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August 4, 2015

Committee on Rules of Practice and Procedure
Administrative Office of the United States Courts
One Columbus Circle, NE
Washington, DC 20544

Re: Amendments to Federal Rules of Bankruptcy Procedure in the Wake of *Stern v. Marshall, Arkison and Wellness*

Greetings:

We are writing to provide the Committee on Rules of Practice and Procedure (the "Committee") comments on amendments to the Federal Rules of Bankruptcy Procedure ("FRBP") designed to deal with the Supreme Court's recent decisions *Stern v. Marshall*, 131 S. Ct. 2594 (2011); *Executive Benefits Ins. Agency v. Arkison*, 573 U.S. ____, 134 S. Ct. 2165 (2014); and *Wellness International Network, Ltd. v. Sharif*, 575 U.S. ___ (2015). We were members of the legal team that represented the debtor, Richard Sharif, before the Court in *Wellness*, and have spent a fair amount of time considering these issues. We hope you find our comments useful in crafting rules to implement these decisions.

We believe that the Committee's September 2013 report recommending amendments to FRBP 7008 - 7012 was an excellent start and should serve as the foundation for the Committee's current analysis. Over the balance of this letter, we describe some additional amendments that we suggest be adopted as a result of the Court's decisions in *Arkison* and *Wellness* and additional reflection.

Before turning to the substance, let us note the obvious — the opinions expressed in this letter are ours alone. They should not be attributed to O'Melveny & Myers LLP, other attorneys at O'Melveny or any of O'Melveny's clients.

1. The Rules Should Require That Parties Expressly State Whether Or Not They Consent to Final Bankruptcy Court Adjudication.

We start from the proposition that the FRBP should provide clarity and simplicity to proceedings whenever possible. Therefore, we urge that the amendments to the FRBP require that parties expressly state whether or not they consent to the bankruptcy court entering a final judgment in

disputed matters.[1] For the reasons described below, we believe that requiring that consent (or lack thereof) be expressly and clearly stated will minimize peripheral litigation over whether a party really consented, and is the clearest and most efficient means of addressing this issue.

The majority opinion in *Wellness* synthesized this point when it observed that good practice requires that consent be express and invited the Rules to be amended to so provide. As the Court stated, "[e]ven though the Constitution does not require that consent be express, it is good practice for courts to seek express statements of consent or non-consent, both to ensure irrefutably that any waiver of the right to Article III adjudication is knowing and voluntary and to limit subsequent litigation over the consent issue. Statutes or judicial rules may require express consent where the Constitution does not." 575 U.S. at ___, n.13.[2]

This is not "merely" the view of the five Justices who joined in all aspects of the majority decision in *Wellness*.

For example, in his concurrence in *Wellness*, Justice Alito declined to join the part of the majority opinion that held that the current version of FRBP 7012(b) does not already require express consent in *Stern* matters. Justice Alito explained that this aspect of the majority's decision is premised on the fact that the current version of FRBP 7012(b) requiring express consent only literally applies to matters that are statutorily core; it does not address *Stern* matters at all. But, according to Justice Alito, current FRBP 7012(b) does not deal with *Stern* matters

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[1] We suggest that these amendments to the FRBP apply to all adversary proceedings and, accordingly, be drafted as part of the 7000 series of the FRBP.

We do not believe that the Committee should, at this time, amend FRBP 9014 to make these provisions of the FRBP applicable to contested matters. But we do think that it would be appropriate for the Committee to consider at some time in the near future — after the amendments to the 7000 series of the FRBP are adopted — whether some sort of similar amendments should be adopted for contested matters. It is less likely that a contested matter will be beyond the constitutional authority of a bankruptcy court to enter a final judgment without consent. But given that the Court has not attempted to delineate the full range of matters where a bankruptcy court can enter a final judgment without consent, it is possible that some contested matters may require adjudication by an Article III court absent consent. If FRBP that deal with consent are to be adopted for contested matters, it is likely that they will need to be different than the FRBP for adversary proceedings given a number of procedural differences — e.g., the parties to a contested matter are often more numerous and are not susceptible of precise identification when the motion is filed, contested matters move more quickly than adversary proceedings.

At the present time, we do not have a specific suggestion to make with respect to contested matters and believe that this topic should be considered after amendments to the 7000 series of the FRBP are adopted.

[2] The initial bench version of the slip opinion issued on May 26, 2015 was stronger still. When the slip opinion was first issued, footnote 13 concluded by stating that "this Court recently submitted to Congress, pursuant to the Rules Enabling Act proposed amendments to Rules 7008 and 7012 that remove reference to the core/non-core distinction and thus require parties in all bankruptcy proceedings to state expressly whether they consent to the bankruptcy court's entry of judgment." While this part of footnote 13 was deleted in the final decision since it incorrectly stated that the Court had already approved amendments to the Rules requiring that parties expressly state whether they consent, it is clear that a substantial majority of the Court believes that this is the better practice and will look favorably on proposed amendments so providing.

because "at the time this Rule was promulgated, no one was thinking about a *Stern* claim." Justice Alito then cited the Court's decision in *Arkison* where the Court unanimously held that 28 U.S.C. § 157(c) should be read to apply to *Stern* matters, as well as statutorily non-core matters, even though the statute does not mention *Stern* matters at all.[3]

Similarly, in *Roell v. Withrow*, 538 U.S. 580, 596 (2003), Justice Thomas (joined by Justices Scalia, Kennedy and Stevens) made the point that requiring that consent be express is the better practice. Justice Thomas's opinion in *Roell* was a dissent. But the points of disagreement between the majority and his dissent did not deal with what is the better practice; all Justices agreed that if consent is to be required, the better practice is to require that consent be express.

The Committee also concluded that consent should be stated expressly in writing when it considered this issue in 2013. The Committee's prior proposed amendments would have revised FRBP 7008 and 7012 to require that every complaint, counterclaim, crossclaim, third-party complaint and responsive pleading (whether by answer or dispositive motion) "include a statement that the party does or does not consent to entry of final orders or judgment by the bankruptcy court." These issues were vetted and analyzed extensively at the time. The September 2013 Report indicates that the comments that the Advisory Committee received at that time endorsed the proposed revisions, subject to a few minor issues. None of those minor issues questioned that the Rules should require that consent be stated expressly in writing and the Advisory Committee was unanimous in making this proposal. Report of the Advisory Committee on Bankruptcy Rules, May 8, 2013, at 3- 4.

We strongly endorse the view that the Rules should require that consent, or lack of consent, be stated expressly in writing. To provide otherwise would invite difficult peripheral litigation as to whether a party <u>really</u> consented (how much activity or inactivity is enough).

2. <u>The Rules Should Adopt Provisions of the Sort Set Forth in FRCP 73 Designed to Ensure that Any Consent is Knowing and Voluntary.</u>

We suggest some additional refinements tailored to deal with the constitutional requirement, emphasized by the Court in *Wellness*, that only consent that is both knowing and voluntary will be effective. The Committee's 2013 proposed amendments predated *Wellness* and did not address this topic. Given the guidance provided by the Court in *Wellness*, we believe that the proposed amendments should include procedures designed to ensure that a party's consent satisfies this constitutional requirement and minimizes peripheral litigation over whether consent was knowing and/or voluntary.

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[3] Justice Alito would not have joined in the part of the majority decision that held that current FRBP 7012(b) does not require express consent in *Stern* matters and instead suggested that the Court not reach this issue given his belief that Sharif had forfeited the ability to make any arguments based on *Stern* by not raising them at the earliest opportunity below.

To do so, we suggest that the applicable Bankruptcy Rules incorporate language modeled on the provisions of FRCP 73(b)(1) and FRCP 73(b)(2) designed to ensure that consent to a federal magistrate entering a final judgment is knowing and voluntary. FRCP 73(b)(1) provides that the clerk "must give the parties written notice of their opportunity to consent pursuant to 28 U.S.C. § 636(c)." Similarly, FRCP 73(b)(2) provides that a "district judge, magistrate judge, or other court official may remind the parties of the magistrate judge's availability, but must also advise them that they are free to withhold consent without adverse substantive consequences." We suggest that similar provisions be included in the amended Bankruptcy Rules.

It is particularly appropriate to borrow from FRCP 73 given that these procedures are designed to ensure that consent is knowing and voluntary. Unless a party is advised of the right to withhold consent to a bankruptcy court entering a final judgment in a *Stern* or statutorily non-core matter, there is a high risk that any consent given will not be knowing. As the majority in *Roell* observed, "[c]ertainly, notification of the right to refuse the magistrate judge is a prerequisite to any inference of consent." 538 U.S. at 587 (2003). Moreover, the applicable provision of the Federal Magistrate Act indicates that these provisions of FRCP 73 were adopted in an effort to establish "procedures to protect the voluntariness of parties' consent." 28 U.S.C. § 636(c)(2).

Given that parties to a bankruptcy case often have multiple matters before the bankruptcy court that arise in or relate to the bankruptcy case — some of which the bankruptcy court may determine on a final basis — bankruptcy litigants should be assured that a decision not to consent in one matter will not result in negative consequences or repercussions either with respect to the matter at hand or to other matters before the bankruptcy court arising in or related to that bankruptcy case. Indeed, the complexity and multi-faceted nature of bankruptcy proceedings suggests that such safeguards are particularly important for bankruptcy litigation, perhaps even more so than in the magistrate system.

3. The Bankruptcy Rules Should Require that the Bankruptcy Court Make a Determination at the Outset of Bankruptcy Litigation as to How it Will Proceed.

We endorse the requirement set forth in the amendments to FRBP 7016 proposed by the Committee in 2013 that would require the bankruptcy judge to conduct a pretrial conference at which the "bankruptcy court shall decide, on its own motion or a party's timely motion, whether to: (1) hear and determine the proceeding and issue proposed findings of fact and conclusions of law; (2) to hear the proceeding and issue proposed findings of fact and conclusions of law; or (3) to take some other action."

The analysis to be conducted by the bankruptcy court in making these determinations will depend on a number of factors. For example, if all the parties have expressly consented to the bankruptcy court entering final judgment, the bankruptcy court might limit this aspect of the pretrial conference to probing as to whether that consent was knowing and voluntary. In contrast, if not all parties have consented, the bankruptcy court will probably be benefited by

briefing and argument on whether the bankruptcy court can constitutionally enter a final judgment without consent.

We believe that the Rule should avoid requiring that the bankruptcy court follow any specific procedure since one size does not fit all and a bankruptcy court should have appropriate latitude to deal with the specifics of the matter before it; the language contained in the version of FRBP 7016 that the Committee proposed in 2013 does this well. However, because of the importance of these jurisdictional matters, we suggest that the Committee draft official comments to FRBP 7016 that describe the sort of factors a bankruptcy court should consider and the range of possible ways of proceeding and encourage that the scheduling order issued pursuant to FRBP 7016 provide for briefing and argument when there is a dispute regarding the ability of the bankruptcy court to enter a final judgment without consent.

As with other proposed rules, addressing these matters at the outset of litigation should minimize confusion and peripheral litigation. In addition, we think that it is important that the bankruptcy court be directly involved in addressing these issues, rather than simply relying on the prospect that the parties may deal with them appropriately. This follows for several reasons.

First, the statute contains similar language, although of course crafted in the core/noncore rubric that predated *Stern v. Marshall*. 28 U.S.C. § 157(b)(3) provides that the "bankruptcy judge shall determine, on the judge's own motion or timely motion of a party, whether a proceeding is a core proceeding under this subsection or is otherwise a proceeding that is otherwise related to a case under chapter 11." We believe that the fact that the statute directs that the bankruptcy court "shall" make this determination on its own motion even if no party raises the issue reflects a Congressional determination that jurisdictional matters should be addressed by a bankruptcy court even if none of the parties raises it, or even if they are in agreement. In *Arkison*, the Court emphasized that this responsibility falls squarely on the bankruptcy court: "It is the bankruptcy court's responsibility to determine whether each claim before it is core or non-core." *Arkison*, 134 S.Ct. at 2171.

Second, having the bankruptcy court ensure that these issues receive attention is good practice. A court is always obligated to address its jurisdiction even if no party bothers to do so. This is particularly important in bankruptcy matters given that many of the parties are neither sophisticated nor represented by counsel.

Third, dealing with these issues directly and clearly at the outset of bankruptcy litigation will reduce confusion and later problems. The procedural posture in which *Wellness* came before the Seventh Circuit Court of Appeals illustrates the problems that otherwise can result. Despite the fact that 28 U.S.C. § 157(b)(3) requires the bankruptcy court to make a determination as to whether a cause of action is core or noncore, neither the bankruptcy court nor the district court ever made that determination. Thus, the Seventh Circuit's "analysis of the alter-ego claim [was] somewhat hampered by the posture of this case." 727 F.3d 751, 774 (7th Cir. 2013). Because no court had yet made a determination as to whether the alter-ego action was core or noncore, the Seventh Circuit needed to go through the analysis as to whether it was a *Stern* claim if it was

statutorily core. "So we proceed on the assumption that that the alter-ego claim was a core proceeding..." *Id.* at 762. And based on that assumption that the alter-ego action was statutorily core, the Seventh Circuit analyzed whether the alter-ego action was also a *Stern* matter. *Id.* at 773 - 776. That analysis was designed to frame a series of possible remedies, with which remedy was applicable to depend on how the district court on remand decided whether the alter-ego action was core or noncore. *Id.* at 777 ("Accordingly, on remand the district court shall first determine whether the alter-ego claim is a core or a noncore proceeding.") Given the failure of any lower court to address this issue and the "total lack of argument from Sharif and WIN on whether the alter-ego claim is truly core or noncore, we will leave it to the district court to make that determination in the first instance." *Id.* at 776. And since different results would flow depending on how the district court decided the core/noncore issue, the Seventh Circuit outlined the alternative paths the district court should follow depending on how it decided that initial question. *Id.* at 776 - 777. This type of confusion can be mitigated — and appellate courts (including district courts acting as appellate courts) can be provided clarity as to what issues were actually decided below and need to be addressed on appeal — through adoption of proposed FRBP 7016.

4. **The Bankruptcy Rules Should Not Take a Position Regarding What Matters Are Within a Bankruptcy Court's Constitutional Authority to Decide Absent Knowing and Voluntary Consent.**

The FRBP necessarily need to deal with the full range of disputes brought before bankruptcy courts. But for better or worse, the Supreme Court (and many appellate courts) have not yet clearly delineated the line between matters that a bankruptcy court can constitutionally decide without consent and those where an Article III court must enter judgment (absent consent).

This lack of clarity is exacerbated by the fact that most of the Court's decisions deal with what matters a bankruptcy court cannot constitutionally decide without consent. We presently have less clarity on what matters a bankruptcy court can decide without consent.

Moreover, *Wellness* illustrated that there may be a growing discomfort among the Justices as to whether the line between public and private rights is the proper analytical framework under which to evaluate this issue.

As a result, we suggest that the official comments to the Bankruptcy Rules forthrightly acknowledge this present lack of certainty by including appropriate caveats to the effect that the law is presently unsettled as to what matters a bankruptcy court can decide without consent. We also suggest that the official comments to the Bankruptcy Rules be clear that even if a party does not to consent to the bankruptcy court entering a final judgment, the bankruptcy court may nonetheless have the constitutional and statutory authority to enter a final judgment.

5. **The Bankruptcy Rules Should Provide that Bankruptcy Appellate Panels ("BAPs") Proceed Based on Express Consent.**

When the Court decided *Stern v. Marshall* in 2011, one of the unsettled issues was whether the BAP system passes constitutional muster. We think that the Court's recent decision in *Wellness* provides an opportunity to address this and to solidify the foundation of the BAP system by revising the 8000 series of the FRBP as described below.

The relevant statute, 28 U.S.C. § 158(b)(1), authorizes the judicial conference of each circuit to establish a bankruptcy appellate panel to hear appeals from bankruptcy courts "with the consent of the parties." So consent of all the parties is a statutory requirement to a BAP hearing an appeal.

The statute also provides that a BAP shall hear an appeal unless the appellant elects at the time of filing the appeal to have the matter heard by a district court or any other party makes this election within 30 days after service of the notice of appeal. 28 U.S.C. § 158(c)(1).

Despite the fact that 28 U.S.C. § 158(b)(1) provides that a BAP may hear an appeal only with the parties' consent, the FRBP presently do not require any such statement of consent. Rather, FRBP 8001(e) provides that a party may elect to have an appeal heard by a district court by filing the election required by 28 U.S.C. § 158(c)(1). In other words, FRBP 8001presently provides that if the parties are silent, a BAP will hear an appeal and that an appeal will be heard by a district court only if a party takes the affirmative step of opting out.

The practice, at least in our experience, is that no one ever expressly consents to a BAP hearing an appeal. Rather, the official forms provide and actual practice in those circuits that have established a BAP is to refer to all appeals to the BAP unless a party takes the affirmative step of opting out.

Although one could argue that the present version of FRBP 8001 fails to follow the dictates of 28 U.S.C. § 158(b)(1), its phrasing is understandable given that it closely follows the language of 28 U.S.C. § 158(c)(1). In addition, one might say that the current phrasing of FRBP 8001 is premised on the concept that the failure to opt out of the BAP constitutes implied consent.

Of course, in *Wellness*, the Court held that implied consent passes constitutional muster if that consent is knowing and voluntary, but suggested that a rule requiring that consent be stated expressly in writing would be better practice. The current version of FRBP 8001 is inconsistent with that better practice and might invite disputes as to whether this opt-out system satisfies the requirement that consent be knowing and voluntary.

Accordingly, we suggest that FRBP 8001 be revised to adopt essentially the same procedures as we recommend for practice before the bankruptcy court — i.e., for each circuit that has adopted a BAP (i) a notice should be provided to each party by the clerk's office at the time an appeal is taken indicating that an appeal will be heard by a BAP only if each party consents and that failure to consent will not be held against a party, (ii) each party should be required to state in writing at the outset of an appeal whether or not it consents to the BAP hearing an appeal, and

(iii) FRBP 8001 should be phrased so that matters are referred to a BAP only if each party indicates that it consents in writing.

We believe that these revisions would better align the procedures for appeals to a BAP with the Court's decision in *Wellness*.

It may also be wise to continue the existing language in FRBP 8001 that refers to the election to have an appeal heard by the district court since that does track the language of 28 U.S.C. § 158(c)(1). This would be redundant but that redundancy in the rule would be the result of the fact that the statute is also redundant.

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We appreciate the opportunity to provide the Committee our comments and thank you in advance for your consideration. If you would like to discuss this matter with either of us further, of course we would be pleased to respond.

Sincerely,

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