UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

IRVING H. PICARD, Plaintiff, - against - SAUL B. KATZ, et al., Defendants.	11-CV-03605 (JSR)

MEMORANDUM OF LAW IN SUPPORT OF DEFENDANTS' OPPOSITION TO TRUSTEE'S REQUEST FOR A JURY TRIAL

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Defendants respectfully submit this memorandum of law in opposition to the anticipated demand by Plaintiff Irving H. Picard ("Trustee") for a jury trial in this action. The Seventh Amendment does not afford the Trustee the right to a jury trial in this case.

ARGUMENT

I. THE TRUSTEE IS NOT ENTITLED TO A JURY TRIAL

The Seventh Amendment of the United States Constitution provides that "[i]n suits at common law, where the value in controversy shall exceed twenty dollars, the right of trial by jury shall be preserved." *See* U.S. Const. amend. VII. The Supreme Court has interpreted "suits at common law" to mean suits in which legal rather than equitable rights are to be determined. *Granfinanciera, S.A. v. Nordberg*, 492 U.S. 33, 41 (1989). The Court has developed a two-pronged test to determine whether a jury trial right attaches to a particular claim: first, whether the claim would have been deemed legal or equitable in 18th-century England; and second, whether the remedy sought is legal or equitable in nature. *Id.* at 42 & n.4; *see also In re CBI Holding Co., Inc.*, 529 F.3d 432, 466 (2d Cir. 2008).

The Trustee is not entitled to a jury trial under this test.

The two claims remaining in this case, one for fraudulent conveyance and one for equitable subordination—and indeed the nine claims that were dismissed—arise solely under the Bankruptcy Code. Prior to its filing under the Securities Investor Protection Act ("SIPA"), Bernard L. Madoff Investment Securities LLC ("BLMIS") had no right to assert any of these claims. The Trustee's ability to do so now derives solely from BLMIS' status as a debtor in bankruptcy. Bankruptcy proceedings are inherently

proceedings in equity. *Local Loan Co. v. Hunt*, 292 U.S. 234, 240 (1934). Consequently, no jury trial right attaches to these claims.

A. No Jury Trial Right Attaches to the Fraudulent Conveyance Claims

The Supreme Court has several times addressed the right of a non-debtor defendant to a jury trial in a bankruptcy avoidance action. The outcome in each case has depended largely upon whether the defendant had filed a claim in the underlying bankruptcy proceedings and thereby submitted to the equitable jurisdiction of the Bankruptcy Court. Those decisions compel the conclusion that a debtor has no jury trial right as to a claim it acquired only as a result of its own invocation of bankruptcy jurisdiction.

In *Katchen v. Landy*, 382 U.S. 323 (1966), a preference defendant *had* filed a claim against the estate. The Supreme Court held that any right to a jury trial was thereby lost. "[A]lthough petitioner might be entitled to a jury trial on the issue of preference if he presented no claim in the bankruptcy proceeding and awaited a federal plenary action by the trustee, when the same issue arises as part of the process of allowance and disallowance of claims, it is triable in equity." *Id*. at 336 (citation omitted); *see also Langenkamp v. Culp*, 498 U.S. 42, 44-45 (1990) (*per curiam*) ("[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.").

In *Granfinanciera*, however, the fraudulent conveyance defendants had *not* filed claims. Because the defendants would have been entitled to a jury trial had no bankruptcy been filed, and because they had not filed claims against the estate, the

Supreme Court held that the defendants retained their jury trial rights. *See* 492 U.S. at 47-48, 56-59.

A debtor, of course, has submitted itself to the jurisdiction of the Bankruptcy Court. Few courts have been presented with a debtor's demand for a jury—because a debtor seldom has any such right. Indeed, at least one circuit has held that the "Seventh Amendment confers no right to a jury trial on a debtor . . . who files voluntarily for bankruptcy and is a defendant in an adversary proceeding." *In re Hallahan*, 936 F.2d 1496, 1505-06 (7th Cir. 1991) (noting the injustice that would result if a creditor were held to be stripped of a jury trial right as a result of filing a claim while the debtor retained such a right). Where the defendant is a creditor that has filed a claim against the estate, no court has found that a debtor has a jury trial right as to a claim arising from the Bankruptcy Code.

In the rare cases in which a debtor was granted a jury trial, the right has generally been found to have attached to state law causes of action that were owned by, and brought for the benefit of, the debtor itself. For example, in *Germain v. Connecticut National Bank*, 988 F.2d 1323 (2d Cir. 1993), the bankruptcy trustee brought state law causes of action belonging to the debtor against a creditor that had filed a claim. *See id.* at 1325-26. The Second Circuit held that the debtor possessed, and retained, a jury trial right for these claims. Contrasting these claims with "equitable" bankruptcy relief such as "the restitution of fraudulent transfers under 11 U.S.C. § 548," the Court noted that the debtor did not "charge [the creditor] with violating any Bankruptcy Code provision," *id.* at 1328, nor seek any bankruptcy relief, *id.* at 1329. *See also In re Jensen*, 946 F.2d 369, 374 (5th Cir. 1991) (debtor retained jury trial right for state law claims brought against

"non-creditor third parties to augment the bankruptcy estate" and bankruptcy filing did not transform pre-petition legal claims into equitable ones).

Here, the circumstances are very different. The Trustee is asserting claims that were never owned by BLMIS. Prior to its SIPA filing, BLMIS had no right to avoid its own transfers to its customers on fraudulent conveyance grounds, and, thus, had no jury trial right in connection with any such claim. Any jury trial right, therefore, would have to derive from the federal statutes that became operative because of the filing—SIPA and the Bankruptcy Code. But these statutes grant no right to a jury trial. On the contrary, the claims under these statutes were granted to the Trustee not for the benefit of BLMIS, but to give effect to the equitable objectives of the Bankruptcy Code, for the benefit of creditors.

No decision supports the existence of a debtor's jury trial right under these circumstances. Indeed, in a closely analogous case, the debtor's lack of any such right was confirmed. In *In re Enron Corp.*, 319 B.R. 122 (Bankr. S.D. Tex. 2004), a representative of the debtor sought a jury trial for adjudication of preference claims assigned to it by the debtor. Noting that "Enron did not possess any of the avoidance claims before it filed its bankruptcy petition," *id.* at 126, the Court in that case held:

> "A defendant in an avoidance action has the right to a jury trial unless it has waived that right. A defendant waives its right to a jury trial on an avoidance action by filing a proof of claim. But, the trustee has no right to a jury trial in an avoidance action to begin with. And the trustee has no authority to invoke the right to a jury trial on behalf of a defendant who chooses not to ask for a jury trial. And, if the trustee had a right to a jury trial, the trustee must waive that right by invoking the avoidance process because it directly addresses the property of the bankruptcy estate, the eventual amount of claims against the estate, and the distribution of the property of the bankruptcy estate, all of which involve the equitable bankruptcy process for which there is no right to a jury trial." *Id.* at 127.

Further, while the Trustee may be expected to argue that this case falls within the scope of *Granfinanciera*, the facts here differ crucially from those that animated that decision.

First, in *Granfinanciera*, the *defendant*, who was *not* a creditor and never submitted to bankruptcy jurisdiction, sought a jury trial—not the debtor. Here, in sharp contrast, the suit is brought by the Trustee against creditors who have filed claims. Therefore, *Katchen* and *Langencamp* are the more analogous precedents.

Second, it does not appear that the fraudulent conveyance suit in *Granfinanciera* was the focal point of the bankruptcy proceeding. Under such circumstances, the Supreme Court, for purposes of analyzing the Seventh Amendment right of a defendant that had not filed a claim, found that fraudulent conveyance actions "are quintessentially suits at common law that more nearly resemble state-law contract claims brought by a bankrupt corporation to augment the bankruptcy estate than they do creditors' hierarchically ordered claims to a pro rata share of the bankruptcy res," and concluded that such claims "appear matters of private rather than public right." 492 U.S. at 56 (citation omitted).

Here, it is becoming increasingly obvious that the Trustee's more than 900 avoidance actions against creditors, of which this is one, are part of a litigation campaign that is not only central to the BLMIS bankruptcy proceeding, but also *does* seek the hierarchical reordering of creditor claims. The Trustee's own words belie any contention that he is endeavoring to augment the estate by recovering assets transferred outside of the creditor body. He has repeatedly stated that his claims against customers are the

largest asset in the estate, (Trustee's Mem. in Opp'n to the Sterling Defs. Mot. to Dismiss or, in the Alternative, for Summ. J. at 1), and of the over 900 actions commenced by the Trustee, "at least 95% are directed at customers." (Mem. of Law of SIPC in Support of Trustee's Mot. for Certification of Order for Interlocutory Appeal or for Entry of Separate Final J. at 17). Through these avoidance claims the Trustee seeks "the adjustment of economic benefits and burdens and to implement a distribution scheme for the public good," and he admonishes customers that they must "socialize" their losses. (Letter from Oren J. Warshavsky to the Hon. Jed S. Rakoff (Oct. 10, 2011), *Picard v. Hein*, 11-CV-04936 (JSR), doc. no. 14.) In the Trustee's view, therefore, the litigations fall outside the scope of the Supreme Court's description of a "private" litigation. *See Granfinanciera*, 492 U.S. at 56; *Germain*, 988 F.2d at 1331-32. For this reason as well, the Seventh Amendment does not afford the Trustee the right to try his fraudulent transfer claims to a jury.

B. No Jury Trial Right Attaches to the Equitable Subordination Claims

The Trustee's equitable subordination claims, asserted under Section 510(c) of the Bankruptcy Code, plainly sound in equity rather than in law. *HBE Leasing Corp. v. Frank*, 48 F.3d 623, 634 (2d Cir. 1995) ("Equitable subordination is distinctly a power of federal bankruptcy courts, *as courts of equity*, to subordinate the claims of one creditor to those of others." (emphasis added)); *In re Lafayette Hotel P'ship*, 227 B.R. 445, 453 n.6 (S.D.N.Y. 1998) ("Section 510(c) of the Bankruptcy Code provides for the subordination of claims that are otherwise allowable when *equity principles* would be offended by allowing such claims to be on par with those of other creditors." (emphasis added)).

Consequently, the Seventh Amendment does not provide for a jury trial in connection with this claim.

II. THE TRUSTEE MUST WAIVE HIS EQUITABLE SUBORDINATION CLAIMS IF HE IS ALLOWED TO TRY HIS FRAUDULENT CONVEYANCE CLAIMS TO A JURY

Finally, even if the Trustee could claim a jury trial right as to his fraudulent transfer claims, the Trustee would be required to waive his equitable subordination claims if he chose to exercise that right.

In *Germain*, the defendant was concerned that if the trustee obtained a jury verdict on its state law causes of action, the debtor would in the future use the verdict as a basis for equitable subordination of the creditor's claims against the estate, even though the trustee had no jury trial right as to that claim. *See* 988 F.2d at 1329 n.7, 1332. The Court was hesitant to issue an advisory opinion, but assumed "that the Trustee ha[d] waived his right subsequently to seek equitable subordination of [the creditor's] claim." *Id.*; *see also In re 3DO Co.*, C-03-05023-CW, 2004 U.S. Dist. LEXIS 25367, at *8-9, 20 (N.D. Cal. Apr. 27, 2004) (reasoning that the Second Circuit's analysis in *Germain* "would have changed" had the trustee brought an equitable subordination claim and relying on *Germain* for the proposition that, where equitable claims "cannot be resolved without resolution of the legal claims, the legal claims are converted to equitable claims and lose their status as claims that should be treated to a jury").

Here, the Trustee is pursuing both avoidance and equitable subordination claims. *Germain* thus requires that if he had any jury trial right, which he does not, he would have to waive his equitable subordination claims or give up his right to a jury trial with respect to his avoidance claims.

CONCLUSION

For the reasons set forth above, Defendants respectfully request that the Court find the Seventh Amendment inapplicable to the Trustee's two remaining claims in this action.

Dated: New York, New York
October 14, 2011

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