AMERICAN BANKRUPTCY INSTITUTE
JOURNAL
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Feature

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Inaction as Implied Consent

Bankruptcy Courts' Authority to Enter Default Judgment on Stern *Claims After* Wellness

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Does doing nothing constitute "knowing and voluntary" consent? More specifically, does a defendant, by failing to appear and defend a fraudulent transfer claim after the defendant has been served with a summons and complaint, impliedly consent to a bankruptcy court's authority to enter a final default judgment in the case? The answer is "yes," according to a recent case, *Hopkins v. M&A Ventures (In re Hoku Corp.)*.[2] This appears to be the first written decision to address the issue since the U.S. Supreme Court clarified the standard for implied consent in *See Wellness Int'l Network Ltd. v. Sharif*.[3]

Why Consent Is Necessary

Readers of the *ABI Journal* are familiar with the Court's 2011 *Stern* decision,[4] which spawned hundreds (and perhaps thousands) of court decisions and articles.[5] Stated succinctly, *Stern* held that although a particular matter may be included in the statutory list of "core" matters properly subject to final adjudication by a bankruptcy court,[6] bankruptcy courts may nonetheless lack constitutional authority to enter final judgments in such matters.[7] In other words, a defendant may possess a constitutional right to have an Article III judge decide a particular claim even though the U.S. Code states that an Article I bankruptcy judge will suffice. Such claims are often called "*Stern* claims."

After *Stern*, bankruptcy courts struggled to sort out the impact of the decision: what should they do with *Stern* claims? In its 2014 *Arkison* decision, the Court instructed that in most cases, the appropriate course is for the bankruptcy court to hear the proceeding and submit proposed findings of fact and conclusions of law to the district court.[8] *Arkison* also confirmed that the parties, by their consent, may waive their right to insist on an Article III adjudicator.[9] However, the Court reserved for another day the question of whether that consent may be implied and whether the parties in that case had so consented.[10]

In 2015, the Court addressed head-on the question of whether a defendant may impliedly consent to have a *Stern* claim finally decided by a bankruptcy court. In *Wellness*, the Court held that a party may impliedly consent to final adjudication by a bankruptcy court if "'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."[11] Under this standard, the consent must be "knowing and voluntary."[12] On remand, the Seventh Circuit concluded that the defendant, "[b]y waiting until his [appellate] reply brief to challenge the bankruptcy court's authority," had forfeited his right to challenge final adjudication by the bankruptcy court.[13]

Under *Wellness*, it is clear that a party may forfeit its rights to an Article III adjudicator by its affirmative conduct — either by litigating without objection or, in the Court's words, "voluntarily appear[ing] to try the case" before the bankruptcy court.[14] However, what if a party never appears at all? *Wellness* does not answer this question.

1 Holland & Hart LLP represents parties in connection with various Hoku adversary proceedings. This article only represents the views of the authors and not of the firm's clients.
2 *See* Case No. 15-08043, 2015 WL 8488949, at *3 (Bankr. D. Idaho Dec. 10, 2015).
3 *See Wellness Int'l Network Ltd. v. Sharif*, 135 S. Ct. 1932 (2015).
4 *Stern v. Marshall*, 131 S. Ct. 2594 (2011).
5 Find archived *ABI Journal* articles and other ABI-generated content, including podcasts, at abi.org/abisearch.
6 *See* 28 U.S.C. § 157(b)(2).
7 *Stern v. Marshall*, 131 S. Ct. at 2608.
8 *See Exec. Benefits Ins. Agency v. Arkison*, 134 S. Ct. 2165, 2173 (2014).
9 *Id.* at 2172.
10 *Id.* at n.4.
11 135 S. Ct. at 1948 (citing *Roell v. Withrow*, 538 U.S. 580, 590 (2003)).
12 *Wellness*, 185 S. Ct. 1938.
13 *See Wellness Int'l Network Ltd. v. Sharif*, 617 F. App'x. 589, 590 (7th Cir. 2015).
14 *Wellness*, 135 S. Ct. at 1948.

Case Law Before *Wellness*

Post-*Stern* but pre-*Wellness*, bankruptcy courts were split regarding their authority to enter default judgments against defendants who failed to appear to defend *Stern* claims.

Some courts concluded that they could not enter final judgments in such cases. For example, in *In re Sutton*,[15] the U.S. Bankruptcy Court for the Western District of Michigan was asked to enter a default judgment in a trustee's action to recover on an open account against a noncreditor. The court found that under the Supreme Court's *Northern Pipeline* decision,[16] such a claim was a type as to which it could not enter a final judgment without the parties' consent. The court further found that by failing to respond to the complaint, the defendant had not waived his right to adjudication by an Article III court because a waiver requires "an intentional relinquishment or abandonment of a known right or privilege."[17] Forfeiture, on the other hand, requires only "the failure to make the timely assertion of a right."[18] The court found that the defendant had not forfeited his right to an Article III court because "declaring a forfeiture is a serious matter that requires restraint," and courts "'do not presume acquiescence in the loss of fundamental rights.'"[19]

Hon. **Martin Glenn** of the U.S. Bankruptcy Court for the Southern District of New York came to the opposite conclusion in *In re Oldco M. Corp.* In *Oldco*, the court held that it had the constitutional authority to enter a final default judgment in an avoidance action against a defendant who failed to appear.[20] The court based its decision on the fact that the summons served on the defendant contained clear, bold language warning that failure to respond "will be deemed to be your consent to entry of a judgment by the bankruptcy court."[21] Thus, by failing to respond, "the defendant evinced clear and knowing, albeit implied, consent to this Court's entry of a default judgment."[22] The court supported its decision with decades-old Second Circuit precedent that providing defendants could impliedly consent to a non-Article III court's final adjudication of non-core matters.[23]

The *Hoku* Case

In *Hoku*, Hon. **Jim D. Pappas** of the U.S. Bankruptcy Court for the District of Idaho considered the same question as the cases addressed above: does a bankruptcy court have the constitutional authority to enter a final default judgment on a *Stern* claim against a non-appearing defendant? However, *Hoku* addressed the question with the additional guidance provided by *Wellness* — namely, that consent may be implied and it must be "knowing and voluntary." The *Hoku* court, like the *Oldco* court, concluded that it had constitutional authority to enter the default judgment.[24]

In *Hoku*, the defendant was served with a fraudulent transfer complaint and a summons that included this conspicuous language: "If you fail to respond to this summons, your failure will be deemed to be your consent to entry of a judgment by the bankruptcy court and default may be taken against you for the relief demanded in the complaint."[25] The defendant never appeared in the case or responded to the complaint, so the clerk entered a default and the trustee sought entry of a default judgment.

After finding that the fraudulent transfer claim was a *Stern* claim under Ninth Circuit precedent,[26] the court granted the trustee's motion for a default judgment. On the issue of consent by inaction, the court expressly adopted the *Oldco* reasoning. It held that by failing to respond to the summons and complaint in the face of clear warning language about the consequences of failing to do so, the defendant impliedly consented to the bankruptcy court's authority to enter a default judgment, or put another way, forfeited the right to an Article III judge.[27] In short, the defendant's "total failure to appear and defend can be presumed to satisfy the *Wellness* standard."[28]

The court supported its conclusion with a practical consideration. Specifically, even after a bankruptcy court enters a default judgment against a defendant, the defendant's access to an Article III court is not necessarily cut off. Federal Rule of Civil Procedure 55(c), incorporated by Bankruptcy Rule 7055, is liberally applied to provide relief from default judgments. In connection with a motion to set aside a default judgment under that rule, a defendant could move to withdraw the reference so that an Article III court could, if it so wished, review the default judgment.[29]

Other practical considerations not expressly discussed by the court support the court's holding. For example, it is unclear how a plaintiff would request that a district court enter default judgment in an adversary proceeding that has been referred to a bankruptcy court. The bankruptcy rules provide no guidance. Must the movant first move to withdraw the reference? Presumably so, because otherwise no district court case exists.

Efficiency and division of labor between district and bankruptcy courts are also better served by allowing bankruptcy courts to enter final default judgments. If district courts hold exclusive power to enter default judgments on *Stern* claims, they will potentially be tasked with reviewing large numbers of recommended findings of fact and conclusions of law arising from routine avoidance actions. In addition, they may face a growing number of motions to withdraw the reference filed by parties who seek to circumvent the bankruptcy court and obtain final judgment from a district court in the first instance.

Conclusion

The *Hoku* decision reaches the correct result: if a defendant is conspicuously warned that a failure to appear equals consent and the defendant fails to appear, it has consented. It

15 470 B.R. 462 (Bankr. W.D. Mich. 2012).
16 *See N. Pipeline Const. Co. v. Marathon Pipe Line Co.*, 458 U.S. 50 (1982).
17 *Sutton*, 470 B.R. at 475 (citing *Johnson v. Zerbst*, 304 U.S. 458, 464 (1938)).
18 *Id.* (citing *United States v. Olano*, 507 U.S. 725, 733 (1993)).
19 *Id.* at 476 (citing *Johnson*, 304 U.S. at 464).
20 *See Exec. Sounding Bd. Assocs. Inc. v. Advanced Mach. & Eng'g Co. (In re Oldco M Corp.)*, 484 B.R. 598, 600 (Bankr. S.D.N.Y. 2012).
21 *Id.* at 601.
22 *Id.* at 615.
23 *Id.* at 606 (citing *Men's Sportswear Inc. v. Sasson Jeans Inc. (In re Men's Sportswear Inc.)*, 834 F.2d 1134 (2d Cir. 1987)).
24 *See Hoku*, 2015 WL 8488949, at *3.
25 *Id.* at *2. It appears that this language has become a standard feature of bankruptcy summons forms. For example, the national summons form (B2500A) includes the same language (*see* www.uscourts.gov/forms/bankruptcy-forms/summons-adversary-proceeding-0).
26 In the Ninth Circuit, a fraudulent transfer claim against a noncreditor is a *Stern* claim as to which a bankruptcy court lacks constitutional authority to enter final judgment without the parties' consent. *See Exec. Benefits Ins. Agency v. Arkison (Matter of Bellingham Ins. Agency Inc.)*, 702 F.3d 553, 565 (9th Cir. 2012).
27 *Hoku*, 2015 WL 8488949, at *3.
28 *Id.*
29 *Id.* at *3.

would be a strange result if a more conscientious defendant (one who appears in a case but fails to raise a *Stern* objection) may forfeit its Article III access, while a less-conscientious defendant (one who receives a summons and does nothing) preserves its Article III access. At some point, a forfeiture must occur. Moreover, allowing bankruptcy courts to enter final default judgments on *Stern* claims avoids needless procedural machinations and provides litigants with a clear procedure to obtain enforceable judgments.

It remains to be seen whether other courts will follow *Hoku*. In the meantime, parties seeking default judgments on *Stern* claims in bankruptcy court may wish to hedge their risks by adding a savings clause to the judgment, which could provide that if the judgment is later deemed to exceed the scope of the bankruptcy court's authority, the judgment will convert to proposed findings of fact and conclusions of law.[30] abi

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30 *See* 8 William L. Norton, Jr. and William L. Norton, III, *Norton Bankr. L. & Prac.* § 161:11 (3d ed. 2015).