

ALERTS

Supreme Court to Review Another Decision Limiting Bankruptcy Court's Power

July 8, 2014

The United States Supreme Court, on July 1, 2014, granted a petition for certiorari in an important Seventh Circuit case limiting the power of bankruptcy courts to decide property disputes. *Wellness International Network, Ltd. et al. v. Sharif*, 727 F.3d 751 (7th Cir. 2013). The Seventh Circuit had held last year that the bankruptcy court lacked the constitutional authority to determine whether purported trust assets were property of the debtor's estate. In its view, this was a "state-law claim between private parties that is wholly independent of federal bankruptcy law and is not resolved in the claims-allowance process." 727 F.3d at 776.

As we noted in an earlier *Alert*, the Supreme Court had just held, on June 9, 2014, that certain nominally "core" proceedings (e.g., fraudulent transfer suits) could be litigated in the bankruptcy court, but only if that court's proposed fact findings and legal conclusions were subject to the district court's *de novo* review. *Executive Benefits Ins. Agency v. Arkison (In re Bellingham Ins. Agency)*, 2014 WL 2560461 (U.S. Sup. Court June 9, 2014) ("Bellingham"). This ruling followed the Court's decision in *Stern v. Marshall*, 131 S. Ct. 2594, 2620 (2011) (5-4), which, we noted in another *Alert*, held that bankruptcy courts "lack . . . constitutional authority to enter final judgment on a state law . . . claim [by the estate] that is not resolved in . . . [the] process of ruling on . . . [the] creditor's claim." According to the Court, Article III of the Constitution did not permit a bankruptcy court in *Stern* to enter a final judgment on the debtor's counterclaim for tortious interference. *Bellingham*, at *4; 131 S. Ct. at 2620.

Relevance

The litigants challenging the constitutional authority of the bankruptcy court in *Bellingham* and *Stern* were third parties who had been sued by the bankruptcy estate. In *Wellness*, however, the debtor who voluntarily chose to file his bankruptcy petition after a stinging defeat in the federal court system had belatedly challenged the bankruptcy court's constitutional authority after losing a fight over his discharge and his ownership of trust assets in that court. The Supreme Court will have to resolve a conflict between the Seventh Circuit and other U.S. Courts of Appeals over the bankruptcy court's ability to decide routine property ownership issues.

Practically, a lender who has successfully pursued a debtor in the court system and is then confronted with its debtor's bankruptcy does not want to spend valuable resources and more time litigating over whether the bankruptcy court can determine what assets are included within the debtor's bankruptcy estate. Until *Wellness*, other appellate courts had regularly held that bankruptcy courts had the power to determine whether property in the debtor's possession belongs to the estate under Bankruptcy Code § 541 as federal law claims despite the presence of state-law issues. *In re Johnson*, 960 F.2d 396 (4th Cir. 1992) (holding that bankruptcy courts continue to have authority to enter final orders and actions against debtor to determine whether property in debtor's possession belongs to bankruptcy estate); *In re Croft*, 737 F.3d 372, 374 (5th Cir. 2013) (holding that actions under Code § 541 are federal claims although issues of state law present). The Seventh Circuit's narrow focus on state law issues in *Wellness* would shift much of the usual bankruptcy court litigation to the district courts, creating unnecessary delay and expense to creditors.

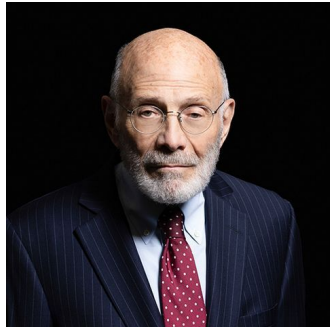
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If you have any questions concerning this *Alert*, please contact your attorney at Schulte Roth & Zabel or the author.

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