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## Litigator's Perspective

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### Jury Waivers in Pre-Petition Documents as Binding on a Trustee in Avoidance Actions



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Courts and commentators have discussed several powerful issues in recent years related to whether a jury trial is available in an avoidable transfer action filed by a bankruptcy trustee or debtor in possession during a bankruptcy case. This article is limited to one such issue: whether jury waivers in pre-petition documents bind a trustee in avoidance actions. This issue arises because a trustee sometimes requests a jury trial in a chapter 5 avoidance action, such as an action based on 11 U.S.C. §§ 544 or 548. Defendants in such cases should be cognizant of pre-petition contractual jury waivers that may bind the trustee.

#### Two Rulings Upholding Jury Waivers Against a Trustee Bringing an Avoidance Action

It is well settled that a trustee stands in the shoes of the debtor and succeeds to all the assets of the bankruptcy estate.<sup>1</sup> Thus, it stands to reason that an appropriately granted pre-petition jury waiver would be enforceable against a trustee, as it concerns actions by the trustee for suits on a defendant's pre-petition contract breach or a defendant's post-petition breach of a pre-petition contract. The more difficult issue is our topic: whether the contractual waiver extends to avoidance actions.

In *Adelphia Recovery Trust v. Bank of Am. NA*,<sup>2</sup> several pre-petition loan documents governed the relationship between the debtor and the bank defendants. The loan documents contained provisions generally stating that the "administrative agent, each lender, each issuing lender and each borrower here-

by knowingly, voluntarily, and intentionally waive to the fullest extent permitted by law any right they may have to a trial by jury in respect to any litigation based hereon."<sup>3</sup> A bankruptcy ensued. A confirmed chapter 11 plan provided for a new trust and empowered it to bring avoidance actions. In an adversary proceeding against the bank defendants, the trust requested a jury trial. The district court held that the loan document jury waivers were binding on the trust to the extent that they would have been binding on the debtor.<sup>4</sup> Thus, the district court disallowed a jury on many (although not all) of the causes of action that were pleaded.

Among the causes of action for which the *Adelphia* court disallowed a jury trial were causes of action seeking avoidance and recovery of supposed intentionally and constructively fraudulent transfers "to the extent [that the plaintiff] is pursuing the claims in the shoes of the Obligor Debtors."<sup>5</sup> Many plaintiffs in a fraudulent transfer action are debtors in possession, bankruptcy trustees or their successors in the form of liquidating trusts suing a defendant creditor (*i.e.*, one signatory to a pre-petition loan or credit agreement) on behalf of the estate of an obligor (*i.e.*, another signatory to the same loan or credit agreement). Thus, this disallowance has powerful significance for bankruptcy practitioners.

At least one other court has applied a pre-petition jury waiver to Bankruptcy Code-created avoidance actions, not just pre-petition causes of action

<sup>3</sup> *Id.* at 19.

<sup>4</sup> *Id.* at 25.

<sup>5</sup> *Adelphia Recovery*, *supra*, at \*52-53. The *Adelphia* court rejected applicability of the jury waivers for causes of action in which the trust sought to recover on behalf of a related company (referred to as "ACC"). According to the *Adelphia* court, because ACC was not a signatory to the loan documents that included the jury waivers, the trust when suing on behalf of ACC was not bound by the waivers. *Id.* at 32-36. Nor could estoppel lead to enforcement of the jury waivers, because the defendants had shown no direct benefit to ACC from the loans made via the loan documents. *Id.* at 38-39.

<sup>1</sup> See *Stumpf v. Albrecht*, 982 F.2d 275, 277 (8th Cir. 1992).  
<sup>2</sup> 2009 U.S. Dist. LEXIS 63375 (Dist. S.D.N.Y. July 8, 2009).

inherited by the trustee. In *Kapila v. Bank of Am. NA (In re Pearlman)*,<sup>6</sup> the trustee made a jury demand in a fraudulent transfer case. The fraudulent transfer stemmed from transfers that the debtor made to bank creditors under the applicable loan documents, which contained jury waivers. The trustee argued that the jury waivers were not binding on him because he was asserting a fraudulent transfer claim, not a disagreement arising under the loan documents. The court rejected the trustee's argument and determined that the trustee could not choose to avoid being bound by the loan documents' jury-waiver provision, while asking the court to consider the loan documents' repayment terms as a basis for the fraudulent transfer claim.<sup>7</sup> In *Kapila*, the court went so far as to say that

the Trustee is never entitled to a jury trial in an avoidance action. Although a right to jury trial is held inviolate in many circumstances, a trustee loses this 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."<sup>8</sup>

This conclusion is broader than determinations of some other courts.

### **Kapila's Rejection of *Picard v. Katz***

Some other courts have been hesitant to limit a trustee's right to a jury trial. The trustee in *Kapila* argued that like other litigants, bankruptcy trustees have rights under the Seventh Amendment and promoted the analysis from *Picard v. Katz*.<sup>9</sup> Bankruptcy practitioners analyzing jury waivers in avoidance-action contexts do well to be alert to *Picard*, arising from the well-known *Madoff* insolvencies and, like *Adelphia*, being decided by a U.S. District Court. The *Kapila* trustee cited such concepts as "[t]he Seventh Amendment protects a litigant's right to a jury trial only if a cause is legal in nature and it involves a matter of 'private right.'"<sup>10</sup> Further, the trustee cited to pronouncements such as "[t]he [U.S.] Supreme Court has already found that actions to avoid fraudulent transfers are legal and assert private rights."<sup>11</sup>

However, defendants seeking to defeat a trustee's jury trial assertion have arguments against *Picard*, including the fact that *Picard* does not discuss jury trial waivers in pre-petition documents, if any. It is possible that no one presented an anti-trustee argument based on any jury trial waiver in pre-petition loan documents. Another way to seek to limit *Picard* is by noting that in that particular case, the judge justified his decision on the grounds that the court had granted the defendants' motion to withdraw the reference of the adjudication of the fraudulent transfer proceeding.<sup>12</sup> The court felt that this "substantially sever[ed]" the trustee's fraudulent transfer action from both "the claims-allowance process and the hierarchical reordering

of creditors' claims."<sup>13</sup> Thus, *Picard* is distinguishable from cases pending in bankruptcy court (*i.e.*, ones that have not been removed to the district court) because cases pending in bankruptcy court are arguably more closely part of the claims-allowance process.<sup>14</sup> In addition, the *Kapila* court expressly rejected *Picard* as unpersuasive.<sup>15</sup>

### **Debating the Application of Jury Waivers in Avoidance Actions**

What briefing options exist for a bankruptcy trustee who desires a jury trial in a chapter 5 avoidance action and faces a defense motion to strike a jury demand based on *Kapila*? One briefing option is to note that the *Kapila* court felt that a trustee stands in the shoes of a debtor, not a pre-petition creditor.<sup>16</sup> *Kapila* involved both state law (Uniform Fraudulent Transfer Act (UFTA)) and 11 U.S.C. § 548 fraudulent transfer causes of action. In commenting that the trustee has the exclusive right under the Bankruptcy Code to bring both causes of action, the *Kapila* court arguably did not discuss in detail whether the creditor-plaintiff orientation of UFTA causes of action should impact whether a pre-petition jury waiver signed by the debtor binds the trustee. However, the briefing before *Kapila* noted that the federal overlay remains strong as to UFTA causes of action once a bankruptcy case has been filed. Among the cases cited in the briefing was a decision in another adversary proceeding in the same bankruptcy case, *Kapila v. Bennett* (hereinafter, "*Bennett*"). Although not involving a contractual jury waiver, *Bennett* highlighted some unique bankruptcy-imparted aspects governing UFTA causes of action once a bankruptcy case has been filed. The bankruptcy establishes the trustee as the exclusive plaintiff for federal and state law fraudulent transfer claims,<sup>17</sup> which relates to and eliminates interference with "the equitable distribution scheme dependent upon it."<sup>18</sup>

A second briefing option is to note that the cases the *Kapila* court cited on this proposition do not expressly describe any UFTA or other state law fraudulent transfer claim. For instance, *In re Halabi*<sup>19</sup> dealt with a strong-arm cause of action due to an unrecorded assignment of a mortgage, and *In re S. Indus. Mech. Corp.*<sup>20</sup> dealt with a turnover complaint.

Although trustees could also review *In re Palm Beach Finance Partners LP*,<sup>21</sup> which distinguishes and to some extent criticizes *Kapila*, this third briefing option is not powerful for the issue at hand. Contractual jury trial waivers were not a basis for *In re Palm Beach Finance Partners*, unlike the *Kapila* decision.<sup>22</sup> Moreover, the *Palm Beach Finance Partners* court arguably speculated when it posited that one value that the *Kapila* court sought to promote was reciprocity. According to *Palm Beach Finance Partners*, a creditor defendant in a chapter 5 avoidance action, having filed a proof of claim, would not be entitled to a jury trial and thus, denying a jury trial to the trustee plaintiff arguably would

6 493 B.R. 878 (Bankr. M.D. Fla. 2013).

7 *Id.* at 884-85.

8 *Id.* at 888.

9 825 F. Supp. 2d 484, 485-86 (S.D.N.Y. 2011) (finding that trustee had right to jury trial on fraudulent transfer claim).

10 *Id.* at 486 (citing *Granfinanciera v. Nordberg*, 492 U.S. 33 (1989)).

11 *Id.* (citing *Granfinanciera*).

12 *Id.*

13 *Id.* at 486-87.

14 See *U.S. Bank v. Verizon Commc'ns Inc.*, 2012 U.S. Dist. LEXIS 39051 (N.D. Cal. March 21, 2012) (rejecting *Picard*).

15 *Kapila*, 493 B.R. at 889.

16 *Id.* at 878, 884-85.

17 472 B.R. 115 (Bankr. M.D. Fla. 2012).

18 *Id.* at 121-22 (quoting *In re Zwirn*, 363 B.R. 536, 541 (Bankr. S.D. Fla. 2007)).

19 184 F.3d 1335, 1337 (11th Cir. 1999).

20 266 B.R. 827 (W.D. Tenn. 2001).

21 501 B.R. 792, 802-03 (Bankr. S.D. Fla. 2013).

22 501 B.R. 792, 802-04.

promote fairness and reciprocity.<sup>23</sup> The same judge who ruled in *Kapila* also ruled in a companion case, although not publicly reported, known as *Kapila v. Boundary Waters Bank, et al.*<sup>24</sup> In that case, the author represented three defendants, none of whom had filed a proof of claim. The court noted the lack of a proof of claim but denied the trustee a jury trial, based on any extent to which pre-petition loan documents waived a jury and also “because the Trustee’s avoidance action invoke[d] the public rights doctrine and affect[ed] the equitable distribution of claims.”<sup>25</sup>

A fourth briefing option is to uplift legal authorities for construing jury waivers narrowly.<sup>26</sup> The *Kapila* trustee used such authorities as part of a vigorous argument against the application of the contractual jury waivers. However, important federal policies related to the handling of the bankruptcy estate and claims process, considered to be equitable rather than legal in nature, undergirded the *Kapila* decision.<sup>27</sup> In addition, a narrow construction of course does not necessarily exclude clawback causes of action from contractual jury waivers, depending on the wording of the contract.

## Conclusion

The *Kapila v. Bank of America* decision is important for those considering the prospect of or enmeshed in a chapter 5 avoidance action involving pre-petition contractual jury waivers. Considering *Kapila* itself and its companion cases, the decision followed hundreds of pages of briefings and contains extensive reasoning of high interest to leading-edge advocates in avoidance actions. As to how many courts will follow *Kapila* on this issue, the jury is still out. **abi**

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<sup>23</sup> *Id.*

<sup>24</sup> Adv. No. 6:09-ap-00534-KSJ, *slip op.* (Bankr. M.D. Fla. July 16, 2013).

<sup>25</sup> *Id.* at 1.

<sup>26</sup> See, e.g., *Adelphia Recovery Trust v. Bank of Am. NA*, 2009 U.S. Dist. LEXIS 63375; *Morgan Guar. Trust Co. v. Crane*, 36 F. Supp. 2d 602 (S.D.N.Y. 1999).

<sup>27</sup> *Kapila v. Bank of Am. NA*, 493 B.R. at 878, 885-86.