The Return of the Supremes

Ronald R. Peterson, Moderator
Jenner & Block LLP; Chicago

Peter M. Friedman
O'Melveny & Myers LLP; Washington, D.C.

Hon. Thomas B. McNamara
U.S. Bankruptcy Court (D. Colo.); Denver

Matthew D. Skeen
Skeen & Skeen, P.C.; Georgetown, Colo.

THE RETURN OF THE SUPREMES

American Bankruptcy Institute – Rocky Mountains
Denver, Colorado
January 21, 2015

I. ***Wellness International Network Ltd. v. Sharif***, 135 S. Ct. 1932 (2015).

A. **Holding**: The Court held 6-3 that bankruptcy courts may decide *Stern* claims with litigant consent and that such consent may be express or implied. Justice Alito joined the opinion. However, he stated in his separate concurrence that he would not have addressed whether consent may be implied and would have simply held that the debtor Sharif forfeited his right to raise *Stern*.

B. **Dissent**: The three dissenters (Roberts, Thomas and Scalia) would not have reached the question of consent and instead would have reversed the 7th Circuit's determination that the claim at issue was a *Stern* claim.

C. **Highlights of the Decision include**:

1. The Court's efforts to take a practical approach toward the administration of the bankruptcy courts. After the upheaval that *Stern v. Marshall*, 131 S. Ct. 2594 (2011) created, the Court's next two decisions, *Executive Benefits Insurance Agency v. Arkison*, 134 S. Ct. 2165 (2014) and *Wellness*, stretched to decide issues that were preventing the efficient administration of bankruptcy cases. The Court also appeared motivated by the fact that a decision holding that consent was impermissible would call into question the validity of the Federal Magistrate Act and the ability of federal magistrate judges to decide matters with consent.

2. Consistent with this practical approach, the majority relied upon Article III case law that adopts a functional approach: *Commodity Futures Trading*

Commissioner v. Schor, 478 U.S. 833 (1986), and the decisions upholding the constitutionality of certain actions by magistrates (*see Peretz v. United States*, 501 U.S. 923 (1991); *Roell v. Withrow*, 538 U.S. 580 (2003; *Gonzalez v. United States*, 553 U.S. 242 (2008)) rather than the more formalistic decisions of *Granfinanciera, S.A v. Nordberg*, 492 U.S. 33 (1989), and *Northern Pipeline Const. Co. v. Marathon Pipe Line Co*., 458 U.S. 50 (1982).

3. Justice Roberts's dissent adopts the approach of Act cases such as *Taubel-Scott-Kitzmiller v. Fox*, 264 U.S. 426 (1924) in determining what matters stem from the bankruptcy itself, suggesting that old plenary/summary distinctions found under the Act may be relevant.

4. Justice Roberts's umbrage with the fact that majority concluded that *Stern* could have turned on litigant consent seems misplaced in light of the manner in which *Stern* set up the consent issue and described its own holding.

D. **Questions that Remain Post-*Wellness***.

1. Is the filing of the bankruptcy petition by the debtor implied consent?

2. Is moving for summary judgment or requesting some form of dispositive relief by the bankruptcy court implied consent?

3. Is admitting the matter is core and participating in the case before the bankruptcy court without moving to withdraw the reference implied consent?

4. When is implied consent just forfeiture?

5. What procedures are courts implementing to make the parties address the issue and is Bankruptcy Rule 7012's requirement of express consent still valid? Should there be a rule similar to F.R. Civ. Pro. 38 (Jury Trials) where a litigant is required to demand an Article III adjudication in the complaint or answer.

6. Are bankruptcy appellate panels still constitutionally viable?

7. What are the parameters of a *Stern* claim?

8. Are we moving to back to the summary/plenary distinctions of the Act?

9. Are all state law causes of action Stern Claims?

10. Is any action by an estate a Stern Claim?

11. Is Justice Thomas suggesting that the public rights exception applies in bankruptcy?

12. Are Fraudulent Transfers Stern Claim?

13. Will "the world end not in fire, or in ice, but in a bankruptcy court"? Is allowing litigants to consent to having a bankruptcy court decide a *Stern* claim the serious erosion of Article III protections that the dissenters contend it is?

E. **Post-Remand Decision**: On August 4, 2015, the 7th Circuit issued a per curiam decision in which it ruled that Sharif had forfeited his right to raise a *Stern* argument by waiting until his reply brief filed in his 7th Circuit appeal to raise the issue. The 7th Circuit concluded that because the right to an Article III judge is personal, a litigant can both waive and forfeit that right and Sharif did so here. The Court noted that Sharif had raised *Stern* in the District Court for the first time in his reply brief and "repeated his mistake" in the 7th Circuit, leading to the

conclusion that Sharif had forfeited his Article III arguments. Sharif ultimately filed a Fed. R. Bankr. Pro 9024 ((Fed R.Civ. Pro 60(b) motion attempting to vacate the order of the trial court defaulting him, finding that the Bankruptcy Court lacked personal jurisdiction over the alleged grantor and *inter vivos* trust and demanding a turnover of the property in the trust. On December 2, 2015, the Bankruptcy Court entered a 23 page opinion denying the motion. The case goes on and on.

II. ***Baker Botts L.L.P v. Asarco LLC***, 135 S. Ct. 2158 (2015).

A. **Holding**: The Court held 6-3 that Section 327(a) does not allow a bankruptcy court to award fees for successfully defending a fee application. Justice Sotomayor joined the decision because she concludes that there is "no textual, contextual, or other support for reading 11 U.S.C. § 330(a)(1)" to allow for fee defense fees but did not join the majority's discussion rejecting the United States' policy arguments in favor of allowing compensation for fee defense work.

B. **Dissent**: Justices Breyer, Ginsberg and Kagan would have allowed such fees as part of the reasonable compensation for the underlying services in the bankruptcy case. While they agreed with the majority that such fees are not part of the services rendered to the trustee, they concluded that such fees can be a component of "reasonable compensation" to ensure that bankruptcy professionals are paid on par with non-bankruptcy professionals. Relying upon the Court's statement in *Comm'r v. Jean*, 496 U.S. 154, 162 (1990) that "denying attorneys' fees for time spent in obtaining them would dilute the value of a fee award by forcing attorney's into extensive, uncompensated litigation," the dissenters reasoned that

barring bankruptcy attorneys from collecting fees for defending their fees would under-compensate bankruptcy professionals and undermine the Congressional policy behind Section 330.

C. **Highlights of the Decision include**:

1. The majority relies heavily upon the "American Rule" which the Court states is "our basic point of reference" and describes that rule as requiring each litigant to pay his own attorneys' fees, win or lose, unless a contract or statute provides otherwise.

2. Section 330 does not "expressly" depart from the American Rule.

3. Defending a fee application is not part of the services rendered to a trustee, and thus within the scope of the types of fees Section 330 allows because "[t]ime spent litigating a fee application against the administrator of a bankruptcy estate cannot be fairly described as 'labor performed for' let alone 'disinterested services to' that administrator." 135 S. Ct. at 2165. In addition, because reading "services rendered" to include fee defense work would necessarily include instances where the attorneys are adverse to their own client and would include instances where the defense is unsuccessful, the Court rejects this reading of Section 330.

4. Bankruptcy attorneys do not need to shift fees for fee defense work to be compensated on a par with other professionals because non-bankruptcy attorneys are not entitled to such fees either and such shifting is not justified under the text of the statute.

D. Questions Remaining:

1. Can bankruptcy professionals override the American Rule by contract through provisions in engagement letters allowing for the recovery of fee defense fees?

2. If professionals can override the American Rule, must a fee petition shifting provision be approved by the bankruptcy court as part of the retention process?

3. Where is the line drawn between fees incurred in preparing a fee application and fees incurred in defending a fee application? Is the expense of responding to judicial or UST inquiries for additional information, fee defense or fee preparation fees — the Court analogizes the line as that between a mechanic spending time to prepare a detailed bill to allow the client to know what services it received vs. litigating with the client over the reasonableness of the bill. In light of that analogy, is responding to inquiries and all work short of actual litigation compensable?

4. How likely is it that Rule 9011 fees will be awarded in fee defense litigation -- the Court's solution for frivolous objections?

5. Is there any room in the Court's decision to allow professionals to make the argument that the result would be different if the objecting party was not the client the attorneys represented? What if the client affirmatively supported the fee request?

III. ***Bullard v. Blue Hills Bank***, 135 S. Ct. 1686 (2015).

A. **Holding**: A unanimous Court held that an order denying confirmation of a plan is not a final order and cannot be immediately appealed as of right.

B. **Highlights of the Decision**:

1. The Court acknowledges that finality in a bankruptcy context does not require the conclusion of the entire case; instead an order is final in a bankruptcy case "'if [it] finally dispose[s] of [a] discrete dispute[] within the larger case."' 135 S. Ct. at 1692 quoting *Howard Delivery Servs., Inc. v. Zurich Am. Ins. Co.*, 547 U.S. 651, 657 n. 3 (2006). The question in the context of plan confirmation litigation is does the debtor create a new discrete appealable dispute with each plan the debtor proposes or is the entire process of either obtaining a confirmed plan or ending the bankruptcy case the discrete dispute that is appealable.

2. The Court concludes that it is only the conclusion of the "entire process" that results in a final appealable order because only plan confirmation or case dismissal alters the status quo and fixes the rights and obligations of the parties. The Court notes that a confirmation order is entitled to preclusive effect, vests ownership of estate property, and triggers the duty to make distributions to creditors. Denial of confirmation with leave to amend the plan does not change the parties' rights.

3. The Court rejects the argument that requiring a debtor to suffer the dismissal of the case to appeal an adverse confirmation order may prevent effective review of the denial order, noting that appellate review is often imperfect and suggesting that for pure questions of law that divide the courts, certification for immediate appeal provides a sufficient remedy.

C. Questions Remaining:

1. Can a debtor evade dismissal of her case following rejection of a plan by proposing a plan that is acceptable under the court's ruling, objecting to that plan, and then appealing confirmation of the very plan the debtor proposed?

2. Is the Court signaling that lower courts should more readily consider petitions to certify questions for immediate appeal to the circuit courts?

3. Does this decision change the rules regarding what constitutes a final order in the context of a bankruptcy case or is this decision just a reaffirmation of the existing finality principles? For example, is an order denying a motion for vacating, modifying or an annulling the automatic stay a final order?

4. Assume the bankruptcy court grants a motion for summary judgment and that order is appealed to the district court or BAP, which remands the matter to the trial level court, can the prevailing party at the bankruptcy court appeal the remand order to the circuit court?

5. Is an order denying the lifting of an automatic stay appealable?

6. Should you ever take an interlocutory appeal to a Bankruptcy Appellate Panel?

IV. ***Husky International Electronics, Incorporated v. Ritz****, cert. granted,* 2015 U.S. Lexis 7036 (U.S. Nov 6, 2015).

A. **Questions Raised**: In order to establish a *prima fascia* case for fraud, must a plaintiff establish that the defendant made a false representation to the plaintiff.

1. In *Husky International Electronics, Incorporated*, 787 F.3d 312 (2015), the Court of Appeals considered a case whether the plaintiff, Husky, sold

product to a corporation, Chrysler Manufacturing Corp., an entity controlled by the debtor/defendant, Daniel Lee Ritz, Jr. After Husky had advanced $163,999.38 for the sale of goods to Chrysler, Ritz caused Chrysler to transfer substantial sums of cash to other entities controlled by Ritz. The Bankruptcy Court found that these transfers of cash were fraudulent transfers. Ultimately, Ritz filed for relief under Chapter 7 of the Bankruptcy Code, and Husky objected to Ritz's discharger pursuant to 11 U.S.C. § 523(a)(2)(A).

2. The Court of Appeals affirmed the decisions of the Bankruptcy Court, and the District Court found for Ritz because there was no proof that he had made any misrepresentation to Husky. In reaching its conclusion, the Court of Appeals relied on the U.S. Supreme Court's opinion in *Field v. Mans*, 516 U.S. 59 (1995). That decision dealt with the standard of reliance that a victim must show in order to recover under a theory of fraud. Although the Court of Appeals conceded that the Supreme Court did not address the precise issue of whether there needs to be a representation, the Court stated that the Supreme Court assumed that a false representation is necessary to establish "actual fraud".

B. **Conflicts in the Circuits**: The Court of Appeals for the 5th Circuit's holding in *Husky* is directly opposite of the holding of the Court of Appeals for the 7th Circuit in *McClellan v. Cantrell,* 217 F. 3d 890 (7th Cir. 1995). In this case, Harold McClellan sold his ice making business to the debtor's brother for $200,000.00, payable in installments. McClellan held an unperfected security

interest in the sold machinery. The brother defaulted on the installment payments and owed McClellan $100,000.00. McClellan sued the brother, and the lawsuit languished in the Illinois state courts for two years. In the meantime, the brother sold the ice making machinery to his sister, Bobbie Cantrell, for $10.00. the sister later sold the same machinery for $160,000.00 to a stranger. The sister ultimately filed for Chapter 7 relief, and McClellan objected to her discharge on the basis of actual fraud. There was no evidence that Bobbie had made any misrepresentations to McClellan, and probably never met him. However, the Court of Appeals ruled that this was actual fraud. The Court held that fraud is a generic term, which embraces all multifarious means which human ingenuity can devise and which are resorted to by an individual to gain an advantage over another by false suggestions or by the suppression of truth. Fraud includes all surprise, trick, cunning, dissembling, and any unfair way by which another is cheated. *Stapleton v. Holt*, 250 P.. 451 (Olka. 1952).

C. **Issue before the Supreme Court**: Must a litigant establish a fraudulent misrepresentation in order to establish actual fraud?