SO ORDERED.

SIGNED this 03 day of March, 2006.

Dale L. Somers
Dale L. Somers
UNITED STATES BANKRUPTCY JUDGE

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF KANSAS

In Re: **III, Inc.,** **DEBTOR.**	**CASE NO. 03-22200-7** **CHAPTER 7**
STEVEN R. REBEIN, **PLAINTIFF,** **v.** **KEN KOST,** **MICHAEL ADKINS, and** **ROB PETERSON,** **DEFENDANTS.**	**ADV. NO. 05-6077**

RECOMMENDATION TO THE DISTRICT COURT TO GRANT

THE DEFENDANTS' MOTION TO WITHDRAW THE REFERENCE

OF THIS ADVERSARY PROCEEDING

Related motions filed in the main bankruptcy case and the adversary proceeding shown in the caption above are before the Court for consideration. In the main case, Kenneth Kost and Michael Adkins have filed a motion to withdraw the proofs of claim they filed in the III, Inc., case. In the adversary proceeding, Kost, Adkins, and their co-defendant Rob Peterson have filed a motion to withdraw the District Court's reference of the proceeding to this Court. Steven R. Rebein ("Trustee") is the Chapter 7 trustee of III's bankruptcy estate, and the plaintiff in the adversary proceeding. He appears by counsel Thomas M. Franklin. Kost, Adkins, and Peterson (collectively "Defendants") all appear by counsel Paul D. Sinclair and Margaret G. Hague.

Both the motion to withdraw proofs of claim and the motion to withdraw reference are based on the Defendants' asserted right to jury trial. Federal Rule of Bankruptcy Procedure 5011(a) provides that a motion for withdrawal of reference is to be heard by a district judge, but District of Kansas Local Rule 83.8.6(f) directs this Court to make a written recommendation that is to be transmitted to the District Court along with the motion. Consequently, the Court is issuing this document to satisfy the local rule's requirement.

After considering the circumstances surrounding the motions, the Court concludes the Defendants technically waived any jury trial rights they had in the adversary proceeding by failing to make a complete demand for a jury trial within the time allowed. However, the District Court has discretion to relieve the Defendants from that waiver, and this appears to be a situation where that Court should do so. If the District Court agrees

the waiver should be excused, the difficult question of the extent of the Defendants' jury trial rights must be addressed.

The Court concludes that five of the seven counts of the Trustee's complaint carry a right to jury trial. Because Defendant Peterson did not take any action that might have waived his jury trial right, he will definitely be entitled to a jury trial on those five counts, so long as his slight delay in asserting that right is excused. By filing proofs of claim in III's bankruptcy case, defendants Kost and Adkins waived their right to a jury trial on three of the counts. Having waived the jury trial right on those counts, Kost and Adkins cannot now revive that right by withdrawing the proofs of claim. The District Court would be free, however, to exercise its discretion to excuse the waiver and probably should do so under the circumstances.

Ultimately, the Court recommends that the District Court excuse the slight tardiness of the Defendants' demand for a jury trial, excuse Kost and Adkins from the jury trial waiver caused by their proofs of claim, and order that a jury trial be held on all five counts against all three Defendants that carry a right to jury trial. Because allowing Kost and Adkins to withdraw their proofs of claim now would have no affect on their jury trial right, their motion to withdraw the claims should be denied.

FACTS

The Defendants are asserting a right to a jury trial on the claims the Trustee is making against them in the adversary proceeding, relying on the right preserved by the Seventh Amendment to the U.S. Constitution. Whether the Defendants have a jury trial

right under that Amendment depends on: (1) whether they timely asserted the right, and (2) whether the Trustee is asserting legal rights, rather than equitable ones, and is seeking legal remedies, rather than equitable ones.[1] For the most part, only the allegations contained in the Trustee's amended complaint (filed before the Defendants were served with process), whether they are in fact true or not, are relevant to a determination of the Defendants' right to a jury trial. A summary of those allegations, supplemented with information from Debtor III's bankruptcy schedules and the proofs of claim filed by Kost and Adkins, follows.

A. Background facts alleged in complaint

Before April 2002, Sokkia Corporation owned and operated nine stores involved in selling survey instruments at retail, apparently under the name "Fieldworks," and employed the Defendants to run its Fieldworks stores. During its 2001 fiscal year, Sokkia suffered substantial losses, and sales at the Fieldworks stores declined about 8% from the previous year.

In February 2002, the Defendants at least nominally formed a corporation called III, Inc.; they were its incorporators, original shareholders, directors, and officers. The three men were aware of Fieldworks' 2001 sales decline and that it had not been operating profitably. Sokkia also told them that earlier revenue projections had been too optimistic.

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[1]*See Granfinanciera v. Nordberg*, 492 U.S. 33, 41-42 (1989).

In April 2002, III bought the Fieldworks stores from Sokkia. The same attorney represented both III and Sokkia in this transaction. Sokkia provided financing for the purchase, giving III a $300,000 loan, and the right to use up to $1.5 million of the proceeds of Sokkia's receivables. The Defendants did no budgeting or financial forecasting to determine whether the Fieldworks stores would be profitable when separated from Sokkia's other operations, they did not intend to put any of their own money or property into III because it would not be a wise investment, and none of them had any independent resources to fund III's operations. They did not understand the legal consequences of failing to provide III with adequate capital, and decided not to seek advice about the legal implications of incorporating and operating III. Three million dollars would not have been enough working capital to operate the Fieldworks stores. The men knew that III would not have enough money to pay for startup capitalization and organization costs except through loans from Sokkia, and knew that Sokkia had neither the working capital nor the inclination to fund any losses III would suffer while operating the stores.

III had no ability to borrow money to buy the Fieldworks stores or to obtain operating capital from traditional lending sources, and had no prospects for obtaining the necessary financing except from Sokkia. Acting through the Defendants, III promised: (1) to give Sokkia a security interest in all its operating assets; (2) to report to Sokkia any matters affecting the value, enforceability, or collectibility of its collateral; (3) not to sell, transfer, or assign any of the collateral outside the ordinary course of its business without

Sokkia's consent; (4) not to make loans to its officers; (5) to hold all collections on the collateral in trust for Sokkia; and (6) not to make any oral or written misrepresentations to Sokkia in order to obtain credit or an extension of credit. After III bought the Fieldworks stores, it lost over $78,000 on revenues of about $3.076 million for the second quarter of 2002, and then lost over $334,000 on revenues of about $2.949 million for the third quarter. September and October 2002 were III's worst months ever for sales. By October, III's revenues were "$3 million below projections" (the complaint does not specify whose projections these were or when they were made). The projections apparently covered the months from III's purchase of the stores to October.

In September 2002, III bought over $440,000 of new inventory from Leica Geosystems, using cash it was holding as Sokkia's agent. The Defendants had III buy this inventory despite knowing, or with reckless indifference to whether, the purchase either made III insolvent or exacerbated its insolvency. About the same time, each of the men drew about $20,000 out of III that they depicted as loans, although they completed no documentation for them and have refused to pay interest or principal. Throughout 2002 and 2003, one or more of the men charged personal expenses to III's credit cards, and the corporation paid the charges.

In the first week of November 2002, apparently referred or accompanied by the attorney who had helped III and Sokkia with the purchase and sale of the Fieldworks

stores ("Transaction Attorney"), Kost and Adkins, and perhaps Peterson,[2] met with a bankruptcy attorney to discuss III's financial condition. Someone told the bankruptcy attorney that III had been "set up with no capital and was undercapitalized." That attorney told the Defendants that Sokkia's lien rights in III's assets might be vulnerable to attack if III filed for bankruptcy and Sokkia had not previously perfected its lien rights. Intending to conceal from Sokkia the possibly unperfected status of its liens, the three men agreed with the Transaction Attorney not to tell Sokkia about the meeting with the bankruptcy attorney. Then, from November through February 2003, intending to persuade Sokkia not to declare III in default on the sale agreement so they could help themselves by creating plans to get out of III, Kost and Adkins worked to conceal from Sokkia the potential vulnerability of its liens on III's assets.[3] At some point, still allegedly hiding the problems with Sokkia's liens, but obviously revealing that III was considering filing for bankruptcy, they even sent Sokkia a bankruptcy reorganization plan that would treat it as a secured creditor.

During the nine months in 2002 that III operated the Fieldworks stores, the company had revenues of $9.729 million but an operating loss of over $1.285 million. By January 2003, each month was increasing the operating losses and trade creditor

[2]The complaint first says that only Kost and Adkins met with the bankruptcy attorney, and implies the attorney gave advice only at that meeting. However, it alleges the bankruptcy attorney advised not only those two but also Peterson, without explaining how the advice was communicated to him.

[3]The complaint does not allege that Peterson participated in this activity.

obligations. III's operating expenses were averaging about $502,000 per month.

Realizing that Sokkia would not be likely to tolerate III's ongoing losses much longer, Kost and Adkins began to take steps to remove cash and property from III, intending to leave III's creditors unpaid. They formed "The Leitz Corporation," planning to transfer III's assets to it and continue business without paying III's creditors. They asked Sokkia to pay them over $500,000 for their stock in III, and refused to give III any of their own money to cover its ongoing losses. In January 2003, they "announced" that they had decided to remove Peterson as a "partner" in III; the Trustee does not indicate to whom this action was announced, but presumably, they would have told at least Sokkia and Peterson. This action violated III's bylaws and was done "without any intent to recognize Peterson as a shareholder under corporate law."

Certain facts disclosed by the court file in III's main bankruptcy case, but not included in the Trustee's complaint, help place the current dispute in context. III (with a d/b/a of "FieldWorks") filed a Chapter 11 bankruptcy petition on May 28, 2003. It quickly sought permission to use cash collateral, but Sokkia opposed the request and also obtained an *ex parte* order prohibiting the use of its cash collateral. At a hearing just two months after III filed its bankruptcy petition, on July 28, Judge John T. Flannagan[4] denied III's motion. The Debtor converted the case to Chapter 7 the next day, presumably because it could not reorganize without using Sokkia's cash collateral.

[4]Judge Flannagan has since retired, and III's case and related adversary proceedings have been assigned to this judge.

After alleging in his complaint the facts summarized above, the Trustee asks for relief in seven counts.

B. Causes of action asserted in complaint

The Trustee labeled Count 1 of his complaint "Declaration of Personal Liability for Corporate Obligations." In it, he contends the actions of the Defendants, especially forming and running III with grossly inadequate capitalization, failing to operate III as a true corporation, and using III to further their personal interests ahead of those of the corporation, are grounds for declaring: (1) III's stock was not lawfully issued and its issuance should be voided; (2) the Defendants will be treated as proprietors of III, rather than shareholders, who used III to create the appearance of a corporation in order to serve their own personal interests; and (3) the three men will be personally liable for all unpaid debts incurred in III's name. The Trustee alleges the lack of adequate capitalization violated K.S.A. 17-6402 & -6404.

The Trustee labeled Count 2 "Breach of Fiduciary Duties." In it, he contends the Defendants' actions breached fiduciary duties they owed to III, including duties not to engage, without adequate financial planning, in transactions that would render III insolvent, and not to continue III's operations once it became clear they would cause deepening insolvency. He asks in this count for damages and for disgorgement of all salaries and payments to the men.

The Trustee labeled Count 3 "Intentional Interference with Lending Contract." In it, he claims that in addition to the previously described actions of all three men, Kost and

Adkins intentionally caused III to breach the sale agreement between it and Sokkia by (1) making the loans to III's shareholders, (2) concealing from Sokkia their consultation with the bankruptcy attorney, and the Transaction Attorney's failure to perfect Sokkia's liens on III's assets, and (3) spending the proceeds of Sokkia's receivables without hope of recovery. He adds that Kost and Adkins took these actions with the intent to deceive Sokkia and to "hinder, delay, and defeat" it as III's creditor. The Trustee asks to recover the damages the estate suffered as a result of these actions, including III's increased trade payables, the costs of its Chapter 11 case, and increased costs of liquidating its estate after December 1, 2002. Although the specific allegations in this count describe actions only Kost and Adkins took, the Trustee wants these damages from all three men.

The Trustee labeled Count 4 "Claim for Repayment of 'Loans.'" In it, he seeks to recover the loans of $20,000 made to each of the Defendants, including prejudgment interest and attorney fees. It is not clear, but he is probably also trying to recover the amount of personal expenses one or more of the men allegedly charged on III's credit cards that the company paid for. In Count 5, labeled "Turnover 11 U.S.C. § 542," the Trustee asks for turnover, under § 542 of the Bankruptcy Code, of the $20,000 loans and probably the credit card charges.

In Count 6, which he labeled "Objection to Proofs of Claim," the Trustee objects to the proofs of claim filed by each of the three men (although only Kost and Adkins in fact filed proofs of claim), contending the actions described in the complaint are grounds to either deny or subordinate the claims.

In Count 7, which he labeled "Fraudulent Conveyance," the Trustee claims that by charging personal expenses on III's credit cards, for which III later paid, the Defendants caused transfers of III's property in exchange for "no reasonably equivalent value." He seeks to avoid these transfers as fraudulent conveyances, and recover them from the men.

C. Proofs of claim

As indicated, only Kost and Adkins filed proofs of claim. In his, Kost claimed III owes him a general unsecured debt of $15,781.25 for prepetition vacation, a priority debt of $7,159.64 for prepetition vacation and salary, and a Chapter 11 administrative expense of $1,596.15 for vacation. In his proof of claim, Adkins said III owes him a general unsecured debt of $17,043.75 for prepetition vacation, a priority debt of $6,334.96 for vacation and salary, and a Chapter 11 administrative expense of $1,995.32 for vacation. Presumably, by "vacation," they both mean they had earned paid vacation leave in those amounts but had not used it by the time they filed the proofs of claim.

D. Procedural matters

The summons which the Trustee timely served on each of the three Defendants was issued on May 31, 2005. The Trustee filed his amended complaint on June 1, and mailed a summons and complaint to each man on June 2. The Defendants therefore had until June 30 to file an answer or responsive motion.[5] Although they did not ask for an extension of time, the Defendants did not respond to the amended complaint until July 18,

[5]*See* Fed. R. Bankr. P. 7012(a) (if complaint is duly served, answer is due 30 days after issuance of summons, unless court prescribes different time); Fed. R. Bankr. P. 7004(e) (if service is by mail, summons and complaint must be deposited in mail within 10 days after summons is issued).

when they served and filed their joint answer, in which they demanded a jury trial "on all issues so triable."[6] Fourteen days later, on August 2, they filed their motion asking the District Court to withdraw the reference of the adversary proceeding from this Court. Despite the Defendants' delay in filing their joint answer and their motion to withdraw reference, the Trustee has not complained that either pleading was not timely filed.[7]

DISCUSSION

I. The Timeliness of the Defendants' Demand for a Jury Trial

A. Although the right to a jury trial in civil cases is a constitutional right, it can be waived with surprising ease.

As relevant here, the Seventh Amendment to the Constitution provides: "In Suits at common law, . . . the right of trial by jury shall be preserved."[8] Federal Rule of Civil Procedure 38(a), made applicable by Bankruptcy Rule 9015(a), provides that this jury trial right "shall be preserved to the parties [in a civil case] inviolate." Despite this seemingly strong protection, the right to a jury trial can be waived by failing to make a timely demand "even though it was inadvertent and unintended and regardless of the explanation or excuse."[9] Subsection (b) of Civil Rule 38 provides that a demand for a

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[6]The joint answer stated it was filed in response to the amended complaint and only one summons was ever issued for each Defendant, so it is clear the Trustee never served the original complaint but only the amended one.

[7]The Court assumes the attorneys might have informally agreed to extend the answer time, leading the Trustee to ignore the delays.

[8]U.S. Const. amend. VII, *reprinted in* U.S.C.A., U.S. Const. Ann. amend. 7-14 (West 1987).

[9]9 Wright & Miller, *Fed. Prac. & Pro.: Civil 2d*, § 2321 at 166 (1995).

jury trial on any issue for which a right to a jury trial exists may be made at any time after an action is commenced but "not later than 10 days after the service of the last pleading directed to such issue," and subsection (d) adds that the "failure of a party to serve and file a demand as required by this rule constitutes a waiver by the party of trial by jury." So unless the Defendants' jury demand was timely, they have waived any right they may have had to a jury determination on any of the issues raised by the Trustee's complaint. As explained below, the Court concludes that the Defendants' jury demand was untimely, but recommends that the District Court excuse the resulting waiver of their jury trial right under the circumstances.

B. The Defendants waived their jury trial right by failing to make a complete jury demand within the time fixed by Civil Rule 38(b).

A consideration of Tenth Circuit case law about jury trial demands in bankruptcy proceedings exposes a flaw in the Defendants' demand that renders it untimely. In 1990, in *Kaiser Steel Corporation v. Frates (In re Kaiser Steel Corp.)*,[10] the Tenth Circuit ruled that when Congress revised the bankruptcy jurisdiction scheme in the Bankruptcy Amendments and Federal Judgeships Act of 1984, it did not authorize bankruptcy judges to conduct jury trials. A few months later, in *Stainer v. Latimer (In re Latimer)*,[11]

[10]911 F.2d 380, 389-92 (10th Cir. 1990), *overruled in part on other grounds in Connecticut National Bank v. Germain*, 503 U.S. 249 (1992). The Supreme Court overruled a part of *Kaiser* concerning appellate jurisdiction under 28 U.S.C.A. § 1292, not the part about bankruptcy judges' lack of authority to conduct jury trials.

[11]918 F.2d 136, 137 (10th Cir. 1990) (*per curiam*).

building on *Kaiser*, the Circuit held that parties who want a jury trial in proceedings brought in a bankruptcy court "must combine their request for a jury trial with a request for transfer to the district court," or be deemed to have waived the right to jury trial. In effect, this ruling means a demand for a jury trial in a bankruptcy proceeding is not complete until the party making the demand not only asks for a jury trial, but also does whatever might be necessary to bring the proceeding before a court that can conduct the jury trial the party wants. Because the defendants in *Latimer* had apparently never asked for the proceeding to be transferred to the district court, the Circuit did not explain whether the "combined" requests had to be made literally simultaneously, or could be made at different times but still constitute a timely demand for a jury trial.

In 1994, Congress amended 28 U.S.C.A. § 157 to add subsection (e), authorizing bankruptcy judges to conduct jury trials "if specially designated to exercise such jurisdiction by the district court and with the express consent of all the parties." Since 1995, the District Court for the District of Kansas has authorized the District's bankruptcy judges to conduct jury trials when the parties have consented in writing to that procedure.[12] With these changes, part of the basis of the *Kaiser* decision is gone, and this Court can conduct some jury trials. But because *Latimer* declared that a timely demand for a jury trial in a bankruptcy proceeding has two parts — (1) asking for a jury trial and (2) taking action necessary to bring the proceeding before a judge who can conduct the

[12]*See* D.Kan. Local R. 83.8.13(b) (amended Feb. 10, 1995).

jury trial — and this Court still cannot conduct a jury trial without the parties' consent, it seems likely the Tenth Circuit will continue to follow *Latimer* and hold that an effective demand for a jury trial in a bankruptcy proceeding consists of two parts. For a party who wants to have a jury trial conducted by the district court, the two parts would be the same as those required by *Latimer*, a combined demand for jury trial and a motion to withdraw reference. For a party who wants to have a jury trial conducted by the bankruptcy court, the two parts would be a combined demand for jury trial and a written consent to trial before the bankruptcy court.[13] In either situation, the failure to complete both parts in the time allowed would be deemed to be a waiver of the jury trial.

Taking this view of *Latimer* does leave the question whether the two parts of a jury trial demand must be completed at the same time, or can be done separately so long as both are completed within applicable time limits. There seems to be no reason to conclude a party seeking a jury trial can waive the right to one before the time for making a demand for one has passed, just because the party completes one of the two requirements before doing the other. Because the two parts together constitute a complete jury trial demand, the time limit that should apply is the one found in Civil Rule 38(b) for making such a demand: "10 days after the service of the last pleading directed to" any issue triable of right by a jury. Civil Rule 7(a), made applicable by Bankruptcy Rule 7007, specifies what filings are considered to be "pleadings" under the Rules, and adds,

[13]Although all the parties must expressly consent before a bankruptcy judge can conduct a jury trial, the party seeking a jury trial should not be required to obtain all the parties' consent within Rule 38(b)'s time limit, but only the consent the party itself can give.

"No other pleading shall be allowed" except by a court order. Because the Trustee's complaint and amended complaint, and the Defendants' answer are the only filings in this proceeding that qualify as "pleadings" under Rule 7, the answer is necessarily the "last pleading directed to" any jury triable issues in this proceeding. As noted earlier, the Defendants filed their motion asking the District Court to withdraw the reference fourteen days after they served their answer, outside the time limit set by Rule 38(b). To repeat, Rule 38(d) provides that the failure to meet the time limit "constitutes a waiver by the party of a trial by jury." So even though the Defendants' request for a jury trial was probably timely under Rule 38(b) since they included it in their answer, their completed jury trial demand was not timely under the rule because their motion to withdraw reference was filed outside the 10-day time limit.

The Defendants' motion to withdraw reference was filed within the time provided by District of Kansas Local Rule 83.8.6(c), which specifies that such a motion is to be filed within 20 days after the moving party has appeared in a bankruptcy proceeding.[14] This raises the question whether the local rule's deadline could supersede the one set by Rule 38(b). But the Tenth Circuit has pointed out that local rules cannot be inconsistent with the Federal Rules adopted by the Supreme Court.[15] The Tenth Circuit's decision in

[14]The local rule actually says a motion to transfer a proceeding from a bankruptcy court must be filed within 20 days after the moving party "has entered appearance or been served with summons or notice," but it has been interpreted to mean such a motion is timely if either condition is satisfied. *See Disbursing Agent v. Severson (In re Hardesty)*, 190 B.R. 653, 655 (D.Kan. 1995).

[15]*Otasco Inc., v. Mohawk Rubber Co. (In re Otasco, Inc.)*, 981 F.2d 1166, 1167-68 (10th Cir. 1992); *Burger King Corp. v. Wilkinson (In re Wilkinson)*, 923 F.2d 154, 155-56 (10th Cir. 1991); *see also* Fed. R. Bankr. P. 9029(a).

Latimer has made a motion to withdraw reference (or a consent to the bankruptcy court conducting the trial) a necessary part of a timely demand for a jury trial, and this Court believes the local rule cannot be applied in this situation to override the time limit set by Rule 38(b). Because the Defendants' motion was not timely under Rule 38(b), their jury trial demand was not completed timely.

C. The district court should probably exercise its discretion to excuse the Defendants' from the inadvertent waiver of their jury trial right.

Civil Rule 39(b), made applicable by Bankruptcy Rule 9015(a), gives the district court discretion to order a trial by a jury on any or all issues that a party could, by making a timely demand, have required to be tried by jury. While the rule nominally requires a motion to invoke the court's discretion, any request that brings the question to the attention of the court and the other parties is sufficient to authorize the District Court to exercise its discretion under the rule.[16] Here, the Defendants' slightly late demand for a jury should be sufficient. The Tenth Circuit has said that a motion under Rule 39(b) should be granted in the absence of "'strong and compelling reasons to the contrary.'"[17] The Circuit has also held under this standard that a trial court did not abuse its discretion

[16]*FDIC v. Palermo*, 815 F.2d 1329, 1333-34 (10th Cir. 1987) (request in pretrial memorandum filed many months before trial was sufficient to authorize court to grant jury trial under Rule 39(b)).

[17]*Green Const. Co. v. Kansas Power & Light Co.*, 1 F.3d 1005, 1011 (10th Cir. 1993) (quoting *AMF Tuboscope, Inc., v. Cunningham*, 352 F.2d 150, 155 (10th Cir. 1965) and applying statement in reviewing grant of late request for jury trial). In *AMF Tuboscope*, the Circuit declared the trial court's decision to deny the parties' joint, but untimely, request for a jury trial based on the erroneous conclusion they had no right to a jury trial and the court's own reluctance to conduct a jury trial was an abuse of discretion.

by denying a defendant's jury trial request that was made more than two years after the lawsuit was filed when the only excuse for the delay was a mistaken assumption, given the nature of the case, that the plaintiff had asked for a jury trial, an error the Circuit described as "mere inadvertence."[18]

In this case, the Defendants' delay was either four days (counting from the day their answer was filed), or at most twenty-three days (counting from the day their answer was due). The Tenth Circuit's ruling in *Latimer* that merely asking for a jury trial in the time allotted for making that request is not enough in bankruptcy proceedings to constitute a timely jury trial demand creates a tricky procedural trap; a party's brief failure to comply with it should not be considered a "strong and compelling reason" to deny their jury trial request. In addition, the Trustee has not suggested he would suffer any prejudice by being required to try his claims to a jury, or offered any other reason to deny the request due to its tardiness. Under the circumstances, it seems the District Court should exercise its discretion to grant the Defendants' late request for a jury trial on any issues subject to the jury trial right.

II. The Defendants' Right to a Jury Trial on the Claims the Trustee Is Asserting

A. General guidelines for determining whether a jury trial right exists.

The jury trial right that the Seventh Amendment preserves depends on the now-

[18]*Nissan Motor Corp. v. Burciaga*, 982 F.2d 408, 409 (10th Cir. 1992) (*per curiam*).

historical distinction between legal and equitable issues.[19] A leading treatise on federal civil procedure calls distinguishing between matters that were triable at law and those that were triable in equity in 1791, when the Amendment was adopted, "one of the most perplexing questions of trial administration."[20] Because the English law and equity systems overlapped a great deal in 1791, the line dividing law and equity was not very clear then.[21] And since the law and equity jurisdictions of the federal courts were merged in 1938 with the adoption of the Federal Rules, leaving the jury trial right as the only area where the distinction remains important,[22] distinguishing historically legal issues from equitable ones continues to become more and more difficult as time goes by. In addition, because equity was always a supplemental system that acted only when the law courts were not able to provide an adequate remedy, the issues to which the jury trial right attaches have expanded over the years as common law procedures and remedies have been broadened.[23]

In *Granfinanciera v. Nordberg*,[24] the Supreme Court considered whether defendants who were sued by a bankruptcy trustee to recover prepetition transfers alleged

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[19]*See* 9 Wright & Miller, *Fed. Prac. & Pro.: Civil 2d*, §2302.1 at 28 (1995) (indicating jury trial right attaches to issues, not causes of action).

[20]*Id*. § 2302 at 18.

[21]*Id*. at 18-19.

[22]*Id*. at 19.

[23]*Id*. § 2302.1 at 24-25.

[24]492 U.S. 33 (1989).

to have been fraudulent were entitled to a jury trial. The Court noted that the Seventh Amendment not only preserves the jury trial right for suits to determine rights that would have been brought in the law, rather than equity, courts of England in 1791, but also extends it to actions brought to enforce statutory rights that are analogous to common-law causes of action that would ordinarily have been decided at that time by those law courts.[25] Then the Court summarized its approach to the question before it:

> The form of our analysis is familiar. "First, we compare the statutory action to 18th-century actions brought in the courts of England prior to the merger of the courts of law and equity. Second, we examine the remedy sought and determine whether it is legal or equitable in nature." *Tull v. United States*, 481 U.S. 412, 417-18 (1987) (citations omitted). The second stage of this analysis is more important than the first. *Id*. at 421. If, on balance, these two factors indicate that a party is entitled to a jury trial under the Seventh Amendment, we must decide whether Congress may assign and has assigned resolution of the relevant claim to a non-Article III adjudicative body that does not use a jury as factfinder.[26]

Only legal causes of action carry a right to jury trial and, under *Granfinanciera*, the first two steps in deciding whether a jury trial right attaches are to determine: (1) whether, when the Seventh Amendment was adopted, the cause of action would have been considered to be legal, rather than equitable, or is a new cause of action analogous to one then considered to be legal; and (2) whether the remedy sought is legal, rather than equitable. If those steps indicate a jury trial right attaches and the cause of action is one Congress created by statute, a third step is required if Congress has assigned the authority

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[25]*Id*. at 40-42.

[26]*Id*. at 42 (footnote omitted).

to resolve the cause of action to a court or other decision-maker that does not use juries and has not been established under Article III of the Constitution. This final step is to decide whether the Constitution permits Congress to assign the claim to that decision-maker.

The third part of the *Granfinanciera* analysis was necessary because under the statutes applicable to the case, Congress had called fraudulent conveyance actions "core proceedings," which meant that on referral from a district court, a bankruptcy judge could adjudicate the action and issue a final judgment, but Congress had not authorized bankruptcy judges to conduct jury trials.[27] In other words, by designating the action a core proceeding, Congress had effectively declared that it would be tried by a non-Article III court without a jury. Under today's statutes and rules, though, as discussed earlier, no party with a Seventh Amendment right to a jury trial on an issue can be forced to litigate that issue in a bench trial before a bankruptcy judge. For the issue to be tried before the bankruptcy judge, the party must consent to have the jury trial held by that court; otherwise, the jury trial must be held by a district judge.[28] Consequently, under current bankruptcy procedures, the Defendants' right to a jury trial is not affected by whether the Trustee's claims are "core proceedings" under 28 U.S.C.A. § 157(b).

The third part of the *Granfinanciera* analysis might also be the source of some

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[27]*See id.* at 40, n. 3 (noting lack of statutory authority for the bankruptcy judge to conduct jury trial in this case) & at 49-50 (noting designation of fraudulent conveyance actions as "core proceedings" and effect of that designation on bankruptcy judges' authority to issue final judgments).

[28]*See* 28 U.S.C.A. § 157(e); Bankruptcy Rule 9015(b).

apparent confusion on the Defendants' part. In their briefs, the Defendants seem to suggest the Trustee's claims are all covered by the Seventh Amendment jury trial right because they are based on state law. They quote a statement from *Granfinanciera* that said Congress lacked the power "to strip parties contesting matters of private right of their constitutional right to trial by jury."[29] The next sentence of the opinion adds, "[T]o hold otherwise would be to permit Congress to eviscerate the Seventh Amendment's guarantee by assigning to administrative agencies or courts of equity all causes of action not grounded in state law, whether they originate in a newly fashioned regulatory scheme or possess a long line of common-law forbears."[30] Perhaps the Defendants understand this to mean all state law claims must be tried to juries when the claims are asserted in a federal court. This Court believes, however, that this part of *Granfinanciera* was not suggesting that all state law claims carry a jury trial right, but instead indicating that when Congress enacts a statute that adopts a state law cause of action, rather than creates a new statutory claim, the state law origins and specifications of the claim will determine whether it includes a jury trial right. Undoubtedly, because they resemble legal claims more than equitable ones, some state law claims will carry a jury trial right, but others will not.

In response to the Defendants' motions, the Trustee has not argued that any of his claims are equitable rather than legal claims. Instead, he suggests the Defendants are

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[29]492 U.S. at 51-52.

[30]*Id*. at 52.

relying on factual assertions that are not included in the pleadings, although he does not specifically identify which assertions he means. The Court has not discovered any factual questions that preclude determining the Defendants' jury trial rights without hearing any evidence, and so rejects this portion of the Trustee's response. Otherwise, the Trustee contends the Defendants have waived their jury trial rights both by causing III to file for bankruptcy, and by filing proofs of claim in III's bankruptcy case. Although he does not expressly concede the point, his amended complaint and other filings contain no allegation that Defendant Peterson either participated in putting the Debtor in bankruptcy or filed a proof of claim, only that Kost and Adkins did.

The Court will first consider whether the Trustee's claims are common-law ones that carry a right to jury trial, or are equitable ones that do not. If any of the claims are subject to a jury trial right, the Court will consider whether the jury trial right Kost and Adkins would otherwise have is affected by their actions (1) in causing III to file for bankruptcy and (2) in filing proofs of claim against III's bankruptcy estate.

B. Are the Trustee's claims legal ones?

1. Count 1 — Declaration of personal liability for corporate obligations

The declaratory judgment procedure largely originated in courts of equity, but the remedy itself is neither legal nor equitable.[31] In Count 1, the Trustee seeks a declaratory judgment that would disregard Debtor III's corporate form and make the Defendants

[31]9 Wright & Miller, *Fed. Prac. & Pro.: Civil 2d*, § 2313 at 108.

personally liable for III's obligations. The Court has discovered non-binding decisions by federal circuit courts reaching opposing conclusions on the question whether a jury trial right exists for a claim based on disregard of the corporate form (also known as piercing the corporate veil or imposing alter ego liability).[32] One of the circuits indicated that differences in the applicable state law on such liability could lead to a different result on the jury trial question.[33] The Tenth Circuit has not considered the nature of a corporate-disregard claim in the jury trial context but, in other situations, has said: "Piercing the corporate veil through the alter ego doctrine is an equitable remedy,"[34] and "[D]isregard of the corporate form is an equitable remedy."[35] The Seventh Circuit has also suggested that equitable relief is typically discretionary while legal relief is not.[36]

These authorities direct the Court to look at Kansas law on disregarding the corporate form to impose personal liability on the corporation's shareholders in order to decide whether a jury trial right exists. The Kansas Supreme Court has said:

> We start with the basic premise that a corporation and its stockholders are presumed separate and distinct, whether the corporation has many stockholders or only one. Debts of a corporation are not the individual indebtedness of its stockholders. However, in an appropriate case the corporate form will be

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[32]*Compare International Financial Services Corp. v. Chromas Technologies Canada, Inc.*, 356 F.3d 731, 735, 739 (7th Cir. 2004) (jury right exists) *with William Passalacqua Builders, Inc., v. Resnick Developers South, Inc.*, 933 F.2d 131, 135-36 (2d Cir.1991) (no jury trial right).

[33]*International Fin. Servs.*, 356 F.3d at 737.

[34]*McKinney v. Gannett Co., Inc.*, 817 F.2d 659, 666 (10th Cir. 1987) (citation omitted).

[35]*Floyd v. IRS*, 151 F.3d 1295, 1300 (10th Cir. 1998) (citing *McKinney*).

[36]*International Fin. Servs. v. Chromas Tech.*, 356 F.3d at 736.

> disregarded and the corporation and its stockholders may be treated as identical. [Citations omitted.] Power to pierce the corporate veil is to be exercised reluctantly and cautiously. [Citations omitted.]
>
> In *Kilpatrick Bros., Inc. v. Poynter*, [205 Kan. 787, syl. ¶ 4 (1970)], it is held:
>
> > "The corporate entity may be disregarded where it is used as a cloak or cover for fraud or illegality, or to work an injustice, or where necessary to achieve equity. When the corporation is the mere *alter ego* or business conduit of a person, the corporate fiction may be disregarded in the interest of securing a just determination of rights and liabilities."[37]

This quotation suggests that in Kansas law, the corporate-disregard doctrine has an equitable basis, and combined with the Tenth Circuit's statements that the doctrine is an equitable remedy, provides grounds for resolving the law-versus-equity question in this case. While the question is certainly not free from doubt, the Court recommends that the district court rule the corporate-disregard remedy under Kansas law is an equitable one not covered by a jury trial right.

Although the Trustee's complaint expressly seeks only a declaration that the Defendants are personally liable for III's debts, the Court believes that the Trustee actually wants money judgments that he can enforce directly against the Defendants for those debts, not just the right to bring another suit against them to collect on their declared liability. Claims seeking only money are usually considered to be legal ones.[38] On the other hand, while III's corporate liabilities undoubtedly include obligations to pay

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[37] *Amoco Chemicals Corp. v. Bach*, 222 Kan. 589, 593 (1977).

[38] *Passalacqua Builders*, 933 F.3d at 136; *cf. International Fin. v. Chromas Tech.*, 356 F.3d at 737 (fact remedy of piercing corporate veil does not itself result in money damages contributes to conclusion remedy is equitable, not legal).

debts, perhaps the most typical of all the obligations enforceable at law,[39] they might also include obligations enforceable in equity, such as an obligation to render specific performance of a contract.[40] That is, the question of III's liability on a claim is separate from the question whether its corporate form should be disregarded so the Defendants would be personally liable for III's obligations. While the Court has found no case discussing this possibility, it seems the confusion over the legal or equitable status of the corporate-disregard remedy might arise because some courts look at that remedy alone and conclude it is equitable, but others look at the step that typically follows a decision to disregard the corporate form, namely making the shareholders liable for the corporation's debts, and conclude the remedy is legal. Conceptually, at least, the shareholders' liability under the disregard remedy is distinct from the corporation's liability on its obligations, and might be decided separately. Of course, in the event there is a dispute about III's liability on a claim, the Defendants would, if the claim against the corporation is a legal one, have a right to a jury trial on that dispute (except to the extent they might have waived the right).

2. Count 2 — Breach of fiduciary duties

In Count 2, the Trustee contends the Defendants' actions breached fiduciary duties they owed to Debtor III, including duties not to engage, without adequate financial

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[39]*See Granfinanciera*, 492 U.S. at 47-49; 9 Wright & Miller, *Fed. Prac. & Pro.: Civil 2d*, §2308 at 82 (action of assumpsit or debt was legal action).

[40]*See* 9 Wright & Miller, *Fed. Prac. & Pro.: Civil 2d*, §2309 at 85 (1995) (action for specific performance of contract was historically equitable).

planning, in transactions that would render III insolvent, and not to continue III's operations once it became clear they would cause deepening insolvency. He asks in this count for damages and for disgorgement of all salaries and payments to the men. In one of its decisions, the Third Circuit discussed the deepening insolvency theory of liability at length, making clear that it is a tort theory and, at least when the remedy sought is money damages, is a legal claim, not an equitable one.[41] The Supreme Court has also indicated that tort claims seeking money damages are legal claims.[42] The Court recommends that the district court conclude the right to a jury trial attaches to this count of the Trustee's complaint.

3. Count 3 — Intentional interference with contract

In Count 3, the Trustee contends at least Kost and Adkins, and maybe Peterson as well, intentionally and improperly caused III to breach its contract with Sokkia. He asks for money damages allegedly caused by those actions. It appears to the Court that intentional interference with a contract, also known as tortious interference with a contract, is a tort theory of liability.[43] As noted in discussing Count 2, a tort claim

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[41]*Official Committee of Unsecured Creditors v. R.F. Lafferty & Co., Inc.*, 267 F.3d 340, 349-51 (3d Cir. 2001).

[42]*See City of Monterey v. Del Monte Dunes at Monterey, Ltd.*, 526 U.S. 687, 709-11 (majority opinion on this point) & 727-31 (opinion concurring in part and concurring in judgment) (1999).

[43]*See* Restatement (Second) of Torts § 766 (1979) (defining tort of intentional interference with performance of contract by third person); *Turner v. Halliburton Co.*, 240 Kan. 1, 12 (1986) (noting that Kansas recognizes causes of action for both tortious interference with contract and tortious interference with contractual expectations or prospective business advantage).

seeking money damages is a legal claim.[44] The Court recommends that the district court conclude the right to a jury trial attaches to this count of the Trustee's complaint.

4. Counts 4 & 5 — Repayment of loans & credit card payments

In Count 4, the Trustee asks for a judgment requiring the Defendants to repay loans that III allegedly made to each of them, and probably also requiring them to reimburse III for personal expenses it paid because the expenses were charged to its credit cards. In Count 5, the Trustee asks for turnover of the same debts. As indicated earlier, actions to recover debts like these are clearly legal ones.[45] They are claims brought to augment the bankruptcy estate, and so constitute private rights rather than public ones.[46] This means that even if it intended to do so by enacting § 542, Congress cannot deprive parties litigating these claims of the right to a jury trial by relabeling them as "turnover" claims and placing them in the exclusive jurisdiction of a specialized court of equity.[47] The Court recommends that the district court conclude the right to a jury trial attaches to Counts 4 and 5 of the Trustee's complaint.

5. Count 6 — Objection to proofs of claim

In Count 6, the Trustee objects to the claims Kost and Adkins asserted against III's

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[44]*See Monterey v. Del Monte Dunes*, 526 U.S. at 709-11 (majority opinion on this point) & 727-31 (opinion concurring in part and concurring in judgment).

[45]*See Granfinanciera*, 492 U.S. at 47-49; 9 Wright & Miller, *Fed. Prac. & Pro.: Civil 2d*, §2308 at 82 (action of assumpsit or debt was legal action); *see also* definition of "assumpsit" in *Black's Law Dictionary* (8th ed. 2004).

[46]*See Granfinanciera*, 492 U.S. at 55-56.

[47]*Id*. at 60-61.

bankruptcy estate by filing proofs of claim. Objections to filed claims are clearly part of the bankruptcy "claims-allowance process which is triable only in equity."[48] The Court recommends that the district court conclude the right to a jury trial does not attach to this count of the Trustee's complaint.

6. Count 7 — Fraudulent conveyance

In Count 7, the Trustee seeks to recover amounts one or more of the Defendants allegedly charged for personal expenses on III's credit cards, contending they constitute fraudulent conveyances. In *Granfinanciera*, the Supreme Court held that such claims are legal ones that carry a right to a jury trial and that Congress cannot eliminate the jury trial right by assigning exclusive jurisdiction of the claims to an agency or tribunal that does not conduct jury trials.[49] The Court recommends that the district court conclude the right to a jury trial attaches to this count of the Trustee's complaint.

7. Summary of jury trial rights

To summarize, the Court concludes that no jury trial right attaches to the Trustee's claim in Count 1 for a declaration that III's corporate form should be disregarded and the Defendants held personally liable on its obligations, and his claims in Count 6 objecting to the proofs of claim that Kost and Adkins filed. The jury trial right does attach, however, to all the other counts of the Trustee's complaint. The Trustee does not contend that Peterson was involved in causing III to file for bankruptcy or that he filed a proof of

[48]*Langenkamp v. Culp*, 498 U.S. 42, 44-45 (1990).

[49]492 U.S. at 41-64.

claim in III's case, so he is undoubtedly entitled to a jury trial on Counts 2, 3, 4, 5, and 7, unless the District Court concludes he waived the right by making an untimely jury demand and declines to excuse that waiver. The question remains, however, whether and to what extent Kost and Adkins waived their jury trial rights by causing III to file for bankruptcy and by filing proofs of claim against III's estate, and whether their effort to withdraw those claims can now undo any waiver that occurred.

III. Waiving Jury Trial Rights in Bankruptcy Proceedings by Taking Certain Actions in Bankruptcy Court

A. Whether Kost and Adkins waived their jury trial rights by causing III to file for bankruptcy.

The Trustee contends Defendants Kost and Adkins waived their jury trial rights by causing III to file for bankruptcy, but cites no authority to support this argument. He alleges the two men owned interests in and controlled III, but has not suggested why corporate shareholders and officers should be considered to have submitted themselves personally to the jurisdiction of a bankruptcy court by causing their corporation to file a petition there. It seems reasonable that the men should be subject to the bankruptcy court's jurisdiction for claims arising from actions they caused III to take after it filed for bankruptcy, but the Court sees no justification for extending this concept to actions taken prepetition. Many courts have concluded that a debtor who files a voluntary petition has not waived the right to a jury trial for all matters that might arise in relation to the

bankruptcy case.[50] A person's actions in causing a third party to file a voluntary petition would give even less reason to conclude the person had waived all jury trial rights.

The most that might be said for the Trustee's argument here is that if he is able to prove it is appropriate to disregard III's corporate form for purposes of making Kost and Adkins personally liable for its obligations, it might also be appropriate to treat them as if they had filed personal bankruptcy petitions, and consider the extent to which that might have waived their jury trial rights. But under the Supreme Court's decisions in *Beacon Theatres v. Westover*[51] and *Dairy Queen, Inc., v. Wood*,[52] when a single case involves both legal and equitable issues, the trial must almost always be arranged so that the jury questions are decided first, in order that the decision on the equitable issues will not, through issue or claim preclusion, impinge on the right to have a jury decide the legal issues. As matters stand now, Defendants Kost and Adkins are entitled to a jury trial on five of the Trustee's claims (except to the extent they might have waived that right by making an untimely demand, or by filing proofs of claim). The Trustee's corporate-disregard claim would have to be resolved in his favor before the question whether Kost and Adkins waived any jury trial rights by causing III to file for bankruptcy could be considered. To the extent that claim might involve factual issues that are also involved in

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[50]*See WSC, Inc., v. The Home Depot, Inc. (In re WSC, Inc.)*, 286 B.R. 321, 323-32 (Bankr. M.D. Tenn. 2002) (courts have not agreed whether debtor necessarily waives all jury trial rights by filing voluntary bankruptcy petition, discussing a number of cases).

[51]359 U.S. 500, 506-11 (1959).

[52]369 U.S. 469, 470-73 (1962).

the legal claims, *Beacon Theatres* and *Dairy Queen* clearly require the legal issues to be decided before the equitable one. Under these circumstances, it seems the question whether Kost and Adkins might have waived their jury trial rights by causing III to file for bankruptcy is effectively moot because any jury trial they are entitled to must be held before the District Court can rule on the corporate-disregard question.

The Court recommends that the District Court reject the Trustee's assertion Kost and Adkins have waived any of their jury trial rights here by causing III to file its bankruptcy petition.

B. Whether, and to what extent, Kost and Adkins waived their jury trial rights by filing proofs of claim.

1. Waiver by filing proofs of claim.

In 1966, in *Katchen v. Landy*,[53] the Supreme Court held that because bankruptcy courts had jurisdiction to adjudicate disputes relating to property within their actual or constructive possession and because Congress had provided for them to determine such disputes in equitable proceedings without juries, a bankruptcy court had jurisdiction to decide a trustee's preference counterclaim against a creditor who had filed a proof of claim. This conclusion, the Court added, did not violate the creditor's Seventh Amendment right to a jury trial because the creditor's presentation of its claim to the bankruptcy court converted its legal claim into an equitable claim to a pro rata share of

[53]382 U.S. 323, 326-36.

the bankruptcy estate, a claim triable without a jury.[54] Although the Court held in *Granfinanciera* that defendants in actions to recover fraudulent transfers were entitled to a jury trial, the Court made clear that the question before it concerned only defendants who had not filed claims against the bankruptcy estate.[55] In 1990, about a year and a half after deciding *Granfinanciera*, the Court ruled in *Langenkamp v. Culp*[56] that a creditor who filed a claim against a bankruptcy estate had no right to a jury trial on the trustee's responsive claim to recover a preference. The Court explained, "[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*."[57] These decisions clearly mean that Kost and Adkins lost at least some of their jury trial rights by filing proofs of claim in III's bankruptcy case. The question remains whether they lost those rights with respect to all the Trustee's claims that involve a right to jury trial.

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[54]382 U.S. at 336-40. The Defendants suggest that the Supreme Court's decision in *Beacon Theatres, Inc. v. Westover*, 359 U.S. 500 (1959), and subsequent cases applying it were not analyzed in *Katchen*, *Granfinanciera*, or *Langenkamp v. Culp*. This is wrong. In *Katchen*, 382 U.S. at 338-40, the Court expressly rejected the argument that *Beacon Theatres* required issues arising in connection with a bankruptcy case that could be brought either as equitable issues or legal issues to be brought in a legal proceeding in order to preserve the right to jury trial.

[55]492 U.S. at 36.

[56]498 U.S. 42, 42-45 (1990) (*per curiam*).

[57]498 U.S. at 44 (emphasis in original; citation omitted).

2. Extent of waiver caused by filing proofs of claim.

Seventy years ago, in *Alexander v. Hillman*,[58] the Supreme Court held that parties who filed claims against a receivership estate had submitted themselves to the jurisdiction of the equity court presiding over the receivership for purposes of any counterclaims for affirmative relief that the receivers might assert against them. Fifty years ago, in *Inter-State National Bank v. Luther*,[59] the Tenth Circuit relied on *Alexander* in reaching the conclusion that parties who file claims in bankruptcy cases impliedly consent to the bankruptcy court's jurisdiction to determine without a jury any compulsory or permissive counterclaims the bankruptcy trustee might assert against them. Forty-one years ago, however, in *Katchen v. Landy (In re Katchen's Bonus Corner, Inc.)*,[60] the Circuit modified its *Inter-State* decision and held the claim-filing creditor's implied consent to the bankruptcy court's jurisdiction did not extend "to counterclaims which do not involve a preference, setoff, voidable lien, or a fraudulent transfer, and which are wholly unrelated to the creditor's claim."

In *Katchen*, the bankruptcy trustee had responded to a creditor's claim with three preference claims and a claim for an unpaid subscription for the corporate stock of the debtor.[61] The Circuit ruled that by filing claims in the bankruptcy case, the creditor had

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[58]296 U.S. 222, 238-43 (1935).

[59]*Inter-State National Bank v. Luther*, 221 F.2d 382, 386-90 (1955) (3-2 decision en banc).

[60]336 F.2d 535, 536-37 (10th Cir. 1964) (4-3 decision en banc), *aff'd on other grounds*, 382 U.S. 323 (1966).

[61]336 F.2d at 537-38 (concurring opinion, describing the facts more fully than majority opinion).

consented to the bankruptcy court's jurisdiction over the preference claims but not the unpaid subscription claim.[62] The creditor appealed and the Supreme Court affirmed the Circuit's ruling about the preference claims,[63] but the trustee did not appeal the ruling about the subscription claim.[64] So far as the Court has found, *Katchen* remains the Tenth Circuit's last ruling on the extent of a claim-filing creditor's implied consent to a bankruptcy court's jurisdiction and consequent waiver of jury trial rights.

In *Germain v. Connecticut National Bank*, the Second Circuit offered an explanation that seems to make it easier to understand and determine the extent of the jury trial rights a creditor gives up by filing a proof of claim in a bankruptcy case, although the question the court faced was the extent of a bankruptcy trustee's right to jury trial.[65] That Circuit pointed out that the Supreme Court's decisions in *Langenkamp* and *Katchen* referred to the process of allowing and disallowing claims.[66] This reference suggests looking at § 502(d) of the Bankruptcy Code,[67] which provides for an entity's claim to be disallowed if property is recoverable from the entity under §§ 542, 543, 550, or 553, or the entity is the transferee of a transfer that is avoidable under §§ 522(f), 522(h), 544,

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[62]*Id.* at 537.

[63]382 U.S. at 325.

[64]*Id*. at 326.

[65]988 F.2d 1323, 1327 (2d Cir. 1993) (2-1 decision).

[66]*Id*.

[67]*Id*.

545, 547, 548, 549, or 724(a), unless the entity has paid in or turned over the property for which it is liable under those provisions. The Circuit reasoned these sections contain the trustee counterclaims that are involved in the claims-allowance process under the Bankruptcy Code and can affect the allowance of the entity's claim.[68] Filing a proof of claim, the Circuit said, does not affect the entity's jury trial right on trustee claims that would augment the bankruptcy estate but have no impact on the allowance of the entity's claim under § 502.[69] This line of reasoning seems to coincide with the Tenth Circuit's ruling in *Katchen* that filing a proof of claim waives a creditor's jury trial right for permissive counterclaims only if the counterclaims seek to recover preferences (§ 547), setoffs (§ 542 and § 553, although they explicitly address creditors' rights of setoff, not bankruptcy estates' rights), avoided liens (§ 544), or fraudulent transfers (§ 548).

In their proofs of claim, Kost and Adkins both contend that III owes them for prepetition salary and unused vacation time, and for postpetition salary. As suggested above, had they not filed proofs of claim, Kost and Adkins would have had jury trial rights only for Counts 2, 3, 4, 5, and 7 of the Trustee's complaint. The claims the Trustee asserts in Counts 2 and 3, for damages for breach of fiduciary duties and for intentional interference with contract, would not appear to arise out of the same transaction or occurrence as the Defendants' claims for salary and vacation pay, and do not appear to be covered by any of the provisions listed in § 502(d) of the Bankruptcy Code, so these

[68] *Id.*

[69] *Id.*

Trustee claims should not be considered to be a part of the claims-allowance process. Consequently, Kost and Adkins have not waived their jury trial right for Count 2 or Count 3 by filing their proofs of claim.

The claims the Trustee asserts in Counts 4 and 5, for repayment of loans and credit card charges and for turnover based on the same obligations, would also not appear to be compulsory counterclaims to the Defendants' claims for salary and vacation pay. At least as asserted in Count 5, however, they are claims that are covered by one of the provisions listed in § 502(d), namely § 542. With exceptions that do not apply here, § 542(b) provides that "an entity that owes a debt that is property of the estate and that is matured, payable on demand, or payable on order, shall pay such debt to, or on the order of, the trustee, except to the extent that such debt may be offset under section 553 of this title against a claim against the debtor." The Defendants admitted in their answer that they owe III's estate for the loans and seem to concede that the debts are matured; they denied in their answer owing the credit card charges, but say in their briefs only that Counts 4 and 5 are both debt collection claims. For Count 5, then, Kost and Adkins have waived their jury trial right by filing proofs of claim. Since Count 4 is essentially the same claim as Count 5, the Court concludes the jury trial right was waived for it as well.

The claim the Trustee asserts in Count 7, for recovery of a fraudulent conveyance, is also not a compulsory counterclaim, but is a claim covered by § 548, one of the provisions listed in § 502(d). Furthermore, the Supreme Court has made clear in *Katchen*, *Granfinanciera*, and *Langenkamp* that a party who files a proof of claim waives a jury

trial on fraudulent conveyance and preference claims asserted against it. So Kost and Adkins waived their jury trial rights on Count 7 by filing their proofs of claim.

In sum, then, by filing their proofs of claim, Kost and Adkins waived their jury trial right for Counts 4, 5, and 7, but not for Counts 2 and 3.

C. Whether (1) Kost and Adkins can undo their jury trial waiver by withdrawing their proofs of claim, or (2) other considerations justify excusing the waiver.

Federal Rule of Bankruptcy Procedure 3006 governs a creditor's right to withdraw a proof of claim it has filed. As relevant here, the Rule says:

> A creditor may withdraw a claim as of right by filing a notice of withdrawal, except as provided in this rule. If after a creditor has filed a proof of claim an objection is filed thereto or a complaint is filed against that creditor in an adversary proceeding, or the creditor . . . has participated significantly in the case, the creditor may not withdraw the claim except on order of the court after a hearing on notice to the trustee . . . , and any creditors' committee elected pursuant to § 705(a) . . . of the Code. The order of the court shall contain such terms and conditions as the court deems proper. . . .

The 1983 Advisory Committee Note to the Rule indicates that it involves the same considerations as those underlying Civil Rule 41(a). Under subdivision (1) of Rule 41(a), a plaintiff cannot voluntarily dismiss an action after the adverse party has served an answer or a motion for summary judgment unless all the parties who have appeared stipulate to the dismissal. Otherwise, subdivision (2) of Rule 41(a) applies and the plaintiff must obtain the court's order to dismiss the action. A leading treatise on federal civil procedure says that under Rule 41(a)(2), federal courts have usually refused to allow

a dismissal that is being sought in order to avoid a previous waiver of trial by jury.[70] That, of course, is what Defendants Kost and Adkins are trying to do in this case by withdrawing their proofs of claim.

Kost and Adkins cite the Eighth Circuit's decision in *Smith v. Dowden*[71] as support for their motion to withdraw their claims. In that case, when the Chapter 7 trustee objected to a proof of claim that a partnership had filed, the partnership moved under Bankruptcy Rule 3006 to withdraw its claim.[72] The bankruptcy court granted the motion without reserving any jurisdiction over the partnership or its general partners.[73] More than two months later, the trustee sued the general partners, seeking to recover a fraudulent transfer, and the partners asked for a jury trial.[74] Reversing the lower courts, the Eighth Circuit ruled that the bankruptcy court order approving withdrawal of the claim rendered the proof of claim a legal nullity and left the parties in the same position as if the claim had never been filed.[75] Consequently, by the time the trustee sued the partners, any waiver of the partners' right to a jury trial that had occurred when the partnership filed its claim had been revoked, and just like the party in *Granfinanciera*

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[70]9 Wright & Miller, *Fed. Prac. & Pro.: Civil 2d*, §2364 at 286 (1995) (citing a number of cases, but none which are binding on this court).

[71]47 F.3d 940 (8th Cir. 1995).

[72]*Id*. at 941.

[73]*See* 47 F.3d at 941 & 943-44.

[74]*Id*. at 941.

[75]*Id*. at 943.

who had never filed a claim, the partners had the right to demand a jury trial.[76] Because Kost and Adkins did not successfully withdraw their claims before the Trustee objected to their claims and sued them, *Smith v. Dowden* provides no support for their argument that they should be able to revive their jury trial rights in this case by withdrawing the claims now.

Instead, if no other considerations were involved, the motion to withdraw the proofs of claim should probably be denied under the usual Rule 41(a)(2) approach that dismissal will not be allowed when it is sought only to avoid a previous jury trial waiver. On the other hand, since Defendant Peterson has not filed a proof of claim, he is undoubtedly entitled to a jury trial on all the Trustee's legal claims (assuming the District Court decides to excuse the minimal tardiness of his demand), so refusing to excuse Kost and Adkins's jury trial waiver would mean different factfinders would have to resolve those claims covered by the waiver, creating the possibility of inconsistent results. In addition, as explained earlier, even Kost and Adkins are entitled to a jury trial on some of the Trustee's claims, so excusing their waiver on others will just add a few more claims for the jury to resolve, not create a jury trial where none would otherwise occur. Under these circumstances, it seems reasonable to have the jury decide all the Trustee's legal claims.

[76] *Id*. at 943.

CONCLUSION

For these reasons, the Court recommends that the District Court order Counts 2, 3, 4, 5, and 7 of the Trustee's complaint to be tried to a jury as to all three Defendants. The Defendants' brief delay in completing their jury demand by moving to withdraw the reference should be excused, and the jury trial waiver resulting when Kost and Adkins filed proofs of claim should also be excused. Because Kost and Adkins have asked to withdraw their claims only in order to avoid any jury trial waiver the claims caused, but that waiver should be excused on other grounds, their motion to withdraw the claims should be denied. Since a jury trial should be held and the Defendants do not consent to this Court presiding over such a trial, the District Court must withdraw the reference of any jury trial it orders to be held. However, this Court stands ready to handle any further proceedings the District Court may wish to assign to it, including any matters that may precede a jury trial.[77]

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[77] *See Disbursing Agent v. Severson (In re Hardesty)*, 190 B.R. at 656-57 (even if jury trial must be held in district court, district court may decline to withdraw reference until case is trial-ready).