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ARTICLES

A Bankruptcy Submission Hold

The sharp increase in the number of bankruptcy cases has been coupled with a similar mushrooming of bankruptcy-related litigation.

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With the Great Recession of 2008, bankruptcy filings in the United States skyrocketed. There were 850,912 total bankruptcy petitions filed in 2007; that number ballooned to 1,593,081 in 2010. Am. Bankr. Inst., *Annual Business and Non-Business Filings by Year (1980–2010), available at* http://www.abiworld.org. The sharp increase in the number of bankruptcy cases has been coupled with a similar mushrooming of bankruptcy-related litigation. As fewer and fewer companies have reorganized and section 363 sales have become the norm, much of that litigation is now being pursued by trustees of liquidating trusts who often prefer to prosecute that litigation before juries that are seething with anger against Wall Street investment banks, other financial institutions, architects of Ponzi schemes, and "overpaid" executives.

Non-Debtors' Actions in Bankruptcy Determine Their Jury Trial Rights

The Seventh Amendment right to a jury trial right applies "in suits at common law." Generally, courts determine whether the right exists by considering two elements—"the nature of the action and of the remedy sought." *Tull v. United States*, 481 U.S. 412, 417 (1987). First, courts must compare the action with "18th-century actions brought in the courts of England prior to the merger of the courts of law and equity." *Id.* (internal citations omitted). Second, they examine "the remedy sought and determine whether it is legal or equitable in nature." *Id.* (internal citations omitted).

The U.S. Bankruptcy Code, 11 U.S.C. §§ 101 et seq., includes no provisions relating to parties' jury trial rights in a bankruptcy proceeding; the only relevant statutory provisions are found in federal jurisdictional sections. *See* 28 U.S.C. §§ 157(e), 1411. It is axiomatic, therefore, that nothing in the Bankruptcy Code either diminishes or expands the constitutional right to a jury trial embodied in the Seventh Amendment. *See* Nancy C. Dreher, *Bankruptcy Law Manual* § 2A:45 (5th ed. rev. Nov. 2010).

In *Katchen v. Landy*, 382 U.S. 323 (1966), the Supreme Court considered whether a bankruptcy court can hear, without a jury, an action by a bankruptcy trustee to recover pre-petition preferential transfers. The Court acknowledged that a non-debtor defendant in a preference action would have a Seventh Amendment right to a jury trial if a trustee brought suit outside the bankruptcy court. *Id.* at 336. However, "when the same issue arises as part of the process of allowance and disallowance of claims, it is triable in equity." *Id.* The Court held that, because of the bankruptcy context, the non-debtor's legal claim is converted into an equitable claim for a *pro rata* share of estate property. *Id.*

In 1989, the Supreme Court revisited the issue of jury trial rights in bankruptcy in the context of a fraudulent conveyance action, *Granfinanciera, S.A. v. Norberg*, 492 U.S. 33 (1989). In *Granfinanciera*, the Court applied the *Tull* standard and determined that a fraudulent conveyance action is legal in nature. *Id.* at 47–49. The Court then reconciled its ultimate conclusion—that the non-debtor retained a right to trial by jury—with its earlier decision in *Katchen*, holding that it was only the non-debtor's submission of a claim to the bankruptcy court in *Katchen* that had triggered the equitable claims allowance process. The Court held that, by filing a claim, a non-debtor subjects its otherwise legal claims to the bankruptcy court's equitable powers. In contrast, because the defendant in *Granfinanciera* had not filed a claim, it retained its jury trial right. *Id.* at 57–58. The *Granfinanciera* Court also considered and rejected the applicability of another theory regarding the non-debtor's jury trial rights known as the "public rights doctrine," but that theory is not relevant for purposes of this article.

A year later, the Supreme Court further clarified the jury trial rights of non-debtors in bankruptcy in *Langenkamp v. Culp*, 498 U.S. 42 (1990). The facts in *Langenkamp* were analogous to those in *Katchen*—a defendant was sued by a trustee seeking to recover a preferential transfer. As in *Katchen*, and in contrast to *Granfinanciera*, the defendant had filed a proof of claim in the bankruptcy proceeding. Predictably, therefore, the Court determined that the non-debtor was not

entitled to a jury trial. *Id.* at 45. The Court then provided a succinct summary of the state of the law and the rationale behind it:

> [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. . . . [T]he creditor's claim and the ensuing preference action by the trustee become integral to the restructuring of the debtor-creditor relationship through the bankruptcy court's *equity jurisdiction*. As such, there is no Seventh Amendment right to a jury trial. If a party does *not* submit a claim against the bankruptcy estate, however, the trustee can recover allegedly preferential transfers only by filing what amounts to a legal action to recover a monetary transfer. In those circumstances the preference defendant is entitled to a jury trial. Accordingly, "a creditor's right to a jury trial on a bankruptcy trustee's preference claim depends upon whether the creditor has submitted a claim against the estate."

Id. at 44 (emphasis in original; internal citations omitted).

Circuits Disagree on Debtors' Forfeiture on Jury Trial Rights

Although the Supreme Court has addressed the issue of the jury trial rights of non-debtors, the Court has never considered whether a debtor in bankruptcy has a Seventh Amendment right to trial by jury. There is a split of authority among the various circuit courts of appeals on this issue. However, the better reasoned view, both legally and equitably, is that by filing for bankruptcy relief, a debtor submits to the equitable jurisdiction of the bankruptcy court and thereby forfeits its Seventh Amendment rights.

The Seventh Circuit was the first circuit court to consider the jury trial rights of a debtor in *N.I.S. Corp. v. Hallahan* (*In re Hallahan*), 936 F.2d 1496 (7th Cir. 1991). In *Hallahan*, a creditor sued a debtor for non-dischargeability of a claim for breach of a covenant not to compete; the debtor demanded a jury trial. The court held that the debtor did not have a jury trial right for two independent reasons. First, under the *Tull* standard, a dischargeability action is equitable, not legal, so that no Seventh Amendment right exists inside bankruptcy or otherwise. *Id.* at 1505. Second, even if a dischargeability action were legal in nature, the debtor had no jury trial right because that right was forfeited when the debtor filed its bankruptcy petition and submitted itself to the equitable jurisdiction of the bankruptcy court (referred to in this article as the submission theory). Applying the rationale of *Granfinanciera* and its progeny, the court explained that its conclusion was premised on fundamental fairness:

> Hallahan cannot claim a right to jury trial because, as a Chapter 7 debtor, he voluntarily submitted his case to bankruptcy court. The Supreme Court did not address the extent of the debtor's Seventh Amendment right to jury trial in bankruptcy court in *Granfinanciera*. However, if creditors "by presenting their claims subject[ ] themselves to all the consequences that attach to an appearance," thereby losing any jury trial right otherwise guaranteed by the Seventh Amendment, debtors who initially choose to invoke the bankruptcy court's jurisdiction to seek protection from their creditors cannot be endowed with any stronger right. A defendant or potential defendant to an action at law cannot initiate bankruptcy proceedings, thus forcing creditors to come to bankruptcy court to collect their claims, and simultaneously complain that the bankruptcy forum denies him or her a jury trial.

Id.

In dicta, the court also indicated that the same result would follow if a debtor were the plaintiff, as opposed to the defendant: "Even if Hallahan was [sic] *pursuing* a 'legal' claim, by submitting it to the bankruptcy forum he lost any Seventh Amendment jury trial right he might have." *Id.* at 1506 (emphasis added).

The Sixth Circuit adopted the submission theory *in toto* in *Longo v. McLaren* (*In re McLaren*), 3 F.3d 958 (6th Cir. 1993), a factually analogous case involving a debtor-defendant demanding a jury trial in a dischargeability action. More recently, the Ninth Circuit Bankruptcy Appellate Panel adopted the submission theory in *Hickman v. Hana* (*In re Hickman*), 384 B.R. 832 (9th Cir. B.A.P. 2008). In *Hickman*, a debtor sought to dismiss his bankruptcy case to retain a jury trial right after discovering potentially valuable counterclaims against a creditor who had initiated a dischargeability action. The *Hickman* court, though careful to limit its holding to the facts of the case, interpreted a debtor's jury trial right as directly analogous to a non-debtor's under Supreme Court precedent:

> The underlying principle, then, to be drawn from the Supreme Court decisions is that the crucial event is the act of a Chapter 7 debtor coming into a court of equity to seek "restructuring of the debtor-creditor relationship through the bankruptcy court's *equity jurisdiction*." Issues that are ordinarily legal are transformed into equitable issues for which jury trial is not available, and the actor gives up the right to contend otherwise.

Id. at 839 (quoting *Langenkamp*, 498 U.S. at 44) (emphasis in original).

The submission theory also has been adopted by a significant number of district and bankruptcy courts. *See, e.g.*, *Mid American Concrete Constr. Co., Inc. v. Sears Roebuck & Co.*, No. 91-C-6286, 1993 WL 177140 at *2 (N.D. Ill. May 6, 1993) ("The important factor in considering waiver is not whether the party seeking a jury trial is a plaintiff or defendant, creditor or debtor, or whether a proof of claim is involved, but whether the party seeking a jury trial voluntarily brought the action in bankruptcy or was involuntarily joined as a party by another participant in the bankruptcy proceeding."); *Hutchins v. Fordyce Bank & Trust Co.* (*In re Hutchins*), 211 B.R. 322, 324 (Bankr. E.D. Ark. 1997) ("The vast majority of cases hold that a debtor in bankruptcy has submitted his claims to the equitable jurisdiction of the bankruptcy court such that there is no entitlement to trial by jury."); *Crews v. Lyons* (*In re Lyons*), 200 B.R. 459 (Bankr. S.D. Ga. 1994) ("Debtor has waived his right to a jury trial by filing his petition in bankruptcy.").

Three other circuits—the Second, Third, and Fifth—have rejected the broad submission theory set forth in *Hallahan*, *McLaren*, and the other cases cited above. *See In re Jensen*, 946 F.2d 369 (5th Cir. 1991); *Germain v. Conn. Nat'l Bank* (*In re O'Sullivan Fuel Oil Co., Inc.*), 988 F.2d 1323 (2d Cir. 1993); *Billing v. Ravin, Greenberg & Zackin*, P.A., 22 F.3d 1242 (3d Cir. 1994). These courts reach two related and fundamental conclusions. First, they hold that a debtor's act of filing a bankruptcy petition does not affect a blanket forfeiture of Seventh Amendment rights. *In re Jensen*, 946 F.2d at 374; *Germain*, 988 F.2d at 1330; *Billing*, 22 F.3d at 1250. Second, these courts hold that a Seventh Amendment forfeiture occurs only when the claims allowance process is implicated. *In re Jensen*, 946 F.2d at 374 ("[T]he debtors' claims do not here 'arise as part of the process of allowance and disallowance of claims.'"); *Germain*, 988 F.2d at 1330 ("For waiver to occur, the dispute must be part of the claims-allowance process or affect the hierarchal reordering of creditors' claims."); *Billing*, 22 F.3d at 1253 (debtor has no right to jury trial because legal malpractice claim interrelated with bankruptcy counsel's fee application to bankruptcy court).

The submission theory articulated in the cases above is the better-reasoned view, both legally and equitably. Legally, the Second, Third, and Fifth Circuits misconstrue the bedrock principle underlying the Supreme Court's rulings in relation to non-debtors. These courts improperly conclude that the basis for the loss of the right to a jury trial in the non-debtor context—that filing a proof of claim implicates the claims allowance process and thus submits the non-debtor to the bankruptcy court's equitable jurisdiction—is the only possible basis for a Seventh Amendment jury trial forfeiture in the debtor context.

This conclusion is not supported by a close reading of the Supreme Court cases discussed above. The Supreme Court's holdings are premised on non-debtors taking certain actions that seek "restructuring of the debtor-creditor relationship through the bankruptcy court's *equity jurisdiction*." *Langenkamp*, 498 U.S. at 44 (emphasis in original). While the focus of these cases happens to be on the claims allowance process, it is conceivable, even likely, that given the fundamental differences between debtors and non-debtors, a debtor will submit to the equitable jurisdiction of the bankruptcy court in a much different manner than a non-debtor. The singular act of filing a bankruptcy petition is the most direct action that any party can take to "restructur[e] . . . the debtor-creditor relationship through the bankruptcy court's *equity jurisdiction*"; indeed, this action actually commences the equitable bankruptcy process. Therefore, as a legal matter, the submission theory is the better-reasoned perspective.

The submission theory is also better reasoned in terms of ensuring equity between debtors and non-debtors. If the submission theory is rejected, non-debtors are greatly disadvantaged in the bankruptcy process. Take, for example, a situation in which a bank is owed millions of dollars by a debtor but is concerned that the debtor may sue to recover an allegedly preferential transfer. Under the Supreme Court precedents described above, the bank is faced with a Hobson's choice —it must either forfeit its multimillion-dollar claim to retain its jury trial right or forfeit its jury trial right to pursue its multimillion-dollar claim. In this situation, the bank's jury trial right is very costly, and the mere act of filing a proof of claim in the bankruptcy court will result in a forfeiture of the bank's constitutional right. Contrast the bank's predicament with that of the debtor's in this situation: Despite the fact that the debtor itself commenced the entire bankruptcy proceeding to restructure its debtor-creditor relationships, if the submission theory is rejected, the debtor retains its jury trial right in the preference action. The debtor's filing of a bankruptcy petition is an immeasurably more profound act than the non-debtor's filing of a mere proof of claim, but if one rejects the submission theory, non-debtors are inequitably disadvantaged. Therefore, as an equitable matter, the submission theory achieves a fairer result.

Although the Supreme Court has not yet addressed the issue of a *debtor's* Seventh Amendment right to a jury trial, for both the legal and equitable reasons described above, the submission theory is the better-reasoned view. While the applicability of the submission theory to involuntary bankruptcy proceedings, an issue reserved by the Seventh Circuit in a footnote in *Hallahan*, is beyond the scope of this article, the authors believe that the analysis outlined above applies equally to such proceedings; if the involuntary debtor takes advantage of the benefits of the Bankruptcy Code after the order for relief is entered (the automatic stay, filing of a plan, cram-

down, etc.), the debtor should be deemed to have submitted to the equitable jurisdiction of the bankruptcy court and forfeited its Seventh Amendment rights.

Liquidating Trustees, as Assignees of Debtors, Are Not Entitled to Jury Trials

Under the Bankruptcy Code, "a plan may . . . provide for . . . the retention and enforcement by the debtor, by the trustee, or by a representative of the estate appointed for such purpose, of any such claim or interest." 11 U.S.C. § 1123(b)(3). Often, a plan will provide for the creation of a liquidating trust and the appointment of a liquidating trustee. The plan will then transfer certain assets, generally the estate's remaining causes of action, to the trust, and all allowed unsecured creditors will receive ratable beneficial interests in the trust *res*. Many of the issues that arise in the context of liquidating trust litigation—such as whether the causes of action were properly preserved for post-confirmation litigation, whether the bankruptcy court retains post-confirmation jurisdiction over such claims, and whether the trustee has standing to prosecute such claims—are beyond the scope of this article. Instead, this final section focuses on a singular question—does the liquidating trustee have a Seventh Amendment right to a jury trial when it is prosecuting causes of action assigned to the trust?

It is black letter law that an assignee "acquires no greater rights than were possessed by the assignor" and thus "stands in the shoes" of the assignor. 6 *Am. Jur. 2d Assignments* § 113 (rev. 2010). For this reason, "in an action on the claim assigned, the assignee of a chose in action is ordinarily subject to any setoff or counterclaim available to the obligor against the assignor, and to all other defenses and equities that could have been asserted against the assignor at the time of the assignment." *Id.* § 116.

Based on this black letter law, an assignee-liquidating trustee's Seventh Amendment right to a jury trial should be identical to the assignor-debtor's right—the trustee "stands in the shoes" of the debtor for purposes of the Seventh Amendment analysis. To the extent that the debtor is not entitled to a jury trial, the liquidating trustee has no greater rights. Despite the extensive use of liquidating trusts in plans of reorganization, however, there are virtually no reported cases construing the Seventh Amendment in the context of a liquidating trustee's demand for a jury trial. We are left, therefore, to consider applicable analogies.

The closest analogy is that, because an assignee is subject to all "limitations" that applied to the assignor, an assignee is generally subject to an assignor's express jury trial waiver. For instance, an assignee is subject to an assignor's pre-assignment, contractual jury trial waiver. *See, e.g.*, *Fay's*

Drug Co. of Riverside, Inc. v. P&C Prop. Coop., Inc., 51 A.D.2d 887, 887 (N.Y. App. Div. 1976). Similarly, several cases have held that an assignee is subject to a jury trial waiver in the form of a pre-assignment, contractual arbitration provision. *See, e.g.*, *C.B. Sullivan Co., Inc. v. Graham Webb Int'l, Inc.*, No. 07-cv-170-SM, 2008 WL 249060 (D.N.H. Jan. 28, 2008); *E-Time Sys., Inc. v. Voicestream Wireless Corp.*, No. 01-5754, 2002 WL 1917697 (E.D. Pa. Aug. 19, 2002).

The "limitations" binding on an assignee may also include defenses based on the assignor's pre-assignment conduct, such as *in pari delicto*. For instance, in the context of liquidating trust litigation, the Sixth Circuit has held that "in pari delicto is a defense that may be raised against a [post-confirmation liquidating] trustee to the extent the defense could be raised against a debtor itself." *Liquidating Trustee of Amcast Unsecured Creditor Liquidating Trust v. Baker* (*In re Amcast Indus. Corp.*), 365 B.R. 91, 123 (Bankr. S.D. Ohio 2007) (citing *Terlecky v. Hurd* (*In re Dublin Sec., Inc.*), 133 F.3d 377, 380–81 (6th Cir. 1997), and *In re Donahue Sec., Inc.*, 304 B.R. 797, 799 n.4 (Bankr. S.D. Ohio 2003). The Fifth and Tenth Circuits have held that *in pari delicto* is also applicable to a Chapter 7 trustee pursuing litigation as the representative of a debtor's bankruptcy estate. *Reed v. City of Arlington*, No. 08-11098, 2010 WL 3585375 at *5 (5th Cir. 2010); *Sender v. Buchanan* (*In re Hedged-Investment Assocs., Inc.*), 84 F.3d 1281, 1284–85 (10th Cir. 1996). Similarly, the Second and Third Circuits have held that the *in pari delicto* defense applies to unsecured creditors' committees acting as assignees of the debtor. *Mediators, Inc. v. Manney* (*In re Mediators, Inc.*), 304 F.3d 822, 825–26 (2d Cir. 1997); *Official Comm. of Unsecured Creditors v. R.F. Lafferty & Co., Inc.*, 267 F.3d 340, 355–58 (3d Cir. 2001).

Based on the black letter law of assignments and the analogies described above, a liquidating trustee, as an assignee of the debtor's estate under section 1123(b)(3) of the Bankruptcy Code, stands in the shoes of the debtor and obtains no greater entitlement to a jury trial than the debtor possessed at the time of assignment. If a debtor has forfeited its right to a jury trial under the submission theory, that right should not be magically reinstated in the hands of a liquidating trustee.

Conclusion

With the recent surge in bankruptcy filings and the accompanying increase in bankruptcy-related litigation, it is essential that litigators practicing in the bankruptcy arena possess a fundamental understanding of traditional Seventh Amendment issues and their application to various litigants in the bankruptcy context. Understanding the rationale for the Supreme Court's precedents on non-debtors' jury trial rights is essential to a proper analysis of the rights of other litigants, such as

debtors and liquidating trustees. Although the Supreme Court has not yet addressed a debtor's Seventh Amendment rights, the better-reasoned view of the current circuit court split is that a debtor forfeits its right to a jury trial by filing a bankruptcy petition. If a creditor submits to the equitable jurisdiction of the bankruptcy court and forfeits its right to a jury trial by filing a proof of claim, certainly a debtor should be deemed to have forfeited its right to a jury trial by submitting the restructuring of all of its debtor-creditor relationships to the equitable jurisdiction of the bankruptcy court. Because a liquidating trustee is merely an assignee of a debtor and thus stands in the debtor's shoes, a liquidating trustee similarly lacks a Seventh Amendment right to a jury trial.

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