

**UNITED STATES BANKRUPTCY COURT
DISTRICT OF MAINE**

In re: * **Chapter 11**
* **Case No. 03-20069**
NORTHEASTERN GRAPHIC SUPPLY, INC. *
*
Debtor *

NORTHEASTERN GRAPHIC SUPPLY, INC., *
* **Adversary No. 03-2097**
Plaintiff *
*
v. *
*
NET 2 PRESS, INC., d/b/a CONECO LITHO *
GRAPHICS, *
*
Defendant *

MEMORANDUM OF DECISION

Before me is the plaintiff/debtor’s motion to strike the defendant’s jury demand. It poses the question whether, in a chapter 11 debtor’s mixed core and non-core breach of contract action, the defendant’s counterclaims, seeking affirmative recovery against the debtor’s estate, operate to waive jury trial rights that would otherwise adhere. I conclude that the counterclaims do so operate.¹

Background

Northeastern Graphic Supply, Inc. (“Northeastern”), a chapter 11 debtor-in-possession, initiated suit against Net 2 Press, Inc., d/b/a Coneco Litho Graphics (“Coneco”), asserting that Coneco

¹ No disputed facts pertain. This memorandum sets forth my conclusions of law. Unless otherwise indicated, all citations to statutory sections are to the Bankruptcy Reform Act of 1978, as amended, 11 U.S.C. § 101 *et seq.*

owes it \$186,657.99 under twenty-nine unpaid pre- and post-petition invoices for goods sold.²

Coneco's answer, which includes a jury demand, asserts various defenses and a five-count counterclaim seeking affirmative recovery from Northeastern's estate of, at a minimum, \$247,000 (negligent misrepresentation, breach of contract, breach of implied covenant of good faith and fair dealing, and promissory estoppel) and \$119,000 (restraint of trade). The parties agree that, in the parlance of the Federal Rules of Civil Procedure, Coneco's array of counterclaims includes compulsory, as well as permissive, claims.³

The pretrial scheduling order noted Coneco's timely jury demand and acknowledged the non-core character of some claims.⁴ The parties have consented to this court's entry of final judgment.⁵

² Northeastern's complaint asserts unpaid pre-petition invoices totaling \$128,854.21 and unpaid post-petition invoices totaling \$57,803.78. The complaint also seeks "turnover of assets" (Count II) and "unjust enrichment" (Count III). Each is but an alternative formulation of the breach of contract alleged in Count I.

³ See Fed. R. Civ. P. 13(a) (compulsory counterclaims) & (b) (permissive counterclaims). That distinction, however, is without import for pre-petition counterclaims in the bankruptcy context. See Fed. R. Bankr. P. 7013 ("Rule 13 F. R. Civ. P. applies in adversary proceedings, except that a party sued by a trustee or debtor in possession need not state as a counterclaim any claim that the party has against the debtor, the debtor's property, or the estate, unless the claim arose after the entry of an order for relief.").

⁴ See 28 U.S.C. § 157(b); Arnold Print Works, Inc. v. Apkin (In re Arnold Print Works, Inc.), 815 F.2d 165, 166-68 (1st Cir. 1987) (Breyer, J.) (explaining concepts of core and non-core jurisdiction in the context of, inter alia, post-petition accounts receivable collections).

⁵ Absent such consent, in non-core proceedings bankruptcy judges submit proposed findings of fact and conclusions of law to the district court for de novo review. With consent, the bankruptcy judge may enter final judgment. 28 U.S.C. § 157(c).

Discussion

1. The Parties' Positions

Northeastern's position is straight-forward: by filing counterclaims seeking affirmative recovery against the bankruptcy estate, Coneco has submitted itself to the bankruptcy court's equitable jurisdiction and has waived its jury trial rights. Northeastern argues that characterizing Coneco's counterclaims as permissive or compulsory does not alter the result because in either case Coneco is seeking a piece of the "disputed res" of the bankruptcy estate.

For its part, Coneco concedes that, had it filed a proof of claim in Northeastern's bankruptcy case, it would have forgone its jury trial rights in this adversary proceeding. Coneco also concedes that if all its counterclaims were permissive, pursuing them in the adversary proceeding would be akin to filing a proof of claim and it would likewise lose its jury trial rights. Where Coneco parts company with Northeastern is at the junction of permissive and compulsory counterclaims. Coneco argues that because it did not voluntarily file the vast majority of its counterclaims, and because waiver denotes a voluntary act, it cannot be said to have waived its jury trial rights.⁶ Without such a voluntary waiver, Coneco asserts, it would be unfair to deprive it of its Seventh Amendment jury trial rights. Coneco urges that I adopt an "equitable" approach in this and similar cases, whereby if it is determined that more than half a defendant's counterclaims are compulsory, that defendant's jury trial rights must adhere.

⁶ Coneco alleges that over 90% (in dollar value) of its counterclaims are for damages incurred after Northeastern Graphics filed bankruptcy and are thus compulsory counterclaims under Fed. R. Bankr. P. 7013. See supra, note 3.

2. Distilling the Issue

The parties agree that, had Coneco not sought affirmative recovery in its counterclaims, it could proceed to trial by jury in this court.⁷ The question, then, becomes whether Coneco's demand for recovery from the estate by way of its compulsory counterclaims waives its jury trial rights or, stated differently, whether its counterclaims transform the parties' dispute into a claims dispute within the bankruptcy court's equitable jurisdiction.

3. Analysis

Claims allowance and disallowance proceedings are core matters. 28 U.S.C. § 157(b)(2)(B). Although the core/non-core distinction does not control determination of jury trial rights, Granfinanciera, S.A. v. Nordberg, 492 U.S. 33 (1989) (holding that jury rights obtain in certain core claims, *i.e.*, fraudulent conveyance actions), the Supreme Court has held that the right to a jury does not survive where a creditor has initiated the claims-allowance/disallowance process by filing a proof of claim in the

⁷ Bankruptcy judges may conduct jury trials when the right to a jury is present, the district court has designated him or her with jurisdiction to do so, and the parties consent. 28 U.S.C. § 157(e); *e.g.*, 6 William L. Norton, Jr., Norton Bankruptcy Law & Practice 2d § 143:12, at 143-17 ("Whether the jury demand arises in the context of a case filed either before or after October 11, 1994, the right to a trial by jury in a Bankruptcy Court depends on a number of factors. Most importantly, the determination depends upon whether the proceeding is core or noncore, legal or equitable, and involves public or private rights. It also depends on whether the district has designated Bankruptcy Courts to exercise such jurisdiction, and whether the parties have expressly consented to this exercise."). In this case, the district court has so designated the bankruptcy judges in this district, D. Me. Local Rule 83.6(b), and both parties have consented to my entering final judgment, leaving only for determination whether Coneco's jury trial rights endure.

The problems posed by a bankruptcy court conducting a jury trial in a non-core proceeding where the parties have not consented to its entering final judgment (and, so, its decisions are subject to *de novo* review by the district court) are self-evident. *E.g.*, Control Center, LLC v. Lauer, 288 B.R. 269, 279 n.28 (M.D. Fla. 2002) (discussing problems in such cases).

bankruptcy case. Langenkamp v. Culp, 498 U.S. 42, 44-45 (1990).

For today's purposes, the issue (upon which neither the Supreme Court or the First Circuit has yet ruled) is whether lodging compulsory counterclaims against a bankruptcy estate is tantamount to filing a proof of claim - operating to forfeit jury rights (or, put differently, transform the matter into a claims dispute) in what would otherwise be a civil action triable to a jury. The answer to this question must be guided by the principles set forth by the Supreme Court in Granfinanciera and Langenkamp.

In Granfinanciera, the chapter 11 trustee for debtor Chase & Sanborn Corporation sued to recover allegedly fraudulent transfers. The bankruptcy judge denied the defendants' request for a jury trial because he viewed fraudulent transfer actions as core matters that were, as he understood it, historically tried without a jury. Granfinanciera, 492 U.S. at 37. Both the District Court and Court of Appeals affirmed. Id. The Supreme Court granted certiorari "to decide whether petitioners were entitled to a jury trial," id. at 38, and framed the issue as "whether a person who has not submitted a claim against a bankruptcy estate has a right to a jury trial when sued by the trustee in bankruptcy to recover an allegedly fraudulent monetary transfer," id. at 36. After determining that fraudulent transfer actions for money are legal in nature, and therefore traditionally tried before a jury, the Court turned to the question whether "Congress may and has permissibly withdrawn jurisdiction . . . by courts of law and assigned it exclusively to non-Article III tribunals sitting without juries." Id. at 49.

Recognizing the limits placed on Congress by the Seventh Amendment, the Court reviewed its prior decisions and concluded that "Congress may only deny trials by jury in actions at law, . . . in cases where 'public rights' are litigated. . . . 'Wholly private tort, contract, and property cases, as well as a vast range of other cases, are not at all implicated.'" Id. at 51 (quoting Atlas Roofing Co. v.

Occupational Safety and Health Review Comm., 430 U.S. 442, 458 (1977)). In the matter before it, a fraudulent transfer action, the Court determined that such claims “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.” Id. at 56. As such, fraudulent transfer claims appeared as “matters of private rather than public right,” id., and thus the defendants were entitled to a jury trial.

Conversely, and as support for this proposition, the Court analyzed an earlier case, Katchen v. Landy, 382 U.S. 323 (1966), in which it held that a defendant who filed a claim against the bankruptcy estate had no jury trial right in a suit by the trustee to recover preferential transfers (like fraudulent transfer claims, an otherwise legal action), as a result of the “bankruptcy court’s having ‘actual or constructive possession’ of the bankruptcy estate, and its power and obligation to consider objections by the trustee in deciding whether to allow claims against the estate.” Granfinanciera, 492 U.S. at 57 (quoting Katchen, 382 U.S. at 327). In Katchen, the Court made clear that the result would have been different, i.e., the defendant would have been entitled to a trial by jury, if the defendant had not filed a claim against the estate. Katchen, 382 U.S. at 327-28; Granfinanciera, 492 U.S. at 57-58. The defendant lost his jury trial right because, by submitting a claim against the estate, he subjected himself to the bankruptcy court’s equitable power to disallow those claims. See Granfinanciera, 492 U.S. at 59 n.14.

The difference between Granfinanciera and Katchen, then, is the difference between private and public rights. Otherwise legal causes of action tried in the bankruptcy court do not lose their Seventh Amendment entitlement because they are being tried in a court of equity, but rather because

they are subsumed within a public rights legislative scheme for restructuring the debtor-creditor relationship. Granfinanciera, 492 U.S. at 55 n.10 (recognizing that Congress “may decline to provide jury trials” in cases “involving statutory rights that are integral parts of a public regulatory scheme and whose adjudication Congress has assigned to a[] . . . specialized court of equity”); e.g., Germain v. Connecticut Nat’l Bank, 988 F.2d 1323, 1329 (2nd Cir. 1993) (“An action that bears directly on the allowance of a claim is integrally related to the equitable reordering of debtor-creditor and creditor-creditor relations. If an equitable reordering cannot be accomplished without resolution of what would otherwise be a legal dispute, then that dispute becomes an essential element of the broader equitable controversy.”). What turned Katchen into a public rights case was the filing of a claim against the bankruptcy estate, an attempt by the defendant to recover a piece of the estate res. This thinking was set forth with aphoristic clarity in Langenkamp v. Culp, 498 U.S. 42 (1990) (Per Curiam).

In Langenkamp, the Court stated unequivocally that Granfinanciera and Katchen stand for the proposition that “by 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.”⁸ Langenkamp, 498 U.S. at 44 (quoting Granfinanciera, 492 U.S. at 58-59, and n.14). “In other words, the creditor’s claim and the ensuing preference action by the trustee become integral to

⁸ Langenkamp involved a preference action by a successor chapter 11 trustee of uninsured, nonbank debtors against holders of savings certificates who had redeemed some of those certificates within 90 days of the debtors’ filing. Langenkamp, 498 U.S. at 43. Some of the creditors sued by the trustee had filed claims against the estate. Id. Following a bankruptcy court bench trial, the Tenth Circuit reversed on the ground that those sued by the trustee were entitled to jury trials, whether they had filed claims against the estate or not. Id. The Supreme Court reversed with regard to those creditors that had filed claims against the estate. Id.

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." Id. at 44-45 (citation omitted).

It is within this framework that I must consider Coneco's counterclaims. As already stated, Coneco concedes that if its counterclaims in this action were all permissive, rather than compulsory, it would have no jury trial rights.⁹ Coneco has focused on the compulsory nature of its claims, and attempts to set this supposed lack of voluntariness up against a "voluntary waiver" theory of jury trial rights. Admittedly, there is much discussion in the cases regarding waiver. However, as can be seen from the discussion above, "the Katchen, Granfinanciera, and Langenkamp line of Supreme Court cases stands for the proposition that by filing a proof of claim a creditor forsakes its right to adjudicate before a jury any issue that bears directly on the allowance of that claim - and does so not so much on a theory of waiver as on the theory that the legal issue has been converted to an issue of equity." Germain, 988 F.2d at 1329; see also Murray v. Richmond Steel & Welding Co. (In re Hudson), 170 B.R. 868, 875 (E.D.N.C. 1994) (defendant in breach of contract action brought by trustee lost right to jury trial by "filing a [compulsory] counterclaim and thereby seeking a piece of the disputed res"); Schwinn Plan Comm. v. AFS Cycle & Co. (In re Schwinn Bicycle Co.), 184 B.R. 945, 952-53 (Bankr. N.D. Ill. 1995) (defendant lost jury trial right by filing counterclaim, seeking "to share in assets of the estate available for distribution").¹⁰ Properly viewed, then, it is clear that in this contest there is

⁹ Indeed, by force of its argument, Coneco appears to concede that if more than half its counterclaims were permissive it would not be entitled to a jury trial.

¹⁰ The view that accepts the teachings of Granfinanciera and Langenkamp as applying to counterclaims because of their functional equivalence to the claims-allowance process has come to be known as the "conversion" theory (as opposed to the "waiver" theory), and has been adopted by an "overwhelming majority of courts." Control Center, LLC v. Lauer, 288 B.R. 269, 281 (M.D. Fla. 2002).

no viable distinction between permissive and compulsory counterclaims. That is because the focus is not, as Coneco would wish, on its choice whether to file a counterclaim, but rather on the disputed estate res and Coneco's claim for a piece of it.

In re Hudson, cited above, is illustrative. In Hudson, the trustee filed a breach of contract action against the defendant for money owed. In re Hudson, 170 B.R. at 870. The Defendant filed an answer and counterclaim, admitting that the debtor had performed part of the work called for by the parties' contract, but alleging damages as a result of debtor's failure to complete the work. Id. The district court, in granting the trustee's motion to refer the case to the bankruptcy court for a non-jury trial, held that the defendant's counterclaim qualified as a "claim" against the bankruptcy estate. Id. at 874 ("Filing the counterclaim qualified as filing a claim which triggered the non-jury, public rights process of the allowance and disallowance of claims in bankruptcy."); see also Roberds, Inc. v. Palliser Furniture, 291 B.R. 102, 108 (S.D. Ohio 2003) (following "majority of courts to address the issue," defendant's filing of a counterclaim in suit brought by debtor resulted in loss of jury trial rights); Leshin v. Welt (In re Warmus), 276 B.R. 688, 693-94 (S.D. Fla. 2002) (compulsory counterclaim seeking damages from bankruptcy estate akin to proof of claim and results in loss of jury trial rights); Rushton v. Philadelphia Forest Prods., Inc. (In re Americana Expressways, Inc.), 161 B.R. 707, 712-13 (D. Utah 1993) (defendant lost jury trial right by lodging "defense" that was more in nature of claim for affirmative relief against debtor); Allied Companies, Inc. v. Holly Farms Foods, Inc. (In re Allied Companies, Inc.), 137 B.R. 919 (S.D. Ind. 1991) (counterclaim for reclamation or priority claim implicates claims-allowance process and therefore results in loss of jury trial rights of defendant). The district court concluded its analysis by dismissing defendant's argument that the compulsory nature of

its counterclaim should lead to a different result:

In short, the defendant did not lose its right to a jury trial by filing a counterclaim and thereby waiving the right. Instead, the defendant lost its right to a jury trial by filing a counterclaim and thereby seeking a piece of the disputed res, the debtors' estate, which was subject to the bankruptcy court's equitable power to allow and disallow claims. Regardless of whether the counterclaim was permissive or compulsory, it represented the defendant's attempt to obtain a portion of the debtors' estate. As a result, it was a claim against the estate, and it triggered the non-jury, public rights process of allowing and disallowing claims in the bankruptcy court.

In re Hudson, 170 B.R. at 875; see also Segal v. California Energy Dev. Corp., 167 B.R. 667, 672

(D. Utah 1994) (defendant that filed compulsory counterclaims in response to trustee's breach of contract action gave up jury trial rights it might otherwise have had). As in Hudson, Coneco's response to the debtor's breach of contract action includes a claim for a piece of the estate res. I need not conduct a separate "claim" analysis of Coneco's counterclaims (i.e., whether Coneco's counterclaims actually implicate the claims-allowance process), because Coneco has admitted that its counterclaims seek recovery from the estate.¹¹ Defendant's Supplemental Memorandum in Opposition to [Plaintiff's] Motion to Strike Jury Demand, at 2 ("Nor does [Coneco] contest that were all of its claims voluntary, their filing as a counterclaim would be analogous to the filing of a proof of claim"). As a result, I find that Coneco's counterclaims, whether permissive or compulsory, implicate this court's claims-allowance function and transform the parties' dispute into an equitable one triable without a jury.

¹¹ Although necessary, a claim against an estate may not be sufficient to result in a loss of jury trial rights. See e.g., Germain, 988 F.2d at 1331 (recognizing that in order for a claim against the estate to result in a loss of jury trial rights, the claim must be "inextricably intertwined with a public right; the 'involvement' may not be casual or vague").

Conclusion

Northeastern's motion to strike Coneco's jury demand will be GRANTED. A separate order will issue forthwith.

December 2, 2003

/s/ James B. Haines, Jr.
U.S. Bankruptcy Judge