[s] secured…by' a lien on a principal residence, it did not bar modification of the portion of a claim that would be deemed 'unsecured' for distribution purposes under section 506(a)." Petitioner's Reply Brief, at 10 (quoting *Nobleman*, 508 U.S., at 328).

The Bank attacked the Debtors for citing only reorganization cases to support lien stripping and failing to address the important distinctions between chapter 7 liquidations and chapter 11 and chapter 13 reorganizations. Petitioner's Reply, at 14-15. As the Bank explained, "the ability to strip liens, under certain circumstances, in reorganizations is part of that very different bargain between debtor and creditor, and is balanced against the creditor's ability to share in the reorganization surplus." *Id.*, at 15 (citing *Palomar v. First American Bank*, 722 F.3d 992, 995 (7th Cir. 2013)). Furthermore, section 506 is not the provision that enables lien stripping in chapters 11 and 13; rather, sections 1129(b) and 1325(a)(5), respectively, provide those powers, subject to certain limitations, in reorganization cases. *Id.*, at 15. A similar framework of reorganization-specific provisions applied under the Bankruptcy Act to permit lien stripping in certain situations. *Id.* The Bank emphasized that "[t]here are no such provisions, then or now, for liquidation proceedings."

C. Policy Considerations

The parties' *amici* focused on the policy implications of the Court's ruling. Debtors' *amici* argued that the second lien risk has already been compensated for by higher interest rates. They also argued that allowing a second lien holder to retain its valueless lien would create a

situation in which a second lien holder would be able to extract "hostage value" of its lien from the first lien holder, by refusing to allow the property to be sold free and clear. Debtors' *amici* argued that these considerations violate one of the central tenets of bankruptcy—giving the debtor a "fresh start." However, the Bank highlighted that an important consideration with respect to Debtors' policy arguments, and which Debtors ignored, is the fact that the Debtors' houses are not being sold. Petitioner's Reply Brief, at 15-17.

III. Analysis

A. *Stare Decisis*

The doctrine of *stare decisis*, or "the idea that today's Court should stand by yesterday's decisions—is 'a foundation stone of the rule of law.'" *Kimble v. Marvel Entertainment*, 576 U.S. ___, ___ (2015) (slip op., at 7) (quoting *Michigan v. Bay Mills Indian Community*, 572 U.S. ___, ___ (2014) (slip op., at 15)). As the Court recently explained:

> Respecting *stare decisis* means sticking to some wrong decisions. The doctrine rests on the idea, as Justice Brandeis famously wrote, that it is usually "more important that the applicable rule of law be settled than that it be settled right." *Burnet v. Coronado Oil & Gas Co.*, 285 U.S. 393, 406 (1932) (dissenting opinion). Indeed, *stare decisis* has consequence only to the extent it sustains incorrect decisions; correct judgments have no need for that principle to prop them up. Accordingly, an argument that we got something wrong—even a good argument to that effect—cannot by itself justify scrapping settled precedent. Or otherwise said, it is not alone sufficient that we would decide a case differently now than we did then. To reverse course, we require as well what we have termed a "special justification"—over and above the belief "that the precedent was wrongly decided." *Halliburton Co. v. Erica P. John Fund, Inc.*, 573 U.S. ___, ___ (2014) (slip op., at 4).

Kimble, 576 U.S., at ___ (slip op., at 7-8). Relevant for our purposes is the special application of *stare decisis* in the context of statutory interpretation:

> What is more, *stare decisis* carries enhanced force when a decision…interprets a statute. Then, unlike in a constitutional case, critics of our ruling can take their objections across the street,

> and Congress can correct any mistake it sees. See, *e.g.*, *Patterson v. McLean Credit Union*, 491 U.S. 164, 172-173 (1989)….All our interpretive decisions, in whatever way reasoned, effectively become part of the statutory scheme, subject (just like the rest) to congressional change. Absent special justification, they are balls tossed into Congress's court, for acceptance or not as that branch elects.

Kimble, 576 U.S., at ___ (slip op., at 8). In *Kimble*, the Court emphasized that in "'cases involving property and contract rights"—considerations favoring *stare decisis* are 'at their acme.' That is because parties are especially likely to rely on such precedents when ordering their affairs." *Id.*, 576 U.S., at ___ (slip op., at 9) (quoting *Payne v. Tennessee*, 501 U.S. 808, 828 (1991); *State Oil Co. v. Khan*, 522 U.S. 3, 20 (1997)).

These considerations play an important role in the *Dewsnup* calculus, despite the fact that in *Caulkett* the Debtors refused to ask the Court to overturn *Dewsnup*. Indeed, the Court noted that "debtors do not ask us to overrule *Dewsnup*" and commented that "[f]rom its inception, *Dewsnup v. Timm*, 502 U.S. 410 (1992), has been the target of criticism." *Caulkett*, 575 U.S., at ___ (slip op., at 5) (citing various cases and critical articles). Also of interest is Justice Ginsburg's comment during oral argument that rather than implement Debtors' distinction to "cabin" *Dewsnup* to partially—as opposed to wholly—underwater liens, "the law would be much more coherent if either Dewsnup applies to the totally underwater as well as partially underwater, or Dewsnup is overruled." Oral Argument Tr., at 37:11-14.

In this context, it would seem that the best method of reversing *Dewsnup* and its progeny is through congressional action. In the Brief of Bankruptcy Law Professors Robert M. Lawless, Bruce A. Markell, and John A. E. Pottow as *Amici Curiae* in Support of Affirmance, the *amici* noted that while "this Court can and does overrule statutory precedents when appropriate circumstances arise," Brief of Lawless *et al.*, at 25 (citing *Hubbard v. United States*, 514 U.S. 695 (1995) (overturning previous statutory interpretation and returning to the plain textual

meaning)), Congress could amend the text to add "i.e., as just defined in subsection (a)" after the phrase "allowed secured claim," although the *amici* noted that this would be a "startling drafting requirement." *Id.*

B. Implications for Chapter 11

While the consequences of *Caulkett* might seem alarming at first, it is important to note that special provisions applicable to reorganizations (compared to chapter 7 liquidations) apply in chapters 11 and 13. Judge Posner provided a concise explanation of how lien stripping is treated differently in chapters 7, 11, and 13, and the related policy implications, in *Palomar v. First American Bank*, where the Palomars, chapter 7 debtors, sought to strip-off a wholly underwater second mortgage, held by First American Bank:

> The strip-off right in Chapter 13 is a partial offset to the advantages that Chapter 13, relative to Chapter 7, grants creditors, such as access to a larger pool of assets because the debtor must commit all disposable income for three to five years to repaying his unsecured debts. 11 U.S.C. § 1325(b)(1)(B).
>
> The difference between Chapter 13 (also Chapter 11) and Chapter 7 is the difference between reorganization and liquidation. In the latter type of bankruptcy the debtor surrenders his assets (subject to certain exemptions) and in exchange is relieved of his debts (with certain exceptions), thus giving him a "fresh start." But in a reorganization the assets are not sold—the enterprise continues—though ownership is transferred from the debtor to his creditors. Chapter 13 is only analogous to a reorganization; the debtor does not become a slave. But unlike what happens in a Chapter 7 bankruptcy, his assets are not sold; instead he pays his creditors, over a three- or five-year period, as much as he can afford. 11 U.S.C. § 1325(b). Often this makes the creditors better off than they would be in a liquidation, for the assets, though important to the debtor, may have little market value.
>
> The Palomars point out that liens can sometimes be stripped off even in Chapter 7 bankruptcies. See 11 U.S.C. §§ 522(f), 722. The cited provisions relate, however, to liens on property that is exempt from creditors' claims. Section 522(f) allows the debtor to reduce a lien on exempt property so far as is necessary to preserve the

> exemption[2], while section 722 allows a debtor to redeem "tangible personal property intended primarily for personal, family, or household use, from a lien securing a dischargeable consumer debt" by paying the current value of the lien. Both provisions support the "fresh start" policy of Chapter 7, consistent with the aim of bankruptcy law of balancing the bankrupt's interests against his creditors' interests. In any event, sections 522(f) and 722 are not available to the Palomars—and "fresh start" is not an ambulatory policy invocable whenever a debtor makes an appeal to judicial sympathy. And if there were such a principle it wouldn't be applicable to this case. Given the gross disparity between the current market value of the Palomars' home and the claims secured by it, First American Bank is unlikely, to say the least, to foreclose in the immediate or near future. For that would entail the bank's incurring legal expenses to obtain the ownership of property worth less than the first mortgage on the property; the bank would be compounding its loss. So all that failing to extinguish First American's lien does from a practical standpoint is deprive the debtors of the chance to make some money should the value of their home ever exceed the balance on LBPS's first mortgage. It is hard to see how the deprivation of so speculative a future opportunity could be thought to impair the debtors' ability to make a fresh start. The extinction of the lien would not enable them to obtain a new second mortgage (unless from a predatory lender) or otherwise improve their financial situation.

Palomar v. First American Bank, 722 F.3d 992, 995-96 (7th Cir. 2013).

Similarly, another concern is whether the Court's reading effectively eliminates section 1111(b), which is one of the exceptions to the bifurcation of claims under section 506(a). A secured lender, no matter what happens in bankruptcy, can retain its lien and benefit from any future appreciation. However, *Caulkett*'s and *Dewsnup*'s interpretation of section 506(d) would not affect section 1111(b), because section 506(d) does not affect treatment of claims—it governs the disposition of liens. Therefore, if a chapter 11 creditor did not make the 1111(b)

[2] It should also be noted that section 522(f) applies only to judicial liens and nonpossessory nonpurchase-money security interests. *See, e.g., In re Wilmoth*, Case No. 12-12259, slip op., at 3 (Bankr. D. Del. April 15, 2014) ("The threshold question before the Court is whether the Obligation is a judicial lien or a mortgage, for 'a judgment arising out of a mortgage foreclosure' cannot be avoided for impairing an exemption.") (citing 11 U.S.C. § 522(f)(2)(C)).

election, section 506(a)'s claim bifurcation would still apply, and the creditor would still receive only the value of its collateral pursuant to section 1129(b)(2)(A) (provided the other requirements of chapter 11 are satisfied).

IV. Conclusion

Caulkett applied the much-criticized *Dewsnup* analysis to hold that a chapter 7 debtor may not strip off an underwater junior lien under section 506(d) where the junior lienholder's claim has been allowed pursuant to section 502 and is secured by a lien with recourse to the underlying collateral. Due to the additional debtor protections available in chapters 11 and 13, however, *Caulkett*'s holding is directly applicable only to chapter 7 liquidations and is unlikely to impact reorganizations. As the Court's interpretation of section 506 is subject to a higher bar under the doctrine of *stare decisis*, overturning the *Dewsnup-Caulkett* analysis would likely require congressional action.

IN THE SUPREME COURT OF THE UNITED STATES

- x

WELLNESS INTERNATIONAL : NETWORK, LIMITED, ET AL., : Petitioners : No. 13-935

v. :

RICHARD SHARIF. :

- x

Washington, D.C.

Wednesday, January 14, 2015

The above-entitled matter came on for oral argument before the Supreme Court of the United States at 11:11 a.m.

APPEARANCES:

CATHERINE STEEGE, ESQ., Chicago, Ill.; on behalf of Petitioners.

CURTIS E. GANNON, ESQ., Assistant to the Solicitor General, Department of Justice, Washington, D.C.; on behalf of United States, as amicus curiae, supporting Petitioners.

JONATHAN D. HACKER, ESQ., Washington, D.C.; on behalf of Respondent.

C O N T E N T S

P R O C E E D I N G S

(11:11 a.m.)

CHIEF JUSTICE ROBERTS: We'll hear argument next in Case 13-935, Wellness International Network v. Sharif.

Ms. Steege.

ORAL ARGUMENT OF CATHERINE STEEGE

ON BEHALF OF THE PETITIONERS

MS. STEEGE: Mr. Chief Justice, and may it please the Court:

Stern v. Marshall held that a bankruptcy judge may, consistent with Article III, enter judgment in an action that stems from the bankruptcy itself.

The claim at issue in this case meets that test. Wellness asked the bankruptcy court to decide the first and most fundamental question that arises in every bankruptcy case, what property became part of the debtor Sharif's bankruptcy estate under Bankruptcy Code Section 541 on the day Mr. Sharif filed for bankruptcy.

As this Court recognized over 100 years ago in Mueller v. Nugent, it is essential that bankruptcy judges have that authority. As long as there have been bankruptcy laws, there have been debtors like Mr. Sharif who devised creative ways to keep property in their own possession and out of the hands of their trustees and

creditors. Here, Mr. Sharif's case is --

JUSTICE SOTOMAYOR: But we've already held that a fraudulent conveyance against a noncreditor is an Article III violation, is a Stern claim, essentially.

MS. STEEGE: Yes, Your Honor.

JUSTICE SOTOMAYOR: Or non-Stern claim. So why isn't this the same thing?

MS. STEEGE: Because this action is a case --

JUSTICE SOTOMAYOR: I mean, it's not the same thing because he actually possessed this trust, it's in his name as trustee --

MS. STEEGE: Yes.

JUSTICE SOTOMAYOR: -- and so it's a little bit -- it's a lot different, but --

MS. STEEGE: Yes. But the allegations of the complaint were that Mr. Sharif owned the property and to the extent the trust existed, it should be ignored by virtue of the way he handled his property.

JUSTICE SOTOMAYOR: Oh, but -- but that's the same in a fraudulent conveyance. It was his property and he was just trying to deny his other creditors the benefit of that money. So it's not quite that.

MS. STEEGE: Well, it's different, Your

Honor, because in a fraudulent transfer claim, the debtor actually passes title over to someone, under the definition of 548 or the --

JUSTICE SOTOMAYOR: But here, he's claiming that the beneficiary has title.

MS. STEEGE: Yes, but that's the very dispute that the Court was asked to decide under Thompson v. Magnolia Petroleum, the issue is not what the debtor claims his title is, but whether he has actual possession. And so here -- the assets what we have here are the condominium that he lives in and he's lived in for 20 years, a pharmacy business, he's a pharmacist, that he's been operating for many years and that in the past, he had reported as his business on his personal tax return; we have his own personal retirement account that somehow inexplicably ended up in the mother's grantor trust and then we have bank accounts that he owned.

And so the allegations of the complaint were that he really owned this and this charade that he put up in front of the bankruptcy court of saying, this is owned in a trust, that was the dispute the court had to consider.

And a way, I think, to think of it as differently from a fraudulent transfer action, where

you're going against a true third party to whom title has passed, that chosen action, the intangible right to sue on the fraudulent transfer claim, or as in Stern, the right to bring the breach of contract or tort claim in these other cases, that asset, the right to sue exists in the estate at the time of its creation.

JUSTICE ALITO: The ben -- who is the beneficiary of this trust? His sister, right?

MS. STEEGE: Well, that's --

JUSTICE ALITO: That's what's claimed.

MS. STEEGE: That's what's claimed, yes.

JUSTICE ALITO: And so what would be the effect of a declaration by the bankruptcy court that -- that Respondent was the alter ego; that it was actually his property? The sister -- would the sister be bound by that judgment? Would the sister have to appear in the bankruptcy court as if she were a creditor?

MS. STEEGE: Well, yes, she would be bound because if we accept their characterization, the trustee, through his litigation conduct, binds the beneficiary under well-established Illinois law, the law of -- it's just basic trust law. But more importantly, she did appear in this action. She appeared through counsel. She, too, was subpoenaed. She, too, failed to produce the trust documents in response to requests.

She was given notice of the case as a creditor and could have filed a claim. And there was a safety valve for her and she's, in fact, exercised her ability to -- to have that safety valve. She could have filed a proof of claim in the case.

JUSTICE SOTOMAYOR: Would the court, the bankruptcy court, have had the power to notify her or to subpoena her to come in as a party?

MS. STEEGE: Yes, because if -- if she was a necessary party to the action, the normal rules of Federal Civil Procedure apply through the bankruptcy rules and she would have been required to be brought in. She's not a necessary party under the construct they created.

JUSTICE SOTOMAYOR: Because she's the representative. Right.

MS. STEEGE: They created this construct of this trust --

JUSTICE BREYER: So am I right about the basic facts? Creditor wants some money from debtor, who's in bankruptcy; creditor says, I look at your list of assets, it seems to me something's missing. I have a piece of paper here that you filed one year ago at the bank which says you have $5 million more.

MS. STEEGE: Right.

JUSTICE BREYER: Where is that on the list? He thinks about it and he says, oh, yeah, there was 5 million more, but that wasn't mine. That belonged to Saudi Arabia. Or that belonged to my cousin. Or -- and so they say, let's prove it. And that's what we're at issue. That's what's at issue.

MS. STEEGE: That's correct.

JUSTICE BREYER: Can the bankruptcy court, it happens here, that the claim is not Saudi Arabia, the claim is not my cousin, the claim is that the $5 million was a living trust of which there seems to be very little record, which belonged to his mother. But in principle, it's no different, is it, in your view?

MS. STEEGE: No. That's exactly what we have here.

JUSTICE BREYER: It's a simple claim. But we'll hear from the other side, which will say it's very different.

MS. STEEGE: Right. And that is the basis of bankruptcy. If we -- if we think about what bankruptcy is and what it has historically always has been, it's been about the in rem jurisdiction of the court to take control of the debtor's property. And this case really is easy because the debtor is in possession of the property, the nature of this property

he's personally --

JUSTICE SCALIA: Is that the only basis for distinguishing Stern?

MS. STEEGE: No, it's not, Your Honor. There's a number of --

JUSTICE SCALIA: What else?

MS. STEEGE: Okay. This is decided as a matter of Federal law. Section 541 determines what comes into the estate and what doesn't. It's not --

JUSTICE SCALIA: Whether there's a trust or not is not a question of Federal law, is it?

MS. STEEGE: But the question of whether something belongs to the bankruptcy estate is a Federal question, even if State law informs the answer. This Court's precedent --

JUSTICE SCALIA: Well --

MS. STEEGE: -- in other -- under other statutes. It's Law v. Siegel last year indicated --

JUSTICE SCALIA: It's a question of Federal law even if State provides the answer.

MS. STEEGE: Yes, Your Honor, and that's -- the Court has Interpreted federal statutes dealing with property rights, the Paulsen --

JUSTICE SCALIA: And that wasn't the case in Stern?

MS. STEEGE: That was not the case in Stern. The claim there was --

JUSTICE SCALIA: Well, likewise there, what was in the estate is a question of Federal law, even if State law provided the answer.

MS. STEEGE: The difference here would be if there had been a dispute between the debtor and Stern and her bankruptcy trustee over who got the right to go sue Pierce, the -- the son-in-law, that would have been this case. That would have been the 541 question.

The chose in action is what exists in the estate at the time of its creation. And so that chose of action, when you go out and you seek to go liquidate that, bring the lawsuit, that's the augmenting-type claim that the Court has talked about in its precedent in Stern and in Northern Pipeline.

JUSTICE ALITO: Suppose that Illinois law, and suppose that Illinois law governs the -- this -- the issue of the trust, and suppose Illinois law says that when a -- when it is held that the trustee is -- that -- that the trust is the trustee's alter ego, that the property does not become the -- that the -- the property at issue does not become the property of the trustee until there is a judicial declaration that that -- that occurs.

MS. STEEGE: Well, I don't think that changes the analysis, because, ultimately, in a bankruptcy case, if you're going to have to have a dispute with the debtor --

JUSTICE ALITO: So that's -- that would be a question of the status of this under Illinois law --

MS. STEEGE: Correct.

JUSTICE ALITO: -- not under Federal law, right?

MS. STEEGE: It would inform the decision. But, ultimately, whether the property comes into the estate or not is determined under Section 541. And so the -- the court of appeals, who have addressed this issue, and we list a number of those cases in the third footnote in our brief, all are very uniform. They are looking to State law in a variety of different contexts to figure out what the debtor's rights are in the property because that's the Butner decision of this Court.

But, ultimately, when you make that final determination that it is property of the estate, you look to 541. And Congress would have intended that disputes over trusts be part of that 541 determination by its inclusion of Section 541(d), which talks about what title the debtor holds, whether it's legal title or

equitable title, which is directly, you know, driven toward trusts because that's when you have a division of title. And so it was intended that Federal law would cover that.

And I also think that, you know, a -- a key difference between this and Stern in the form of claim that we have here is this is being brought against the debtor. This isn't being brought against a third party who's been hauled into bankruptcy court against their will. The debtor has chosen to file a bankruptcy, knowing by virtue of the statute that he or she will be required to turn over their property to the bankruptcy trustee; that there may be disputes over that. And there can be legitimate disputes. It doesn't necessarily just have to be a dishonest debtor, like we would contend we have here. And that they're going to be in front of the bankruptcy judge in the first instance having those disputes determined.

It's part of the Federal scheme, exactly what bankruptcy is supposed to accomplish, which is to get all of the debtor's property put into the bankruptcy estate for distribution to creditors. That's the central key point of every bankruptcy case.

And if you don't do that, you lose your discharge like Mr. Sharif. It really is -- this action

really is the flip side of the denial of his discharge, which no one disputes the bankruptcy judge had the authority to decide.

She couldn't decide if he should receive a discharge if we didn't know what it was he was supposed to be doing in the case in terms of the property that he had.

And the two claims really overlap each other; they're the flip side of each other. That's why I think this is different than a cause of action against a third party such as you had in Stern or Northern Pipeline or Granfinanciera and the like.

JUSTICE SOTOMAYOR: But you've not explored the question completely.

MS. STEEGE: Sure.

JUSTICE SOTOMAYOR: Basically the argument that the SG and the -- of you and the SG is that you need express consent -- or I guess the other side, saying you need express consent and they didn't give express consent. How do you get around that?

MS. STEEGE: Well, Your Honor, we think that you don't need it. The Court has held and ruled that implied consent is permissible. The argument is based upon the bankruptcy rule, Bankruptcy Rule 7012. And if you look at Section 157(c), it uses the term "express

consent" and then just the term "consent." In connection with Section 157(c)(2), which deals with the consent of a litigant to proceed to judgment on a noncore Stern claim, it uses the word "consent." So if we assume Congress meant to require express consent in 157(e) dealing with consenting to a jury trial right, they must not have required express consent, and then we have a rule that's going beyond what the statute provides. That's exactly the situation in Roell.

JUSTICE SCALIA: We don't have to reach both of these questions if we find one of them in -- in your favor, do we?

MS. STEEGE: That's correct. If you don't find it to be a Stern claim, then consent would not matter.

JUSTICE SCALIA: Which one is the better one? Which is the prettier question or -- or the one that you think has more real world effect?

MS. STEEGE: Well, I think the first question has real world effect in the sense that if the Court were to take away from bankruptcy judges the power to litigate disputes with the debtor over what they possess comes in or out of the bankruptcy estate, you'd see a sea change in how cases were handled. Because that's the basic dispute you're going to have with the

debtor. You're going to have three disputes with the debtor. It's going to be --

JUSTICE KENNEDY: Even -- even if consent were sufficient to confer jurisdiction? And that's -- that's -- maybe just to continue Justice Scalia's question, are the bankruptcy courts more confused by Question 1 or Question 2?

MS. STEEGE: I think there's a lot of confusion out there, Your Honor, and I think that certainly people are also concerned about the consent question, because the situation that you have today is that both parties could consent, and the bankruptcy judge could enter a judgment, and then the party who loses can turn around and say, well, there's a question about whether I really consented or not or whether it was appropriate.

JUSTICE KAGAN: Can -- can --

MS. STEEGE: So both are -- are problems for the courts right now.

JUSTICE KAGAN: Can I ask, you said implied consent should be sufficient. How would you go about implying consent? When would there be implied consent? On the basis of what?

MS. STEEGE: Well, I think would you would have implied consent where you have -- here you have a

debtor who moved for summary judgment. He asked the bankruptcy judge to enter judgment in his behalf. He never sought withdrawal of the reference. He never sought to ask the district court to take this matter away from him.

We have -- I think the act of filing a bankruptcy puts you in front of the bankruptcy judge for at least the basic administration of estate, property of the estate determinations, but I would -- would submit for all matters involving the debtor, because they all really do relate to that. It's basically property of the estate determinations, whether property can be claimed as exempt and whether debtor gets the discharge. That's what will involve 99 percent of litigation of the debtor.

JUSTICE KAGAN: You've -- you've said, I think, that the consent has to be knowing and intelligent. Is there something that has to be told to the debtor to make the consent knowing and intelligent?

MS. STEEGE: Congress didn't require that here in Section 157, and, you know, it's a maxim of the law that knowledge -- you know, lack of knowledge of the law is no excuse. The statute puts you on notice that there is a list of proceedings, the core proceedings, that are like the old summary proceedings under the

Bankruptcy Act, that the bankruptcy judge can decide the final judgment without the consent of the parties.

And the statute also puts you on notice that if you don't agree with that, you can ask the bankruptcy judge to make a determination, you can ask the district court judge to make a determination for withdrawal of the reference.

JUSTICE SOTOMAYOR: There is a problem, however, here, and that problem is that Stern wasn't decided until the appeal. On rebuttal, I want to talk about the American Colleges' appellate waiver argument.

MS. STEEGE: Yes, Your Honor.

Thank you.

CHIEF JUSTICE ROBERTS: Thank you, counsel.

Mr. Gannon.

ORAL ARGUMENT OF CURTIS E. GANNON,

ON BEHALF OF THE UNITED STATES, AS AMICUS CURIAE,

SUPPORTING PETITIONERS

MR. GANNON: Mr. Chief Justice, and may it please the Court:

We agree with Petitioners on both questions presented. With respect to the first question, we don't think this is like a Stern claim for the two reasons that have already been discussed, that is that the question of whether something is property of the estate

under Section 541 stems from bankruptcy itself.

JUSTICE SOTOMAYOR: But that's too broad an answer, because that would be true of fraudulent conveyances.

MR. GANNON: Well, and -- and it also does not involve an attempt to augment the estate. We're talking about a determination about --

JUSTICE SOTOMAYOR: How about a simpler rule, if you have legal title to something?

MR. GANNON: Well --

JUSTICE SOTOMAYOR: If you -- if you possess it physically or you have legal title to it, then the bankruptcy court can determine.

MR. GANNON: Well, I think --

JUSTICE SOTOMAYOR: They -- he has -- the trustee had legal title. He's just claiming --

MR. GANNON: The trustee had bare legal title and you think that that's --

JUSTICE SOTOMAYOR: -- that there's an equitable requirement to hold it for someone else.

MR. GANNON: And -- and under 541(d), if it is true that the trustee only -- only holds bare legal title, and then ultimately the trust is not looked through because it's found not to exist or because it's found to be the alter ego of the trustee, then the --

then the equitable interest would not have come into -- to the estate.

JUSTICE SOTOMAYOR: Yeah. I'm trying to get away from the --

MR. GANNON: And so that's true.

JUSTICE SOTOMAYOR: I'm trying to get away from the augmentation argument because it's really difficult to apply in a case like this. Anything that's in the estate augments it or anything that comes into the estate.

MR. GANNON: Well, I -- I don't think that that's true. I think that when the Court in Stern and Granfinanciera and Northern Pipeline was talking about the difference between questions that stem from the bankruptcy itself and are integral to the restructuring of the debtor/creditor relationship --

JUSTICE SOTOMAYOR: Well, then --

MR. GANNON: -- they were talking about the baseline that you have there with the estate is the property --

JUSTICE SOTOMAYOR: Well, tell me why my rule is not simpler.

MR. GANNON: Well, I think --

JUSTICE SOTOMAYOR: If you -- if you physically possess it at the time you declare bankruptcy

or you have legal title to it --

MR. GANNON: I think that --

JUSTICE SOTOMAYOR: -- then the bankruptcy -- then it's not a Stern claim.

MR. GANNON: I suppose that -- that that -- what this is feinting towards is the system that the parties have talked about that developed under the 1898 Act that ended up being a relatively reticulated system as described in the Taubel-Scott-Kitzmiller case, in which there are multiple categories in which the bankruptcy court would have jurisdiction to make these determinations. And we agree with Petitioners that on facts like these where there was possession of the property, which we think indisputably the trustee had possession of the trust assets here, and that would be enough to give the bankruptcy judge the jurisdiction -- or the referee under the 1898 Act cases -- jurisdiction to determine who had title. And then if -- if --

JUSTICE SOTOMAYOR: In Stern we said we would look to history.

MR. GANNON: Pardon?

JUSTICE SOTOMAYOR: In Stern we said we would look to history.

MR. GANNON: Portions of the Stern opinion looked to history but it did not indicate that the

historical precedents for this were going to be dispositive and we don't think that -- that the rationale of Stern, Granfinanciera, and Northern Pipeline requires that as an Article III matter, nor does the statute here, because the statutory definition of -- of property of the estate refers to property wherever located and by whomever held. It still ultimately has to be property of the debtor.

And so, if you're going to say that if it's -- if it's -- if the debtor holds title to the property, that is the ultimate determination and if you say that that's not --

JUSTICE SOTOMAYOR: So let's to go -- let's go to the hypothetical. The sister holds title, but you're saying that it belonged to him.

MR. GANNON: Well, I --

JUSTICE SOTOMAYOR: That she holds legal title but, in fact, she -- it's really his money.

MR. GANNON: Well, I -- I think -- I think it would -- if she held legal title and the property had already been transferred to her and that's what the bankruptcy judge determined, then it wouldn't be property of the estate. And -- but we don't know the answer to the question of who holds title until the so-called Stern claim or non-Stern claim has already

been decided, and so I think that that's the trouble with assuming that the answer to the title question or the ownership question -- because that is the answer to the property of the estate question, we can't -- we can't wait to know the -- the merits determination before we know whether it's a Stern claim I think is -- is the problem with approaching it that way.

But it is sensible to say that the question of whether something was property of the estate on day one such that it was the debtor's property -- because that's the determination here -- that that is not like a Stern claim. It's not like a fraudulent conveyance or avoidable transfer where you're attempting to go out, after the bankruptcy has already been initiated, and trying to reduce a chosen action to judgment and liquidate it and therefore increase the size of the estate after the fact.

CHIEF JUSTICE ROBERTS: Counsel, on the consent question, is -- under your theory, is there anything wrong with Congress adding a proviso to every Federal contract saying the contractor hereby agrees to waive any Article III objections to having disputes with the government resolved by something we'll call the congressional courts where the -- the individuals serve for 3 years and Congress has a lot more sway over their

decisions?

MR. GANNON: Well, I suspect yes, if for no other reason than be -- I mean --

JUSTICE SCALIA: Yes, yes what? I forgot the question.

MR. GANNON: Yes, if for no other reason than because --

JUSTICE SCALIA: Yes, it's okay.

MR. GANNON: Yes, that that would be a problem -- I'm sorry, that that would not be permissible. I've forgotten the question.

But the reason why this would not be --

CHIEF JUSTICE ROBERTS: I thought it was an unforgettable question.

(Laughter.)

MR. GANNON: I promise you I won't forget it now.

JUSTICE SCALIA: Yes. Yes, we have no bananas.

MR. GANNON: The reason -- the reason why this would be a problem is -- is because of the structural concerns that you raise there which we don't think are present here. When you said that those were -- were congressional courts that would be more subject to supervision by Congress, we do not think that that

describes the bankruptcy system. We think the bankruptcy system is akin to the magistrate judge system where this Court has repeatedly recognized that the structural concerns that were at issue in Schor were not sufficient to create a problem --

JUSTICE BREYER: You --

MR. GANNON: There is two things here. There is both the consent of the parties but also adequate judicial control, both in the aggregate over bankruptcy judges who are appointed by and removable by Article III judges, and also in every individual case because they don't get any bankruptcy case --

CHIEF JUSTICE ROBERTS: Well, there's judicial control in the sense that you have deferential appellate review and whatnot, but it still takes out of the Federal courts our constitutional birthright to decide cases and controversies under Article III.

MR. GANNON: And I think --

CHIEF JUSTICE ROBERTS: It's hard for me to see how --

MR. GANNON: But I think --

CHIEF JUSTICE ROBERTS: -- sort of vague -- vague notions of, oh, well, the judges are involved there somewhere.

MR. GANNON: But I don't think that this is

vague. We're talking about something different from just having appellate review after the fact. We're talking here about supervision of the bankruptcy judges just like magistrate judges by Article III judges, they're appointed and removed by them. They don't ever get a case unless the Court agrees to give it to them and that seems to me the principal difference between your hypothetical congressional support scheme, which is that the parties are all not even making a voluntary choice because Congress is deeming them to have made the choice, and then also no court is able to say, I don't want the transfer to happen.

And both of those things are not true here because the parties are able to make the choice and the courts are able to withdraw the reference. The parties are always able to ask for the courts to withdraw the reference. This makes it just like the bankruptcy system with respect to whether it's a consentable constitutional violation.

And so we don't think that this is like subject-matter jurisdiction, and the Court in Stern said that, that the division of authority between bankruptcy judges and district court judges and 157 is not a question of subject matter jurisdiction. And we think that is why it's one that's waivable.

JUSTICE BREYER: You need to go back to your experience in your office. I just want to know -- it seems to me by memory, but I'm not positive -- it is not totally unusual and we do have the power to give two affirmative answers where either answer would be sufficient. That is, we could answer both questions.

Now is your -- as a representative of the solicitor general, is your reaction the same as mine, that there are cases where a court had -- where we had two questions.

MR. GANNON: I --

JUSTICE BREYER: And you say one would be enough for the party to win, so would two, but we think it's important to answer both and we will.

MR. GANNON: I do believe that the Court has done that. I don't have any particular cases at the tip of my --

JUSTICE SCALIA: Perhaps so. Perhaps we made other mistakes as well.

JUSTICE BREYER: That's what I wondered. Is there any reason that --

MR. GANNON: I --

JUSTICE BREYER: -- strikes you that that would be a mistake? I don't know anything in the Constitution --

MR. GANNON: Well --

JUSTICE BREYER: -- or in any precedent of this Court that prohibits it.

MR. GANNON: I --

JUSTICE BREYER: So I think saying it is a mistake does not necessarily make it one.

MR. GANNON: I think that that's something that would be in the discretion of the Court. I do think that both of these questions are independently important. It is the case that Petitioners can prevail and you can reverse the judge of the court of appeals on either ground and without having to reach the other.

I do think that until a case -- there probably was not confusion in the bankruptcy courts about whether questions involving the definition of the property of the estate were Stern claims, and so -- but I do think that there is confusion about that just by virtue of the fact that this case is here.

JUSTICE ALITO: Could I ask you --

MR. GANNON: The second --

JUSTICE ALITO: Could I ask you this quick question before your time runs out. If Federal Bankruptcy Rule 7012(b) applies to Stern claims because they're non-core, do you agree with Petitioner that the rule is invalid because it requires express consent and

the statute does not refer to express consent?

MR. GANNON: I don't think you have to get to the point of saying that the rule is invalid. That's not the way the Court approached the case in Roell where the situation was, as my friend just said, exactly parallel. The statute did not require express consent, or it did in some places but not in this one, and the same thing is true if you contrast 157(c)(2) with 157(e), the relevant statutory provision period does not require express consent.

The Federal Rule of Civil Procedure that was applicable in Roell did, and the Court nevertheless said that it was going to overlook the lack of an express waiver there because it found that there was sufficiently implied consent on the record.

JUSTICE KENNEDY: Do you agree that there's --

MR. GANNON: There is --

JUSTICE KENNEDY: Excuse me. Do you agree there's implied consent merely by filing a voluntary bankruptcy petition?

MR. GANNON: Well, I think that the Court --

JUSTICE KENNEDY: I thought that I heard that that's what the Petitioner said.

MR. GANNON: When you said, "a voluntarily

bankruptcy petition?"

JUSTICE KENNEDY: Yes.

MR. GANNON: The Court didn't grant cert on that question but we do think that there's lots of other conduct here but ultimately there's also the forfeiture after Stern itself was decided that we think would be adequate to decide that there was consent in this case.

JUSTICE SCALIA: Mr. Gannon, I hate to protract your presentation here. I wasn't clear about what your answer to Justice Breyer covered. Did you say there are prior cases in which we have decided two constitutional questions?

MR. GANNON: I said two different questions.

JUSTICE SCALIA: Ah.

MR. GANNON: I think that --

JUSTICE SCALIA: What about two constitutional questions given that we're supposed to --

MR. GANNON: I think that --

JUSTICE SCALIA: -- avoid the determination of constitutional questions?

MR. GANNON: I do realize that that is the general prudential rule that the Court applies, but I think that it normally does so in a context of --

JUSTICE SCALIA: I understand --

MR. GANNON: -- here it would be upholding

the statute in both regards and therefore I don't think that the normal concerns about constitutionality rise to the same level.

CHIEF JUSTICE ROBERTS: Counsel. Justice Kagan.

JUSTICE KAGAN: You were saying that you wanted to talk about the importance of both questions. I think you got the first one out. What, in your view, is the importance of the second?

MR. GANNON: Well, I do think that the Court was not able to decide the consent question in executive benefits last term, and that there is a circuit split on it. It would be very useful to know that Stern claims are the sorts of things to which parties consent or those claims are waivable as they are in the magistrate judge context which we think is parallel.

JUSTICE GINSBURG: The government agrees with the Petitioner that the first question, what goes into this estate, that if we had to choose between the two, which would you say is the more important?

MR. GANNON: I -- I think that -- that it would be good to settle that for the purposes of bankruptcy courts, but you would still have the unsettled consent question that has been kicking around ever since Stern and on which there's already a circuit

split.

JUSTICE SCALIA: And vice versa.

CHIEF JUSTICE ROBERTS: Thank you, counsel.

Mr. Hacker.

ORAL ARGUMENT OF JONATHAN D. HACKER

ON BEHALF OF RESPONDENT

MR. HACKER: Mr. Chief Justice, and may it please the Court:

We agree with what I understand the solicitor general's position this morning to be, that the Stern rule is relatively straightforward, which is that a common law claim that seeks to augment the estate with third-party property cannot be withdrawn by Congress from Article III jurisdiction.

We also know that the alter ego claim asserted by Wellness was a common law claim seeking to augment --

JUSTICE SOTOMAYOR: That really begs the question, your client possessed something and he says it really belonged to someone else. Don't you have to decide who it belongs to if there is no clear indication of it?

MR. HACKER: Two -- two point --

JUSTICE SOTOMAYOR: I mean, there may be a clear one, but it still begs the question.

MR. HACKER: Right. Two points on that, Your Honor. Let me start with where this Court started and where the law has been for decades, if not centuries, which is that the trustee of the trust possesses, if anything at all, no more than bear legal title. And so this Court said in the Hardinsburg case, it said in Whiting Pools, and more import -- maybe most importantly there is no case anywhere to the contrary, that when a trust -- a trustee of a trust declares personal bankruptcy, the trust assets do not become part of the estate at the commencement of the bankruptcy.

So what Wellness had to do was establish through its common law alter ego claim that the -- was to bring the assets of the trust into the --

JUSTICE BREYER: So you're just saying that they didn't decide it correctly, but it's terribly easy to imagine a different debtor who goes into bankruptcy and he lists Item 1, 2, 3, and 4. And the creditors come in and say, you know, it's awfully surprising, four or five, six months ago I have a similar list you gave to the National Bank, and it had 10 items on it. What happened to 6 through 10? Ah, the debtor replies, oh, they didn't really belong to me. Why not? Because State law gives it to somebody else because State law is the source of all property law. And they say, no. And

now we have a dispute.

So forget about the trust. Maybe I don't see why that's special. This is simply a question of whether a bankruptcy judge can litigate who owns Items 6 through 10, and one party says State law gives them to my cousin Mary and the other party says State law gives them right to you.

Now, if we say, no, and side with you on that one, what happens to the constitutional grant to Congress to make uniform laws of bankruptcy? I imagine it would still exist, but I can't imagine in what form.

Now you see a pretty hostile argument, so I would like to hear your reply.

(Laughter.)

MR. HACKER: I -- I -- and I think the example is a good one because I do think the trust is very important because we do have decades of law on that, but the example is not problematic because if in that situation the trustee says, I see some other bankruptcy trustee, sees -- I see some other property, and the debtor says, that's not mine, I do think it's true that there wouldn't be a litigable claim there unless the third party also asserted ownership to the property.

But if that happened, if the third party

says, that's not the debtor's, that's all mine, I've had it for years, that's my car, that's my boat, that's my house, then I think it's absolutely clear that under that circumstance the trustee could not extinguish the third party's rights, the bankruptcy court could not distinguish the third party's rights by itself. That's an Article III claim, a classic private rights claim where the bankruptcy trustee, the bankruptcy court is reaching out to take the third party's property on the trustee's --

JUSTICE BREYER: And what is the example of 6 through 10 that you could find that wouldn't involve the issue you have described? Because if there is a piece of property and the debtor is saying it isn't mine, it must be somebody's, and by definition it's not the creditor's, and so it must be somebody else's. And so that other person, if there is a dispute, will say it's mine.

And therefore, isn't your answer to say to my property -- to my question, too bad, the bankruptcy trustee cannot litigate who owns 6 through 10?

MR. HACKER: So long as the third-party asserts --

JUSTICE BREYER: Yes.

MR. HACKER: Yes, that's right, but --

but --

JUSTICE BREYER: Yes, he can't do it. All right. Then we're back to where are we with bankruptcy courts, when you have taken from them the power to litigate what I would think is the most fundamental thing imaginable: How much money does the debtor have in cases where that is in dispute?

MR. HACKER: I don't -- I don't think that's fundamental because you have -- what you're talking about, I mean, this Court already crossed that bridge I think in Stern in saying when you're augmenting the estate with third-party property, you don't assume at the beginning of the Article III litigation that the other side has a claim. That's the whole point. The other side says don't take my property.

JUSTICE BREYER: You said for thousands of years -- I got that point -- for thousands of years this has been the law. So can you think of any case -- I find it rather interesting, I'm reading about Henry II, who, in fact, created many of the laws of England.

So from the time of Henry II onward, is there a case that you have found somewhere which said that the bankruptcy trustee or the bankruptcy judge cannot litigate who owns property, the bankrupt or someone else, in the state -- in the estate.

MR. HACKER: Well, a couple of --
JUSTICE BREYER: I'll read it. I'll read it.
MR. HACKER: First of all, all of the cases --
JUSTICE SCALIA: Besides -- besides Stern, he means.
MR. HACKER: Well, Stern -- yes, Stern is --
JUSTICE BREYER: Stern is a case of a third party and counterclaim, and there never would have been the money in the estate had it not been for the fact that the debtor in fact asserted a claim, a counterclaim against a claim that was being made by an outsider to the estate. It's not too hard to distinguish Stern.
But I am saying other than Stern -- I don't even think Stern -- let's go back to Henry II. Maybe you have so many you'd have to send them on a list, but maybe not.
MR. HACKER: I -- if you look at all of the cases cited on both sides' brief, I think the rule is best stated in the Taubel-Scott-Kitzmiller -- which is one word -- case that says when there is a bona fide claim of adverse possession -- or excuse me, of ownership by a third party, that can't be extinguished except through plenary proceeding.

And that's the exact same situation you're talking about, Your Honor. There's no difference, and there's decades of that law, and that law and that rule was never disputed.

And so going back now to the trust proposition, I think it's important to make clear that Wellness is asserting --

JUSTICE GINSBURG: Who is the third party? You said it's just -- it's no different, no different than a third party coming in and saying that's my vote. Who is the third party here? And what --

MR. HACKER: The third -- go ahead.

JUSTICE GINSBURG: There is only the trustee. This is supposed to be his mother's trust, and his sister is supposed to be the beneficiary, so who is the third party?

MR. HACKER: So two -- there's -- well, three. There's the trust, but importantly, during her lifetime, Soad Wattar was the owner, the only owner of the beneficial interest in the trust assets. So she's the third party.

So to the extent the bankruptcy court wants to decide for itself --

JUSTICE GINSBURG: I thought she was dead.

MR. HACKER: When the bankruptcy was

commenced, she was still alive, and she had the -- it's a revocable living trust right. She has the absolute right to use all of those assets to revoke the trust. That's -- they're her assets. If she had declared bankruptcy, those assets would have been in her estate. There's --

JUSTICE GINSBURG: Did she say, when she was alive, did she say, bankruptcy court, wait a minute, this belongs to me?

MR. HACKER: She was in Syria, I think, I'm not sure at what point. But the point is the trust itself was an existing document and -- and was an existing entity.

And I want to be clear about something. Wellness doesn't dispute that. I mean, Exhibit 13 to Sharif's deposition was the trust amendment in 1996. It was an existing trust.

And, in fact, their first primary argument, which pervades their reply brief, depends on the proposition that the trust was a real entity because what they're saying is a version of what you were saying, Justice Sotomayor, which is that he had possession because he was the trustee of the trust. The possession only exists because he's a trustee of the trust. The trust assets aren't listed in his name. If

they're not in the trust, there's no tenable theory that he is the -- on the face of the assets, that they start in the estate, they're going to have to be gotten somehow. So their theory is, well, he's the trustee of a trust and therefore he has sufficient possession.

And our answer to that is simple. Not one case ever in the history of western law that anybody has found says that trust assets go into the personal bankruptcy estate of a trustee, if and when the trustee declares bankruptcy, this Court said the opposite in Hardenburg, it said the opposite in Whiting Pools in saying that when you have only bare legal title, which is at most the only thing a trustee has, only bare legal title goes in and no other beneficial interests go into the estate.

So then there's a second question, a second argument, which is that well, because in 2002, not one year, Justice Breyer, but seven years before the bankruptcy, we have discovered these documents that suggest that he was treating the trust as trustee was treating the trust assets as his own.

JUSTICE KENNEDY: But in the cases you just cited, did the courts say who decides the question of whether there's bare legal title?

MR. HACKER: Those cases were --

JUSTICE KENNEDY: You -- you said the case very clear, only bare legal title goes. But who -- did it -- did it go on to say that the bankruptcy court cannot decide who has the bare -- whether you have only bare legal title?

MR. HACKER: Right. Those cases were not about that proposition. This -- this is about this -- this threshold proposition that because he's the trustee of the trust and in possession of bare legal title, that's all we need to know. That's their --

JUSTICE BREYER: No argue -- so -- so where you have brought me so far is these cases say -- what they say is you have to -- you can't just grab it; you have to proceed under Section 23 and have a proceeding. But the -- the -- a proceeding -- some kind of a proceeding, I don't know exactly what that kind is, you probably do, but that doesn't mean the trustee doesn't get it. I mean, it's the trustee who litigates it out, it's the trustee who decides, but I don't know what a Section 23 proceeding is.

MR. HACKER: In the older cases --

JUSTICE BREYER: Yeah.

MR. HACKER: -- the rule that would apply, Justice Kennedy, would be the Talburg v. Scott Kitzmiller rule, you have to have a plenary proceeding

to go get it.

JUSTICE BREYER: A plenary proceeding. But where does that take place?

MR. HACKER: That would have been -- it's sort of the equivalent now the parties are treating, I think, not incorrectly as equivalent now of an Article III proceeding. This would have to be --

JUSTICE BREYER: It didn't take place before the bankruptcy judge?

MR. HACKER: Well, at the -- most of these cases at the time, remember, the district court was the bankruptcy court and the question was whether it's the exercise of summary jurisdiction versus a plenary Article III proceeding.

JUSTICE BREYER: Oh, I see the problem.

MR. HACKER: A plenary proceeding. Now it would be an adversary proceeding that would have to be determined finally by the -- the Federal court.

So -- but I want to get to the second point, because it's an important one. Wellness doesn't just rest on the proposition that just because the trustee is a trustee, the trust assets are part of the estate, which I think is completely unsupportable. They go on to say because seven years earlier, as trustee, he treated them as -- the trust assets as his own;

therefore, we should disregard the trust.

That argument, I think, as I think Justice Sotomayor pointed out, is functionally indistinguishable from a fraudulent transfer claim because they're saying, based on his alleged misuse of trust assets at some point in the now distant past, we should treat them as part of the estate, we should disregard the trust, which is just like a fraudulent transfer, which it says because of something the debtor did before, transferring the assets, we should disregard the transfer and treat them as part of the estate.

In that respect, it's -- it's indistinguishable and it is in that respect in the same way because you augment the estate.

JUSTICE SOTOMAYOR: Just to clarify the record, I asked the question whether they were or weren't.

MR. HACKER: Fair enough. And -- and I will try to answer it, which is I think they are in that respect indistinguishable. And then if you follow from what the -- all of the lower courts have said, that a fraudulent transfer action is a Stern claim --

JUSTICE SOTOMAYOR: Well, we've said that, too, against --

MR. HACKER: Held that it's an Article --

basically an Article III claim in Grand Financier. So I think for all of these reasons, it is quite clear that the action to bring these claims into the estate is a common law action seeking to augment the estate with somebody else's property. Property that Soad Wattar owned during her life and that Ragda Sharif owned upon Soad's death.

JUSTICE SOTOMAYOR: So give me examples. The suggested rule that I have for the solicitor general, which he would like the broader one, but if at the time you have legal title to or in physical possession of something, then it's not a Stern claim, not an Article III claim because that is the quintessential question that bankruptcy judges decide are the things that you possess either by title or by constructive holding -- or by holding.

MR. HACKER: Right. I think there's two problems with that analysis. First is that all the trustee has is bare legal title as a matter of law, does not have any property interest, which is what the current bankruptcy code focuses on, what are the debtor's interests in property and it's the -- the trustee of a trust does not have any interest, beneficial or legal interest in the assets, it's only bare legal title.

So to get more interest as part of the estate, you have to have some common law way to do that, some claim for doing that and a classic claim is an alter ego claim, if that's what you think because of something the trustee did, then --

JUSTICE SCALIA: But -- but you say that's always going to be the case, that you need an Article III proceeding whenever the bankruptcy trustee determines that something belongs to the debtor and is in the bankruptcy estate and some other private party says, no, it belongs to me. That always has to be litigated in an Article III court?

MR. HACKER: I don't think this Court needs to decide that. That's not quite the question here because the property interests from the start are outside the estate. But I do think --

JUSTICE SCALIA: Is that what you're arguing here?

MR. HACKER: I -- I -- I would not be surprised if this Court were to hold one day that if a third party has a claim to property, comes into court and says, that's my -- that's my house, I know the debtor says it is, that says it's his and the trustee thinks it's his, that's my house, that that person is entitled to an Article III adjudication --

JUSTICE BREYER: That's exactly -- because -- it's interesting. I mean, I've read the page you have there now with the cases. And I see you can -- the distinction will drive you towards that, not 100 percent, because there will be some instances of colorable -- colorable title and so forth, not 100 percent, but 99 percent, items 6 through 10 go to a different court.

But what -- the constitutional question is the deepest one to me, is we do have a constitutional provision specifically giving to Congress the authority to create a uniform system of bankruptcy courts which have served our economy well, I think. That's what I read. Makes us richer. And on the other hand, we do have the question, as you point out, that this is determining a title where there are two people under State law contesting it. And so which prevails? And until I think Stern, it would have been Congress's delegation, maybe.

And what is the strongest argument for not giving weight? These are sort of like administrative agencies defining -- you know, deciding things that never have been done before. What's the strongest argument? No, don't do it, it might gut the bankruptcy court, but don't do it. Or maybe you want to say it

won't gut the bankruptcy court.

MR. HACKER: That was my answer was I don't think it will gut the bankruptcy court. We think this is just a straightforward application of where we already are -- where we already are with Stern.

JUSTICE BREYER: Yes, yes. I agree with you to this extent. It's either Stern marches forward or it's -- I'd say steps in place.

MR. HACKER: Well, and I don't think -- I don't think we're pushing Stern forward. I do think we're just applying Stern.

But I also want to address your point about uniform bankruptcy code. I think the fact that this Court has long said and understood and the lower courts have accepted that bankruptcy law takes State law and property rights as defined by State law as they find them. That's all we're talking about here. To the extent there is a State law property dispute between a third party and the debtor/bankruptcy trust trustee, that -- that doesn't change the uniformity of the bankruptcy code.

JUSTICE SCALIA: And I suppose the constitutional provision authorizing Congress to establish a uniform law of bankruptcy does not authorize Congress to establish bankruptcy courts that can decide

questions which would normally be decided by Article III courts.

MR. HACKER: That's clearly right. You could establish bankruptcy law, but it's going to be an Article III question, the extent to which the bankruptcy courts can exercise judicial power.

As to one more point on Justice Sotomayor's question, I had two responses. The second one was that physical possession is not a great test. As this case shows, Sharif as trustee didn't physically possess anything. If anybody did, it was the banks where the trust assets were, so you can't think about it in terms of physical possession.

JUSTICE BREYER: That's -- let me proceed with this question one more step. Every day of the week administrative agencies change State law. Every day of the week they change State law, even involving property. And in such a case, the question is whether -- has this administrative agency, under authority of Congress, changed State law affecting people's property rights in a way that deprives them of due process of law? Have they gotten fair procedure?

And so is a possible answer to your problem: If the procedures of the bankruptcy court are fair when they litigate these questions of property right, the

fact that they do affect State law and take property among persons switching it is not forbidden by the Constitution where it indeed is authorized as part of a uniform system of bankruptcy law?

MR. HACKER: I think due process viewed that way is not sufficient. I think, again, this Court answered that question in Stern. There wasn't a claim that there wasn't going to be due process for the disposition of the -- of the property rights there. The problem was that the bankruptcy court was exercising the judicial power of the United States in entering a final judgment. And if I can turn to that argument, I will.

Stern itself is based on a structural separation of powers concerns, that private rights of this kind are exclusively committed to -- by the Constitution, to Article III. It's about the exercise of judicial power, which entails the implementation and enforcement of judgments of the United States that are entitled to full faith and credit by courts both in the United States and elsewhere, pursuant to treaties. They are precedential. They can be law -- they are law of the case in what can be very complicated cases that stretch around different courts and go on for years. That's --

JUSTICE SOTOMAYOR: By the way, is -- are

the arguments you're raising now any different as applied to magistrate judges? If we rule in your favor in this case, are we calling into question our -- our acceptance of magistrate judge positions?

MR. HACKER: Well, a couple of points. First of all, with respect to magistrate judges, it's only with respect to final adjudications. Magistrate judges can still perform the functions --

JUSTICE SOTOMAYOR: So your answer is yes, because you can do -- on express consent, you can do reports and recommendations.

MR. HACKER: As -- as to final adjudications of private rights matters, magistrate judges can still do something, can still litigate and resolve public rights, whatever those kinds of rights and matters are. But I do think it would be difficult after this case to say that a magistrate can exercise judicial power of the United States to enter a final judgment based solely on consent. I think this Court answered that question in Schor, effectively.

Schor would have been an easy case, an incredibly easy case, if consent alone were enough, because that was an issue in Schor, and the parties there did consent. But the Court didn't stop with that one sentence: The parties consented; that's all we need

to know. The Court went on to do an elaborate analysis of the structural concerns involved and why there were no structural concerns, such that the consent was sufficient. And when you boil it all down, basically what Schor said, which is what I think the Court recognized in Stern, was that the structural concerns exist when you're talking about the adjudication of a private --

JUSTICE SOTOMAYOR: I agree, but we didn't say that you couldn't consent in Schor.

MR. HACKER: I understand that. I'm just saying, it would have been a very easy case if consent were enough. And the Court nevertheless went on to say consent is enough here, because we're talking about what is --

JUSTICE SOTOMAYOR: No, consent is enough for arbitration, and there you give up --

MR. HACKER: I understand that. And arbitration is fundamentally different. Arbitration is not the exercise of the judicial power of the United States. An arbitrator doesn't issue a judgment. It's not entitled to full faith and credit. It's a fundamentally different kind of exercise of authority, of which --

JUSTICE KAGAN: Well, but it's something

which has to be enforced by a court except in very extraordinary circumstances. You know, there's much less supervision over the arbitration system than there is over a typical bankruptcy court.

MR. HACKER: Right. But the decision by the parties to go to an arbitrator -- which, by the way, is their own decision. What arbitrator they choose is their own choice. The arbitrator is not controlled -- the salary of the arbitrator is not controlled by Congress. The tenure of the arbitrator is not controlled by Congress. And when the FFA -- excuse me -- the FAA --

JUSTICE SCALIA: There's very little difference --

JUSTICE KAGAN: All those things make it worse. You know, this is a proceeding that's totally divorced from any kind of control by anybody, and yet Federal courts, under the Arbitration Act, simply have to rubber-stamp it and say it's valid except in extremely unusual circumstances.

MR. HACKER: But that's pursuant to Congress's Article I power to say, here is a type of contract that we're going to say is enforceable under a particular situation. That's all arbitration is, is a private contract.

JUSTICE SCALIA: That's just contract law, isn't it? I mean, they're just enforcing the parties' contracts.

MR. HACKER: Right. And that --

JUSTICE SCALIA: But --

JUSTICE KAGAN: This is the parties' contract. It's -- I mean, the entire question is that the parties are consenting to go to bankruptcy court, and the question is: Will that consent be sufficient in the same way that it is in the arbitration system?

MR. HACKER: I understand. But it adds the element that what you're consenting to, by hypothesis, is the exercise of judicial power by the entry of a judgment that will be given full faith and credit, the entry of a judgment by an entity in a --

JUSTICE SOTOMAYOR: No, because that's what happens in arbitration. You're agreeing to the entry of a judgment, of an award. Perhaps not even, because you don't even put that into the contract. Congress is saying, we're going to do it anyway.

MR. HACKER: What I'm saying is, you're not -- you're not consenting to the exercise of the judicial power, to the dilution of the Article III court's authority --

JUSTICE KAGAN: Well, I understand that --

MR. HACKER: -- to issue judgments that are precedential.

JUSTICE KAGAN: Please. I'm sorry.

MR. HACKER: Well, that's all I was going to say.

JUSTICE KAGAN: I -- you know, I understand that formalism matters in many contexts, but the fact that the arbitrator himself doesn't issue the judgment, and instead you have to take it across the street and the Federal court has to issue the judgment, basically on the arbitrator's say-so, again, seems to me -- I mean, the arbitrator case seems to me much more threatening to the integrity of the Federal judicial system than a system of bankruptcy courts which are, from the very beginning all the way through, supervised by -- by district courts.

MR. HACKER: Well, I mean, the -- the key difference, though, I think, is that, as I said, bankruptcy courts are exercising judicial power. Arbitrators aren't. And then when the district court -- in an arbitration proceeding, all the district court is doing is enforcing a judgment -- excuse me -- enforcing an arbitration award, a contractual choice, pursuant to a Congressional judgment that says, here are the rules, the decision rule for enforcing this particular type of

contract. That's an Article I issue. It's within Congress's Article I power to constrain -- to establish the decision rule that the -- the part of the -- the entity exercising judicial power will apply.

In this situation, the party exercising, the entity exercising the judicial power is a non-Article III court. It's as if you said -- you changed the FAA and added another paragraph to say, an arbitrator's awards are exercises -- they're final judgments of the United States, entitled to full faith and credit, subject to appellate review by the -- by appellate courts. And I think --

JUSTICE SOTOMAYOR: Could you spend a moment just talking about the forfeited argument on appeal?

MR. HACKER: On the -- the --

JUSTICE SOTOMAYOR: The -- the argument that consent can be presumed from your forfeiture of the argument on appeal.

MR. HACKER: And I'm glad you put it this way, Your Honor, because I think they're -- they're different points. The -- the law clearly requires consent, and I think everybody agrees it requires knowing and voluntary consent. You have to have at least that. The rule which we think is applicable, and agree with the American College of Bankruptcy, that the

rules writers and this Court in implementing the rule required express consent. I don't think there's a credible argument here that there was express consent.

And I think this Court ought to adopt express consent as the requirement and hold that there was not express consent here, precisely for the constitutional avoidance reasons that Justice Scalia mentioned earlier, to avoid getting into the whole discussion we just had, because if there's insufficient consent here, then we don't need to decide the circumstances under which consent is sufficient.

JUSTICE ALITO: But isn't forfeiture quite different from consent? It's not a species of consent. It's different from consent.

MR. HACKER: And I'm sorry I delayed getting to Justice Sotomayor's question. The reason there's no forfeiture here, among the reasons, is that this was a problem of appellate jurisdiction. There was no appellate jurisdiction here because there was no final judgment in the bankruptcy court. If our first argument is right, then the bankruptcy court lacked authority to issue a final judgment. So when we went up to "appeal," quote/unquote, in the district court, there was no -- it wasn't permissible for that court to exercise appellate jurisdiction --

JUSTICE ALITO: You think a final judgment has to be a valid final judgment in order for there to be an appeal?

MR. HACKER: I think it has to be --

JUSTICE ALITO: It can be final and it can be invalid.

MR. HACKER: Well, it's not a question of being a defect. I think the problem here is there's an absolute lack of any authority to enter a final judgment. There wasn't something from which the district court had any authority to exercise appellate jurisdiction. That was the problem. It wasn't a question of the date it was entered.

JUSTICE ALITO: I mean, if a court enters a judgment against you and you say that court never had jurisdiction to enter that judgment, you can't take an appeal because there wasn't a final judgment because the court below lacked jurisdiction. That's the argument?

MR. HACKER: Well, no, the argument would be: If -- at any point on appeal, I can raise the problem that the court to which I'm appealing lacks appellate jurisdiction, lacks jurisdiction to resolve the case, that's the kind of non-waivable problem. And it's -- something that cannot be waived also can't be forfeited. And -- and so that's the reason that there's

no forfeiture problem here.

Beyond that, it's quite clear that Mr. Sharif made every effort to preserve the issue to the extent he became aware. It was only 6 weeks after Stern was decided that he filed his opening brief. Did not cite Stern, that's true. But only a month or two later his sister, Ragda Sharif, files a motion to withdraw the reference. And then he immediately -- essentially; his lawyer realized what's happened. As soon as he's aware of the Stern argument, as soon as the Seventh Circuit issues its decision in Ortiz actually applying Stern, then he promptly raises this issue.

He's not sandbagging. There's no gamesmanship here. As soon as it's clear that he understands that his consent was required before what happened to him could permissibly happen, he demonstrated that he did not consent to the exercise of that -- of that -- of that jurisdiction.

Now, of course, our primary submission is the bankruptcy court never had that jurisdiction. And to -- and we think that's a correct argument, but to avoid that argument, we think the simpler approach for this Court is to say that express consent was required; it wasn't satisfied; or that if implied consent was sufficient, to apply what this Court applied in the

Roell case in finding implied consent, which clearly was not applicable here.

In Roell, the Court found implied consent only because, quote, "the litigant or counsel was made" -- "was made aware of the need for consent" -- didn't happen here -- "and the right to refuse it" -- also didn't happen here -- "and still voluntarily appeared to try the case."

Further, the Court emphasized in Roell, the party later actually did consent in writing. That also didn't happen here.

So none of the factors that created implied consent in Roell were sufficient, and for that reason we think the Court should affirm the judgment below.

CHIEF JUSTICE ROBERTS: Thank you, counsel.

Ms. Steege, you have five minutes left.

REBUTTAL ARGUMENT OF CATHERINE STEEGE

ON BEHALF OF THE PETITIONERS

MS. STEEGE: In response to the test that Justice Sotomayor proposed about possession, that, in fact, under the historic cases -- the Taubel-Scott-Kitzmiller case, that's the easy situation, the situation we have here where the debtor has actual possession of the property.

And we don't contend that Mr. Sharif had --

had just a legal fiction as a trustee possession. This was the house he lived in, the business he ran, his own retirement accounts, and his own bank accounts. These were assets he was enjoying while trying to take advantage of the bankruptcy system, having, not incoincidentally, left an Article III court where he was litigating and where the Article III judge had held him in contempt and thrown him in jail several times. So he made a choice to go to bankruptcy court. He had actual possession of these assets. And that, under the historic precedent, has always been the easy case for the bankruptcy judge to decide.

That case goes the other way. But that's because the litigant was trying to bring a preference action. What was happening in that case is the sheriff had seized some property, and the argument was he had done it within what was then a four-month preference period, and they were really trying to bring a preference case under the constructive actual possession.

That's different than the situation with a debtor that has actual possession of the property. And so when you look at these cases, whenever it's the debtor who has possession, going back to the historic English law, the courts have always allowed the

bankruptcy referee or judge to make that determination.

With respect to the cases that were discussed, the Whiting Pools and the State Bank of Hardinsburg cases, neither of those cases actually involved trustees. Whiting Pools was decided shortly after this Court decided Northern Pipeline. Northern Pipeline was cited in that case, and that's a case where the bankruptcy judge's judgment ordering the Internal Revenue Service to return property back to the Chapter 11 debtor's estate because it belonged there, subject to their rights as a secured creditor. The Court upheld that. So I don't think that stands for the proposition that bankruptcy judges don't have the authority to decide disputes about where property should come into the estate.

With respect to the issue of consent, yes, this does have an impact. You know, our -- our argument is very much based upon the fact that the Magistrate Act has been held -- upheld in Roell and Peretz and Gonzalez. There is authority in the Fifth Circuit -- six of the judges in the -- in the Fifth Circuit have issued a dissent in a bankruptcy case saying that they see no basis to allow the magistrate system to exist, given that the Fifth Circuit has held that 157(c)(2) consent is unconstitutional.

So you do have a circumstance where the courts are -- the lower courts, anyway -- are seeing the two systems as the same. And they are the same, because the Article III judiciary has control over the bankruptcy process at every step. It refers the cases to the bankruptcy judges; it can take them away. Anyone who ever has a problem with the bankruptcy judge can always seek a motion to withdraw the reference. And it's the district court judge who decides that.

There's also macro-control over the system, in the sense that bankruptcy judges are pointed by the Article III courts, they can be removed for cause by the Article III courts, and for all of the reasons that the Courts of Appeals that address this issue unanimously, across the board and upheld the magistrate system, all of that rationale in those cases applies to the bankruptcy system.

JUSTICE BREYER: Taubel-Scott.

MS. STEEGE: Yes.

JUSTICE BREYER: Burrell, he says that -- they say that where possession was assertively held, not for the bankrupt, but for others prior to bankruptcy, the party in possession who is not subject to summary judgment can be divested only if a plenary sued under Section 23.

By that, I take it he means it's this case. It's true that he said he was trustee. His mother says, no, no, it is my property, or whatever, and -- and therefore that fits within that case; therefore this is one of the ones that went to a full court and didn't go to the -- a bankruptcy case. So that's his case. What's your response to that?

MS. STEEGE: But that's not this case, because the debtor has possession. And Taubel-Scott sets out five circumstances in which we have plenary or summary jurisdiction under that statute. And on the easy side of the line, on the constitutional side, post-Stern, is debtors' possession of that property. You can't make a claim like we have here.

And Wellness never conceded that the trust was valid. That was the dispute before the court. You can't let a debtor -- well, you can, but you -- it would be very difficult for the system if a debtor were allowed to say, I don't really own it. I'm using it; I have it; I have possessed it --

JUSTICE BREYER: Well, the money here is in his bank account. That's the point.

MS. STEEGE: Yeah. I mean, you -- you would have a circumstance where the bankruptcy judge would have no authority. And Mueller v. Nugent, decided back

in 1902, recognized that and said you would have courts that would have no ability to supervise the system that they're charged with supervising.

Thank you.

CHIEF JUSTICE ROBERTS: Thank you, counsel.

The case is submitted.

(Whereupon, at 12:14 p.m., the case in the above-entitled matter was submitted.)

IN THE SUPREME COURT OF THE UNITED STATES

BANK OF AMERICA, N.A., : Petitioner : No. 13-1421 v. : DAVID B. CAULKETT; : AND : BANK OF AMERICA, N.A., : Petitioner : No. 14-163 v. : EDELMIRO TOLEDO-CARDONA :

Washington, D.C.

Tuesday, March 24, 2015

The above-entitled matter came on for oral argument before the Supreme Court of the United States at 10:11 a.m.

APPEARANCES:

DANIELLE SPINELLI, ESQ., Washington, D.C.; on behalf of Petitioner.

STEPHANOS BIBAS, ESQ., Philadelphia, Pa.; on behalf of Respondents.

C O N T E N T S

P R O C E E D I N G S

(10:11 a.m.)

CHIEF JUSTICE ROBERTS: We will hear argument first this morning in Case 13-1421, Bank of America v. Caulkett, and the consolidated case.

Ms. Spinelli.

ORAL ARGUMENT OF DANIELLE SPINELLI

ON BEHALF OF PETITIONER

MS. SPINELLI: Mr. Chief Justice, and may it please the Court:

Respondents' position is that Section 506(d) of the Bankruptcy Code allows Chapter 7 debtors to keep their houses, strip their underwater mortgages, and prevent their lenders from accessing any later appreciation in a house's value. In Dewsnup, this Court rejected that position with respect to partially underwater mortgages and that reasoning applies with equal force to completely underwater mortgages.

Dewsnup held that Section 506(d) voids only liens securing disallowed claims. It does not void liens based on the current value of the collateral. That logic applies whether the current value of the collateral is a million dollars, $1 or zero, as virtually every court to address the question has held, and even the Eleventh Circuit below all but admitted.

Outside bankruptcy, the bank would be entitled to have its lien stay with the property until foreclosure or payment in full.

JUSTICE GINSBURG: What is the value of -- of an -- an under -- completely underwater second mortgage? How likely is it that it will ever -- that the property will ever appreciate to the extent that it will have real value?

MS. SPINELLI: Justice Ginsburg, it's quite likely. In these two particular cases, to be sure, the second liens are deeply underwater. That's not true in every case and there's no reason to think it's true in the typical case.

We have -- Bank of America has many cases pending right now in the Eleventh Circuit. We have cases in which the value of the house would need to rise only by $4,000, where it would need to rise only by $5,000, and given that we're in the middle of a market upswing, it's very plausible and very likely that many of these mortgages will regain equity.

We quote statistics in our opening brief that show that between 2012 and 2014, the number of underwater junior mortgages was cut in half from 4.2 million to 2.1 million. So houses are coming above water every day.

And what Dewsnup held is that the lienholder, according to the basic nonbankruptcy bargain, is entitled to keep its lien until payment in full or until a lender decides to foreclose.

JUSTICE KENNEDY: Do the holders of the second, assuming the second is partially or fully underwater, ever participate in negotiations with the property owner and with the holder of the first lien and say, well, if you keep the property, we'll reduce our junior lead -- lien by 50 percent? Is -- is there a negotiation dynamic that the rule that you propose would further?

MS. SPINELLI: Let me be clear about this, Justice Kennedy, because I think this is important. In Chapter 7 bankruptcies, there are no such negotiations. Chapter 7 is very simple; the debtor turns over his assets. To the extent there are any nonexempt, non-encumbered assets, which there typically are not, the trustee will sell those assets, distribute the proceeds to creditors. The debtor then receives a discharge of all prepetition debt.

JUSTICE KENNEDY: Well, let's just talk about Chapter 7 because that's what I had in mind. Suppose it's a close case and they're thinking of maybe insisting on -- on sale.

Can the junior lienholder say what if -- I'm not going to prevail in the sale, but I'll -- if you don't sell, then I'll cut my -- my lien in half on the chance that it may go up? I mean, you -- so you couldn't ever have this negotiated in -- in a Chapter 7?

MS. SPINELLI: In a Chapter 7 bankruptcy those negotiations simply don't occur. If there's nonexempt equity in the house, the trustee has to sell the house --

JUSTICE KENNEDY: Right.

MS. SPINELLI: -- and distribute the proceeds.

JUSTICE SCALIA: And the trustee doesn't care, I mean, right? I mean, his job is done once -- once the bankruptcy is over. If -- if it goes up, it's the homeowner who -- who would care.

MS. SPINELLI: That's correct.

JUSTICE SCALIA: And he's not part of the negotiation. He's out of it.

MS. SPINELLI: That's -- that's correct.

Now, if --

JUSTICE SOTOMAYOR: I'm sorry. How does this work? I'm sorry. Back up. You say the trustee sells it. How does the mortgage holder in that situation foreclose? Meaning if -- if the debtor no

longer owns the property, this doesn't go free and clean to the purchaser?

MS. SPINELLI: The way it works, Justice Sotomayor, is that if there is non-exempt equity in the house which, of course, was not true in these two cases, the trustee will sell the house; out of those proceeds, the trustee will first satisfy the claim of the senior secured lender. If there's anything left over, it will go to the junior secured lender. If there's not, the junior lender receives nothing, and the junior lien is extinguished.

JUSTICE SOTOMAYOR: So when does -- do the facts of this case matter?

MS. SPINELLI: The facts of this --

JUSTICE SOTOMAYOR: Because this is before the -- the finished -- the wrapping-up of the plan; right?

MS. SPINELLI: In Chapter 7 there is no plan.

JUSTICE SOTOMAYOR: I'm sorry. This is before the bankruptcy is terminated.

MS. SPINELLI: I think it's important to understand that Chapter 7 bankruptcies happen very quickly. A no-asset bankruptcy like this one will usually be wrapped up in 30 to 45 days. Whereas here,

there's no equity in the property to be distributed to creditors, and there are no other non-exempt assets, there's really not very much for the trustee to do. The trustee will file a notice that the case is administered, and at that point, a house that's in a situation of these two houses, in which there is no non-exempt, non-encumbered value, will be abandoned to the debtor.

At that point, the debtor's rights in the property are precisely what they were before bankruptcy. If the debtor is in default on his mortgage, then the lenders can foreclose. If the --

JUSTICE SOTOMAYOR: Let me follow up to something Justice Kennedy -- many of -- your adversary plus many others, amici, have argued that if we rule in the way that you seek, that wholly underwater junior liens are going to be a holdup, and you are going to use it as hostage value, and they point to various situations in which that has occurred.

That, to me, is a concerning policy issue, so explain why that's not true.

MS. SPINELLI: Justice Sotomayor, my answer to that would be that's not a bankruptcy problem. There are not negotiations that take place in Chapter 7 as to which the junior lienholder could exercise any holdup

value.

It's -- it certainly may be the case that later on the debtor may want to negotiate a modification with its senior lender. That happens all the time to people who have been through Chapter 7 bankruptcy and people who have not. And to the extent there's a housing policy issue, I don't think that's properly addressed through interpretation of the bankruptcy code. One of the amici --

JUSTICE SOTOMAYOR: Well, the bankruptcy code -- code wants to give debtors a fresh start.

MS. SPINELLI: That is true.

JUSTICE SOTOMAYOR: And to the extent that Chapter 7 is an attempt to do that, if you're able to hold up that fresh start, that is the concern they're -- they're pointing to.

MS. SPINELLI: Justice Sotomayor, the fresh start that's given to debtors in Chapter 7 has a particular nature. The nature of the fresh start in Chapter 7 is that the debtor surrenders all of his or her assets and in return gets a discharge of all pre-petition debt. It's never been the case that the Chapter 7 fresh start has encompassed an ability to retain property and also strip off liens on that property.

If the debtor wanted -- and this -- this doesn't force the debtor to stay in a house that he or she can't afford. If the debtor -- if the debtor wanted to, say, cure a default on his mortgage and keep the house, Chapter 13 is open to the debtor which permits curing a default on a mortgage and maintaining payments during the course of the plan.

Under Chapter 7, a debtor can, if the debtor is in the situation of these debtors and the house has been abandoned back to the debtor -- if the debtor is in -- is current on its loans can keep the house, pay its mortgage going forward, and be in the same situation that he was prior to bankruptcy. The one thing that Chapter 7 gives a debtor in that situation is that it discharges the debtor of any personal liability for the mortgage debt, so the lender cannot come after the debtor personally. If the debtor decides that the house is too expensive for him to stay in, he can stop paying the mortgage and the only recourse that the lender then has is to foreclose.

So there -- there certainly is an ability for debtors to walk away from houses that they simply can't afford, and there is also an ability through Chapter 13 to cure existing defaults and reach an arrangement for which the debtor can keep the house.

JUSTICE SCALIA: Ms. Spinelli, I -- I dissented in Dewsnup, and I continue to believe that dissent was correct. Why should I not limit Dewsnup to the facts that it involved, which is a partially underwater mortgage?

MS. SPINELLI: Justice Scalia, I don't think that can be done coherently given the reasoning of the Court in Dewsnup. But what the Court held in Dewsnup is that Section 506(d) --

JUSTICE SCALIA: Yes, I understand that, but I think the reasoning was wrong, and -- and very often, we -- we adhere to a prior decision that, on the facts of that case -- and Dewsnup did -- did say, you know, we're just limiting it to the facts of this case, and we're not saying what these terms mean elsewhere in the Bankruptcy Act. So let's take Dewsnup at its word and just limit it to what it involved, which was a partially underwater mortgage. Now, why shouldn't I do that?

MS. SPINELLI: I don't believe that's logically possible even if Dewsnup was wrongly decided because Dewsnup interpreted a specific phrase in a specific place in the code.

JUSTICE SCALIA: I understand that. But we often limit prior decisions to their facts and don't follow their logic.

MS. SPINELLI: Yes, Justice Scalia --

JUSTICE SCALIA: If we followed their logic, we would -- we would never be able to do what I'm suggesting. But we often say, yes, the logic would lead us here, but it was a terrible decision, and we're not going -- we're not going to extend it any further. Why would that be a bad idea here?

MS. SPINELLI: In this situation, we're talking about an interpretation of language in a specific place in a statute, and to do that would be to read the exact same language in the exact same place in the statute to mean different things --

JUSTICE SCALIA: All right, I'm just not getting through to you. I'm willing to do that. I'm willing to do that when -- when the language was read incorrectly the first time.

MS. SPINELLI: Okay.

JUSTICE SCALIA: But as a practical matter -- I'm talking as a practical matter and stare decisis is a very practical doctrine. Why -- why should, as a practical matter, should I adhere to an opinion that I think was wrong?

MS. SPINELLI: Well, I do think Clark v. Martinez would apply in this situation and present -- prevent a barrier to doing that. But in

addition --

JUSTICE GINSBURG: What is -- what is Hart -- what is the case that you just cited?

MS. SPINELLI: I apologize, Justice Ginsburg. That is one of the cases in which the Court has said that the same language in the same place in the same statute cannot mean different things in different factual circumstances.

JUSTICE ALITO: There is a dissenting opinion in a different area of the law on taxpayer standard under the Establishment Clause, a brilliant dissenting opinion that you might want to rely on in this context.

(Laughter.)

JUSTICE BREYER: I've never been able to figure out the answer to question he raises which is I take a dissenting opinion in one case, and then when do I say, okay, forget it?

MS. SPINELLI: Okay.

JUSTICE BREYER: And -- and the answer is sort of personal, in a way. How strongly do you feel, given the need of the law, to advise the lawyers, advise judges, advise Congress and others? If we all keep dissenting all the time, it will be chaos. If we never change, you can't stick to a principle. If you have

found any way of drawing that line, I -- I don't think there is a way --

MS. SPINELLI: I think -- I think there is, Justice Breyer and Justice Scalia, which is that, I mean, this Court has very rarely taken the step of overruling a statutory interpretation decision. Certainly never in the kind of --

JUSTICE SCALIA: I'm not talking about overruling. I'm saying subsist as far as partially underwater mortgages are concerned. The issue before us is whether we should extend it to totally underwater.

Now, I thought you were going to tell me, you know, I feel strongly that -- that Dewsnup was wrong, but I'm not going to upset expectations. I mean, if banks have been, you know, lending money for second mortgages on the assumption that they would not be stripped, I mean, that's what I thought you were going to tell me. Oh, you know, many expectations that have been rested upon this misbegotten opinion of Dewsnup.

MS. SPINELLI: It's -- it's certainly been the case that since Dewsnup was decided until this decision by the Eleventh Circuit in 2012, it was -- it was well-established that Dewsnup applied equally to completely underwater.

JUSTICE KENNEDY: Are you saying, then, that

there have been substantial reliance on the Dewsnup interpretation that you are supporting here by banks that have given second mortgages all over the country, huge reliance that would be upset.

MS. SPINELLI: I have been relying --

JUSTICE KENNEDY: I -- I thought that that's what you were going to say to Justice Scalia, and I don't -- I don't hear that being argued.

MS. SPINELLI: I believe that there has been reliance. I actually don't think that's the most compelling argument as to why the Court shouldn't depart from Dewsnup.

The language in Dewsnup simply can't be read to distinguish between completely and partially --

JUSTICE KAGAN: Well, but if we could go back -- I mean, I kind of agree with you that it's not a very compelling argument, this reliance argument, because I find myself in the same position as Justice Scalia. I read the two Dewsnup opinions, and it seems to me that Justice Scalia clearly has the better of the argument. And then --

JUSTICE SCALIA: Yes.

(Laughter.)

JUSTICE KAGAN: And then the question is, what do we do about that and where do we go from there.

And it does strike me that if -- you know, these are the most sophisticated parties that can possibly be imagined, Bank of America and other banks, and it seems to me that they would be making essentially a bet on -- and they would, you know, think about all the things -- what is the probability that Dewsnup will be extended to completely underwater mortgages.

And presumably, they discounted all their various calculations in order to take into account the probability that another court would say, you know, Dewsnup is not very persuasive, and we're just not willing to extend it any further. And I think that's probably what Bank of America and other banks did, is they said, you know, we think there is X percent chance that Dewsnup will be extended and Y percent chance that it won't, and they made their cost and pricing calculations based on that calculation.

So if that's the case, why should we worry about reliance?

MS. SPINELLI: Justice Kagan, I do believe that banks have relied on the Dewsnup decision. As to whether they specifically made calculations about when it would apply -- whether it would apply in these circumstances, I don't know. But I think I would go back to the premise of your question, which is that this

would be extending Dewsnup. It wouldn't be extending Dewsnup. It would simply be applying Dewsnup to a set of facts in which the interpretation the Court gave in Dewsnup is equally applicable.

JUSTICE GINSBURG: Even though Dewsnup itself said no, we're deciding this case only, and not any other. I think in -- in your brief, you did make the point that Dewsnup is now how many years old?

MS. SPINELLI: It's almost 25 years old, Justice Ginsburg.

JUSTICE GINSBURG: And Congress could have changed it if it didn't like it, and Congress has amended the code.

MS. SPINELLI: That's -- that's correct. I mean, Congress has amended the code substantially both in 1994 and in 2005. In 1994, Congress overruled or modified a couple of these courts' bankruptcy decisions. It overruled Rake v. Wade. It modified the statute in response to this Court's decision in Nobelman.

JUSTICE SCALIA: Well, that proves, at most, that Congress liked Dewsnup as applied to partially underwater mortgages; isn't that right? I mean, that's all it proves. They let it -- they let it stand. They did not overrule Dewsnup as far as partially underwater mortgages. It doesn't say anything about how they feel

about totally underwater mortgages.

MS. SPINELLI: Justice Scalia, there is simply no distinction that can be drawn between partially and completely underwater liens in this situation. Dewsnup held that a secured claim is a claim secured by a lien with recourse to the underlying collateral. That is equally applicable here.

Likewise, I mean, the text of Section 506 certainly draws no such distinction, so it would be an odd thing to do to vindicate textualism to adopt the proposition that Respondents are advancing here.

JUSTICE SCALIA: You really know how to hurt a fellow, don't you?

(Laughter.)

CHIEF JUSTICE ROBERTS: I mean, I understand the notion and agree with it completely that if you have a decision that's wrong, you don't extend it in any way. But there are factual distinctions and there are factual distinctions. I mean, Dewsnup may have been decided on a Tuesday, and this case could be decided on a Thursday, but you would not say, you know, we're not extending it -- you know, we're simply not going to extend it to other cases.

MS. SPINELLI: Exactly, Mr. Chief Justice.

CHIEF JUSTICE ROBERTS: And in this

particular instance, I assume the difference between underwater and -- and totally -- partially underwater and totally underwater is a completely -- a completely fluid one in the sense that at the start of -- the start of the bankruptcy -- I didn't think of that one.

(Laughter.)

CHIEF JUSTICE ROBERTS: That was totally unintended.

(Laughter.)

CHIEF JUSTICE ROBERTS: But -- but the idea is that, you know, throughout a bankruptcy, you could have a mortgage that is -- a lien that's underwater, then totally underwater, then partially underwater. And the idea that you'd latch onto that as a distinction seems to me to be a difficult composition.

MS. SPINELLI: That's exactly right. I mean, the nonbankruptcy right of a lienholder is to retain its lien until payment in full or until foreclosure, which means that the lienholder is entitled to access any equity that may develop in the future due to appreciation of the property to secure its lien.

JUSTICE BREYER: Is this -- is this right? I want to be sure I understand. Under Dewsnup, the last 25 years, lenders and others in the bankruptcy community have understand -- understood the way it works is the

following: If you have a lien and the house is worth 500,000 and your -- your lien is secured and it's worth a million, and they're in Chapter 7, you have a secured interest and they're counted as a secured creditor only to 500,000. As to the remaining 500,000, you're counted as an unsecured creditor, but you keep the lien.

MS. SPINELLI: Right. Well, but --

JUSTICE BREYER: And so therefore, if when they're out of bankruptcy someday or the house goes up, or whatever it is, you still have your lien. Is that right?

MS. SPINELLI: That's right. And let me explain that, Justice Breyer.

JUSTICE BREYER: No. I mean, I don't --

MS. SPINELLI: Section 506 --

JUSTICE BREYER: I just wanted to be sure it was right, but if you'd like to explain it further, do.

MS. SPINELLI: It -- it is right, and I -- and I would, if I might. Section 506(a) bifurcates under secured claims into a secured portion and an unsecured portion, and that determines the distribution that a creditor can get from the estate.

Now, I want to be clear that nothing in the way this Court reads 506(d) will affect that. That is going to be true no matter what. What Dewsnup said is

that Section 506(d) does not refer back to that bifurcation in 506(a). Rather, it uses the word "secured" in the ordinary English and ordinary legal meaning of secured by a lien with recourse to the underlying collateral. And in that situation, given that reading, 506(d) only strips liens securing disallowed claims. If the claim is valid, then the creditor is entitled to --

JUSTICE BREYER: That means that after bankruptcy's over and you're back out of Section 7 -- Chapter 7, your lien -- unless it falls within one of the other two exceptions there -- remains.

MS. SPINELLI: Correct.

JUSTICE BREYER: And therefore -- and that's the understanding. Okay. I understand. Thank you.

MS. SPINELLI: Correct.

JUSTICE KENNEDY: When -- when do trustees decide that they're not sure of the value of the home and that they're going to sell it to find out what it's worth?

MS. SPINELLI: Typically, the value's not disputed. It's -- it's usually quite clear whether there is or is not nonexempt, nonencumbered value in a house, and the trustee will sell the house only if there is nonexempt, nonencumbered value.

The -- you know, it's possible that in a situation in which it's not clear, the trustee might go ahead and sell the house and see how much is realized for it, because that sell -- sale price would then by definition establish the amount of the secured claim.

Typically, in -- you know, typically, in no asset cases like this, there's simply no issue and there's no question that the trustee is not going to be selling the asset.

JUSTICE KENNEDY: Just -- just getting back to the reliance point or really, from your argument, the non-reliance point, the -- your -- your brief talked about the millions of loans and so forth that have been made, but you -- you seem to walk away from any reliance argument.

MS. SPINELLI: Justice Kennedy, let me clear.

JUSTICE KENNEDY: I'm really quite surprised at that.

MS. SPINELLI: Let me be clear. I am not walking away from the argument that the banks have relied on Dewsnup. I think that's unquestionably true. Millions of loans have been made in reliance on Dewsnup's holding. Banks, when they make loans, price them in and extend them based on an understanding of

what their recovery is going to be given default. That is true.

What I was responding to is the notion that banks may have relied on, you know, whether this Court would apply Dewsnup to completely underwater mortgages. I think that's a little bit less strong, although it's true that in the 25 years since Dewsnup, it's -- until this decision by the Eleventh Circuit, it's been well established that Dewsnup does apply to completely underwater liens.

May I reserve the balance of my time?

CHIEF JUSTICE ROBERTS: You may.

MS. SPINELLI: Thank you.

CHIEF JUSTICE ROBERTS: Mr. Bibas.

ORAL ARGUMENT OF STEPHANOS BIBAS

ON BEHALF OF THE RESPONDENTS

MR. BIBAS: Mr. Chief Justice, and may it please the Court:

A claim unsupported by any value is a completely unsecured claim under Section 506(a). An unsecured claim cannot be an allowed secured claim, and its associated lien is void under Section 506(d). Claims with some value remain secured. Claims with no value don't. They would be wiped out in foreclosure, and bankruptcy treats them no better than foreclosure

would.

But before I get to text or holdup value or Dewsnup, let me seize on the striking concession of my adversary. Justices Scalia and Kagan pressed my adversary who conceded that she couldn't demonstrate reliance here. There were bankruptcy courts and district courts that foreshadowed the ruling below, and they pointed to no evidence of reliance. There is -- we challenged in our brief to show that in the Eleventh Circuit lending markets were being affected. No evidence. There are eight circuits in which lien voiding is allowed in Chapter 13. No evidence. We should clear the table of a reliance argument that my adversary all but concedes.

JUSTICE BREYER: How -- how -- she didn't concede it, and -- and it just seems -- you know, it's not just homeowners. You can cure me of this misapprehension, but probably in the last 25 years or 30 years, there have been trillions of dollars that have been loaned to businesses. I mean, think of Lehman Brothers, and -- and they go bankrupt, and suddenly at stake are -- are hundreds of billions of dollars. And a person who has made a mortgage, at least a lawyer would say, okay, you can lend the money; if things go badly, we can keep the lien. We won't collect because he is

bankrupt, but markets go up and down. Keep -- keep -- keep the secured interest, they might go back up, you might get it some day.

Now, that's perfectly obvious advice, it seems to me, from what I know so far.

So -- so when you do that, the mortgage lender has to decide what the interest rate is, how -- what the terms are, and it's pretty hard to believe there isn't some effect on the brain of the -- of the person who is making the mortgage from the simple fact that he gets to keep that lien, it passes through bankruptcy, and eventually the market may go back up.

MR. BIBAS: In addition to Justice Kagan's answer, which is the banks are well advised and can forecast, they can read the text of the statute and Dewsnup's express --

JUSTICE BREYER: We have -- we have had 25 years or 30 years -- 23 years to be exact, and I -- and -- and the -- the fact is that, sure, they go to their lawyer -- they don't -- the lawyers, and the lawyers would read and the lawyers would say.

JUSTICE SOTOMAYOR: I --

MR. BIBAS: Well, I direct the Court to the Levitin amicus brief. There are two empirical studies that found natural experiments. One of them involved

differences in circuits before Nobelman in Chapter 13 lien voiding which found a very slight effect, 0.12 to 0.18 percent, on first mortgages. The other, an empirical study by Philadelphia Federal Reserve economists, likewise found no substantial effect on markets even when different circuits adopted --

JUSTICE KENNEDY: It -- it -- it's hard -- it's hard for me to think that a decision in your favor wouldn't, in a sense, hurt borrowers because the market for a second is going to dry up or become much more expensive. I -- I'll read the briefs and you can tell me about why that theory, economic theory, might be wrong, but it seems to me just common sense.

MR. BIBAS: Justice Kennedy, the Levitin amicus brief explains in greater detail, but there is a problem in the mortgage market in that first mortgagees and debtors often want to work out mutually beneficial resolutions. As my adversary concedes, no negotiation goes on in bankruptcy. The second can prevent this from happening, and we've cited multiple studies that show that the second lenders may wind up forcing homes into foreclosure.

The other point that the Levitin brief makes is that this is primarily a problem with the housing bubble. This is a problem of very high loan-to-value,

piggyback second mortgages. They found no evidence of an effect on low loan-to-value home improvement, home equity lines of credit of the sort that survive now that the regulatory --

JUSTICE KENNEDY: I -- I would agree that their bargaining club might be too big in some instances, the -- the bargaining club of -- of the second. On the other hand, it does seem to me that there is room in close cases for a three-way compromise. I'm -- I'm advised that that just doesn't happen in Chapter 7. I find that hard to believe, but especially in major bankruptcies, not homeowner bankruptcy.

MR. BIBAS: Two responses, Justice Kennedy. The first part of your question was, well, what is the effect on mortgage lending? Even if there were an effect on second mortgage lending, one has to balance that against maximizing the value of first mortgages, which are purchase money mortgages which are helped by unclogging the housing market. The chief economist at Moody's Analytics said that resolving subordinate liens was the biggest obstacle to the housing recovery.

Then your second question is, well, what about loan modifications and bargaining. My answer there is this administration had a number or programs in place after the housing bubble; HAMP and HARP were these

mortgage modification programs. The take-up rate on those were very disappointing, much lower than the administration expected because of this holdup power that --

JUSTICE BREYER: Why is this all about housing? Why isn't it about -- maybe it is. I'm -- I'm expecting an answer. Why -- why is it just about housing? Why isn't it about Lehman Brothers? Why isn't about it about businesses? Why isn't it about commercial property?

MR. BIBAS: Because currently, in Chapter 11 in -- in cramdown reorganizations and the like, similar lien voiding already happens when there is no value to be -- to secure it.

JUSTICE SOTOMAYOR: That's statutorily.

MR. BIBAS: Right, statutorily is --

JUSTICE SOTOMAYOR: Now, where in any statute in 11 or 13 did Congress ever use the word voiding a lien as opposed to stripping down a lien?

MR. BIBAS: It -- it doesn't use the phrase stripping down. It doesn't use the phrase void, Justice Sotomayor. And this is very important. The NACBA brief goes into this. There are references to retaining liens, to satisfying liens, to modifying liens. But as NACBA explains, those provisions all

piggyback on 506, which values a claim. It goes over for adjudication in Chapter 11, the different classes of creditors, and then back to 506(d) which is the provision that says that it voids liens. And NACBA's fear is that if this Court does not allow Section 506(d) to do what it's supposed to do, it could impair not only housing mortgage modifications, but business bankruptcy --

JUSTICE BREYER: Well, yes, but no. I'm -- I'm not -- I just want to understand it. I'm -- housing -- I'm a mall. I'm Lehman Brothers.

MR. BIBAS: Yes.

JUSTICE BREYER: I go bankrupt. There are all kinds of liens all over the place. Doesn't the same law apply to them --

MR. BIBAS: Well, Section 1129 define --

JUSTICE BREYER: -- as to housing?

MR. BIBAS: Yes.

JUSTICE BREYER: It's a general question.

MR. BIBAS: There -- there is. And if it's -- if it's Lehman Brothers, if it's a Chapter 11 bankruptcy reorganization --

JUSTICE KENNEDY: No, no. But assume a big business in Chapter 7.

MR. BIBAS: Yes. Businesses under Chapter 7

do not receive a discharge, and so typically the business is filing under Chapter 11. If there is a liquidation, you are right, though, that the same logic could apply there. And whether it a business bankruptcy or it's a mortgage, a home bankruptcy, there is still the need for the bankruptcy code's policies of finality and a fresh start.

JUSTICE SCALIA: You know, I -- I'm not familiar with the widespread practice of giving -- of taking a second mortgage on a business loan unless it's your father-in-law. It's -- it's a very common practice for -- for purchases of homes. I -- I -- I'm not aware that it's a common practice in businesses, getting -- getting second mortgages. I -- it seems to me quite rare.

MR. BIBAS: But there are different tranches of debt sometimes, senior and junior debt obligations, that would be analogous. But you're right. Numerically, this is going to be a huge issue in -- in the housing market.

JUSTICE SCALIA: Mr. Bibas, I'm really not a poor loser and -- and, you know --

(Laughter.)

JUSTICE SCALIA: -- I've -- I've lost in Dewsnup. What I am concerned about is the -- what

should I say -- the ridiculousness of saying if under Dewsnup -- and you haven't asked us to overrule Dewsnup -- under Dewsnup, if -- if there's $1 worth of value, okay, you don't lose your lien. But if there is zero value, $1 less and it's stripped entirely, it seems to me a -- a very strange -- strange outcome. Why would any intelligent system want to produce an outcome like that?

MR. BIBAS: I'll talk about that doctrinally and then as a policy matter. Doctrinally, the code has dozens of provisions that turn on a dollar difference in eligibility for Chapter 7 or presumptions of abuse of a like. Congress draws these lines. Section 1111(b) for business bankruptcies and reorganizations talks about inconsequential value. You keep your lien if it has some value. If it doesn't --

JUSTICE SCALIA: You think this is a line that Congress drew, right?

MR. BIBAS: Well, Congress drew the other provisions.

JUSTICE SCALIA: Congress intentionally wanted Dewsnup for partially underwater and really doesn't want Dewsnup for totally underwater. Come on.

MR. BIBAS: I didn't say that, Your Honor.

JUSTICE SCALIA: All right.

MR. BIBAS: I -- I'd remind Your Honor of -- of your opinion in Green v. Bock Laundry. If it's necessary to deviate from the text, which Dewsnup admitted it was deviating from the text, pick the deviation that does the least violence to the text, that minimizes the amount of the deviation. We preserve a link and Dewsnup did not completely sever the link between 506(a)'s requirement --

JUSTICE KENNEDY: It may take the least violence from the text, but it leaves, as Justice Scalia suggested, absolutely draconian arbitrary results.

MR. BIBAS: Okay. As a policy matter, Justice Kennedy --

JUSTICE KENNEDY: And his opinion didn't say that you do that.

MR. BIBAS: No. Your Honor, I don't believe it's draconian. If a property is $1 above water, okay, it is preserved under this reading of Dewsnup. But we explained in our brief that foreclosure sale at deep discounts, there are high transaction costs. So a house might have to rise by half or more in value before there's any additional money on the table. So if anything, allowing preservation of a lien that has $1 in nominal value is being somewhat overprotective, erring on the side of being generous and protective when there

would be no money left in foreclosure. What it does is it clears out the liens that are nowhere close to having value in foreclosure.

CHIEF JUSTICE ROBERTS: Isn't the question complicated by the fact that whether it's $1 above or $1 below is a matter of a fairly subjective valuation by the court?

MR. BIBAS: On the contrary, Your Honor, Section 506(a) expressly provides for judicial valuation. Nobelman recognized it would be judicial valuation. The house reports recognized it would be judicial.

CHIEF JUSTICE ROBERTS: Oh, no, I know it's judicial valuation, but that's -- that's the problem. If you're cutting a fine line and saying it's up to the judge who can look ahead and say, well, this is going to happen in the bankruptcy, and I'm worried about that. No one's going to say a valuation at $50,001 is accurate, but 49,999 is not. But that is in control of the judge who's doing the valuation.

MR. BIBAS: Yes. But it's far more accurate than the realistic alternative of foreclosure. There are many more safeguards. One can -- the creditor can submit a proposed valuation. A creditor submits appraisals, expert testimony, there is a hearing. And

that is far more protected than foreclosures which have to have -- be rushed sales, poor notice, poorly advertised, they require cash sales, that leave the creditor much less protection.

The realistic alternative here is throwing the house into foreclosure, and -- and outside a bankruptcy and then, in fact, the creditor winds up worse off. Not just the second, who has nothing to gain and nothing to lose, holds it up, the first mortgagee winds up losing value.

If I might now take the Court back to the text of the statute.

JUSTICE KAGAN: Mr. Bibas, before you do, could I go back to something that the Chief asked about -- that the Chief Justice asked about earlier, which is this question of whether a distinction between fully underwater and partially underwater is coherent at all.

Here's what Dewsnup said. Dewsnup on the one hand said, we're deciding this case and this case only. But it also said this, this is how it framed its holding. "We hold that 506(d) does not allow petitioner to strip down respondent's lien because respondent's lien" -- excuse me -- "because respondent's claim is secured by a lien and has been fully allowed pursuant to

502."

So this claim, too, is secured by a lien and has been fully allowed pursuant to 502. It seems to come within this statement of the holding. And I guess the question is, you know, how -- how is it that we can say that this is a sensical distinction at all given that holding?

MR. BIBAS: Two ways. Let me focus on that sentence and then things elsewhere in the opinion and then Nobelman.

That sentence was careful, unusually careful, to phrase the holding in terms of the particular parties. That respondent had value in the mortgage. That's why the Court said respondent's claim, not claims in general. Then it used the verb "stripped down." That's bankruptcy jargon for a partially secured mortgage and reducing the amount, scaling down the indebtedness, the court said two days later.

JUSTICE KAGAN: Well, I hear you, but it seems as though it's the second half of the sentence that is key here. Why are we doing this? Why are we holding this? Because the claim is secured by a lien and because the claim has been fully allowed. And both of those things also apply here.

MR. BIBAS: Respondent's claim also had some

value that made it unquestionable that it was still secured. But you're -- you're correct. I think, though, that the use of the verb "stripped down" and the use of the respondent particular limits to that situation.

It's very important, though, to go back three sentences before that to see what the court hedged. The court specifically reserved hypothetical applications advanced at oral argument. Petitioner advanced two hypotheticals at oral argument. One of those was of the completely underwater junior mortgage. The court said that those hypotheticals illustrate the difficulty of the broad creditors in government's rule, the same rule that Ms. Spinelli says that the court embraces. The same rule she quoted during her argument as if it were the court's holding, about, well, there's some collateral, therefore, it's secured.

The court declined to rule on all possible fact situations, in light of that hypothetical, and it said we, therefore, focus on the case before us and allow other facts to await their legal resolution.

JUSTICE ALITO: Well, why haven't you argued that we should overrule Dewsnup? Is it because of reliance, because you think that there has been a great deal of reliance on Dewsnup as applied to a partially

underwater mortgage, but not reliance as applied to totally under?

MR. BIBAS: Your Honor, it's quite right that those are two different categories. It's not our burden to take on steri decisis because we win under Dewsnup. Either way, the Court can do what it wants, but we have not advocated it. We've been faithful to Dewsnup's holding and its reasoning, including the express limitations it put on its reasoning. Its reasoning was limited to a case with some value.

JUSTICE GINSBURG: But the law would be much more coherent if either Dewsnup applies to the totally underwater as well as partially underwater, or Dewsnup is overruled.

MR. BIBAS: I don't believe that's the case -- in terms of -- while the Court could consider overruling Dewsnup, we haven't advocated for that. Because even -- our reading of the statute is still more faithful to the text than Petitioner's.

JUSTICE KAGAN: I guess --

JUSTICE SOTOMAYOR: I mean, you're giving the same -- exactly the same phrase in the statute two different meanings, depending on whether one's underwater or not, completely or partially.

MR. BIBAS: No, Your Honor.

JUSTICE SOTOMAYOR: Where do you find that distinction in 506?

MR. BIBAS: Okay. Section 506(a) defines what an allowed secured claim is.

JUSTICE SOTOMAYOR: No. But that's the argument that Justice Scalia made that was rejected. You're giving the same phrase two different meanings.

How do you apply the meaning in Dewsnup to this case?

MR. BIBAS: On -- on 506(d). Dewsnup was interpreting a claim that was a -- it was a hybrid. It was -- it had a secured claim component and an unsecured claim component. The secured claim component had some value. That value was sufficient under 506(a) that there was a partial secured claim.

Dewsnup must be read in light of Nobelman a year later. Nobelman said there's a secured -- it's a Chapter 13 case, but it interprets 506 which applies across the code. Nobelman said there's a secured claim component, there's an unsecured claim component. The creditors in Nobelman advanced the same argument, the same argument that my adversary advances, which is 506 is just about priority and distribution. That it has nothing to do with lien voiding, Dewsnup resolved this issue, every claim that is secured by a lien is secured

by a --

JUSTICE SOTOMAYOR: But Nobelman was not about 506. It was about 1322. And 1322 talks about the bankruptcy court's power to modify the rights of any creditor, whether it's secured or unsecured. That's how it's been read by the courts.

MR. BIBAS: Yes. But 1322's operative phrase is "modifying the rights of holders of secured claims." In order to be a holder of secured claim, one must have a secured claim. And so in Nobelman, this Court stressed petitioners were correct in looking to Section 506(a) for a judicial valuation of the collateral to determine the status of the bank's secured claim, whether there was a secured claim or not. There was a secured claim component, and so the Court said the bank is still the holder of a secured claim because Petitioner's home retains $23,500 of collateral.

So the issue in Nobelman, as in Dewsnup, was, okay, we have a secured claim component under Rumph here -- we have an unsecured claim component. Do we split the baby? Do we chop them in half? And Nobelman said, no, in part, because it's a difficult thing to -- to change the amortization, the loan term, the payments, et cetera. There is some value here that supports this. So we're going to leave it as indivisible hold. This

Court could easily understand allowed secured claim in 506(d) if it wished to preserve Dewsnup's holding just as a binary term. If there's some --

JUSTICE BREYER: If you can do that, linguistically, I can see a difference. The part that I'm having a hard time with is if this earlier case survives. Let's imagine a commercial loan. And I put it in a commercial context, because the numbers -- a mortgage -- a lender lends $5 million -- the senior lender -- to a commercial building, which then goes into the Chapter 7. The junior lender lends 2 million, so now he has 7 million. The property ends up being worth a million. So the senior lender under Dewsnup comes in and says, okay, I have a secured interest for a million, but I can keep the -- the mortgage here for 4 million, you know, in case things change ten years from now. Isn't that under Dewsnup? The senior guy can, that's partly --

MR. BIBAS: Well, in the corporate bankruptcy, this doesn't apply --

JUSTICE BREYER: Okay. Then I'll say -- I just want some numbers. The senior -- the senior person says -- put it on whatever you want. The senior person says, oh, I get to keep my $4 million mortgage. Maybe things will change, you know, and eventually I may be

able to collect some. Right? That's Dewsnup.

MR. BIBAS: Except --

JUSTICE BREYER: Except what?

MR. BIBAS: The -- the difficulty there -- so you're saying that there's a completely unsecured second mortgage that the individual --

JUSTICE BREYER: No. No. I haven't made my example yet.

MR. BIBAS: All right.

JUSTICE BREYER: I just want to know if I'm right so far.

(Laughter.)

JUSTICE BREYER: There's -- there's one mortgage. It's $5 million. The property is worth one.

MR. BIBAS: Right.

JUSTICE BREYER: And so what happens to -- to bank X is he gets maybe, as a secured creditor, the million, if he wants, but if he doesn't want to collect it now, he doesn't have to, and he keeps $5 million. He keeps that mortgage going as long as he wants.

MR. BIBAS: Yes.

JUSTICE BREYER: Yes. Okay. So junior comes in, and junior says, hey, he got to keep 4 million just in case. I have my mortgage for two. Why can't I? Now -- now, I can -- I can think of some words here that

might say, well, there's the difference, is what you are pointing to. I just want to know, in terms of commercial practice or anything else, what's the answer to his point? He got to keep four on the hope it will go up eventually. Why can't I keep my two? My documents are just as good as his. My mortgage is just as good as his. I mean, why can't I?

MR. BIBAS: So there is a functional answer, and a historical answer. I take it you're interested more in the functional answer.

JUSTICE BREYER: Yes.

MR. BIBAS: I'll start there. There is a big difference between a single creditor, single debtor situation. In Dewsnup, the debtor was just trying to stop a foreclosure, so the debtor could get a better deal. Here we have a multi-creditor situation. The creditor -- this junior creditor is seeking a better outcome than it would get in state law foreclosure.

That better outcome comes in part from hold up or hostage value that can limit the ability of the senior lender and the property holder to negotiate a loan modification, a work out, that makes everybody better off, makes assets more freely transferable, and improves the -- the market. And that does come at the price of a junior lender, but that's what happens in a

cram down as well. In a cram down, junior interests are squeezed out so that the senior people can -- can maximize the value of the assets and deal with them freely.

JUSTICE BREYER: Why can't you say the same thing about only one lender? He doesn't have to keep that four, you know. He could say, give me 30 cents extra. I will foreclose today, and -- and there you are, free, never having this hanging over your head. And I'll do it for an extra 30 cents, you find it. Now, that's called -- the same thing you say -- it's called -- what did you call it? Whatever it is. You see, people with mortgages can do that.

MR. BIBAS: Right. But there's not the same multi-creditor --

JUSTICE BREYER: No. There is one rather than two, and maybe two would be better than three, or three would be better than four.

MR. BIBAS: Since you are asking specifically in functional terms -- and I will get to the bankruptcy history later -- it's -- there is a coordination problem when -- a coordination problem can be a game of chicken. Each of them holding out for more money and then people -- two people can drive over a cliff in a game of chicken.

Now, on to the bankruptcy history. Why is this relevant to the law? There's a steady trajectory in bankruptcy law of increasing lien voiding power. Under -- in 1934, section 77(b) authorized lien voiding in business or organizations. In 1938, the Chandler Act, Chapter 12, extended that to individual organizations. In 1952, the amendments broadened it. They rejected the absolute priority rule for individual debtors, so the debtor can hang on to the assets, and the liens can still be voided.

Then in 1978, the modern code enacted Section 506, which applies across the code, Chapter 7, 11, 12, and 13. So this is part of an increasing recognition over time that it's necessary to solve these hold up problems. And the realistic alternative -- my -- my friend, Ms. Spinelli, in her reply brief says, well, if we hang on to this lien, ten years from now, first, we will keep getting paid down, and then our second will come into the money. Right?

Well, that is not realistically what happens in these cases. In borderline cases, 105, 110 percent of loan-to-value, people stay in the houses. They keep paying. It's too much cost to pick up the kids and move to a different home. When you get to 130 percent of loan-to-value, the median home that's underwater with a

second that is underwater is 135 percent loan-to-value.

When you get to 150 percent of loan-to-value, at those ranges, lots of people are in default. They qualify for bankruptcy because they've lost a job, or they are ill. They can't make the payments and pay into a black hole of negative equity. They walk away. The home is thrown into foreclosure anyway, and the senior creditor is worse off. And the junior doesn't care because the junior doesn't get anything either way.

JUSTICE KAGAN: Mr. Bibas, can I take you back to Justice Alito's question, which was about stare decisis, and why you haven't argued it? Because I tell you that my sort of reaction to this case is that these distinctions that you are drawing between partially underwater and fully underwater are not terribly persuasive. But the only thing that may be less persuasive is Dewsnup itself.

(Laughter.)

JUSTICE KAGAN: And so the -- so the question, to me, is -- or at least one question is whether we should bite the bullet and overturn Dewsnup, and maybe you are right, that that's for us to decide. And you -- but if -- if you do have something relevant to say about that matter, here's your chance to say it.

MR. BIBAS: I think it's worth -- if the Court wishes to consider that, and, again, that's not been the position we've advocated, because we don't need it to win. It's worth starting with Justice Thomas's concurring opinion in 203 North LaSalle, which pointed out the massive confusion that has been sewn in the Court's trying to grapple with this ruling, which Judge Gorsuch's ruling Woolsey that says that Dewsnup has lost every away game it's played, that it doesn't fit with the other provisions of the code. There is a lot of confusion there.

It has almost uniform criticism in scholarly commentary. My colleague can't point to reliance interest in the markets. And the empirical studies discussed in the Levitin brief suggest that there isn't substantial reliance on this, in part, because you benefit from first mortgagees who manage to maximize their value by voiding some of these junior ones. And so the reliance interest that my friend has walked away from and the uniform criticism of Dewsnup might interest this Court in considering revisiting it, but it's not necessary, because Dewsnup itself reserved the completely underwater hypothetical on the face of its opinion.

It was exceptionally narrow, and the lawyers

could read and see that it declined to reach this issue. And I -- I do think that it is very important to read Dewsnup together with Nobelman, that Dewsnup doesn't stand on it's own, that Nobelman -- it's true. It was under 1322(b)(2). It was a Chapter 13 case, but it was fundamentally about interpreting 506(a). Is it just a distribution provision, as my client argued --

JUSTICE SOTOMAYOR: No. What -- what the Court said -- I don't understand that argument. It said there's -- yes, you -- you divide it up to secured and unsecured, but you treat it all the same.

MR. BIBAS: Yes.

JUSTICE SOTOMAYOR: That's what it said.

MR. BIBAS: You treat it all the same --

JUSTICE SOTOMAYOR: Exactly. For purposes --

MR. BIBAS: You decline to cut it into pieces, and one of the reasons that you decline to cut it into pieces is because the claim secured by a lien encompasses both secured --

JUSTICE SOTOMAYOR: So once -- once the Court has the power, what it was saying under 1322, to modify that, then the Court could change both the secured or -- and I'm -- the whole lien is what it was talking about.

MR. BIBAS: But the last part of the opinion pointed out that if you modify the unsecured portion you have a ripple effects upon the secured portion. You wind up changing things like the -- the interest rate or the amortization or the fees. And so you might be viewed as -- as sabotaging or undermining what deserves to remain a secured component. In this situation, there is no -- no such problem.

So all -- it is worth noting, by the way, my friend also says, well, this lien, it can sit out there, maybe it retains value sometime in the future; isn't that enough value. And I think Justice Breyer was gesturing towards that. All eight circuits after Nobelman have understood that Nobelman drew a line between some value and no value. All eight circuits that confront lien voiding in Chapter 13 allow it because they recognize that the completely underwater junior qualifies as no value within the meaning of the code.

Present economic value is what this Court's cases have consistently focused on. The value of the claim is equal to the value of the collateral, this Court has said, and that's the present value of the collateral. The statute uses the present tense in Section 506, whether it is or is not. It's not about

forecasting or speculating into the future. That would be unworkable. But judicial valuations are workable. The Bankruptcy Rules, Rule 3012 and 7001 provide for it. And there is abundant case law that shows it to be both workable and fairer to creditors than the alternative which is a foreclosure.

The judgment below should be affirmed.

CHIEF JUSTICE ROBERTS: Thank you, counsel.

Ms. Spinelli, you have 4 minutes left.

REBUTTAL ARGUMENT OF DANIELLE SPINELLI

ON BEHALF OF THE PETITIONER

MS. SPINELLI: Thank you.

Just a couple of points.

Completely underwater liens are not valueless. Their value stems from the potential for appreciation in the collateral.

Indeed, a lien that's completely underwater by a dollar might have more value than a lien that is supported by a dollar of equity, depending on the potential for appreciation.

The value if the houses were sold today is simply irrelevant because the situation only arises where the debtor is keeping the house. And one could have said in Dewsnup, look, the current value of the collateral is less than the amount of your loan. It's

fair to give you the current value of -- of the collateral.

Dewsnup held to the contrary, and that's precisely the same here. There is no distinction that supports drawing a line at completely underwater liens, given that the secured creditor has the same nonbankruptcy right to have its lien stay with the collateral until foreclosure and payment in full and to realize any appreciation in the value of that collateral.

This -- this doesn't give a junior lienholder a better deal than it would receive under State law. It gives it the same deal it would receive under State law.

To respond to a point that I think Justice Sotomayor made, the fact that there are specific provisions in Chapters 11 and 13 that do permit stripping down liens in certain circumstances supports the Dewsnup Court's view of 506(d). It certainly doesn't undermine it. 506(d) is not the provision that strips down liens in Chapters 11 and 13. Rather, there are specific provisions which are in the addendum to our brief in Section 1325 for Chapter 13, and actually this is not in the addendum, 1129(b) for Chapter 11.

Those provisions would make no sense if

506(d) were itself a lien-stripping provision. And just to take one for example, if one looks at Section 1325(a)(5) which appears on page 6A of the blue brief, that sets out the terms under which a Chapter 13 debtor can strip down liens, and it says that with respect to each allowed secured claim provided for by the plan, the plan provides that the holder of such claim retain the lien, securing such claim until the earlier of the payment of the underlying debt determined under nonbankruptcy law or discharge.

Now, it would make no sense to permit the lender to keep its lien until payment of the full debt if the lien had already automatically been stripped down under 506(d) to the value of the collateral, and that's just one example.

We discussed some others in our briefs, including Section 722, and we also discuss in our briefs the -- the textual indications in Section 506 that support the Dewsnup's Court's holding. So -- and those are all reasons why Dewsnup was correctly decided in the first instance and shouldn't be overruled.

But to respond to Justice Kagan's question, beyond that, the rule of law simply doesn't allow this Court in the typical situation to overrule a statutory interpretation decision in a case like this where

Congress, over the past 25 years, has acquiesced in that decision.

CHIEF JUSTICE ROBERTS: Thank you, counsel.

MS. SPINELLI: Thank you.

CHIEF JUSTICE ROBERTS: The case is submitted.

(Whereupon, at 11:10 a.m., the case in the above-entitled matter was submitted.)