PAGE PROOF

# 04-5972-BK(L)

## 04-6300-BK(XAP)

IN THE

# United States Court of Appeals

FOR THE SECOND CIRCUIT

In re: CBI HOLDING COMPANY, INC.,

*Debtor,*

BANKRUPTCY SERVICES, INC.,

*Plaintiff–Appellant–Cross-Appellee,*

*v.*

ERNST & YOUNG, ERNST & YOUNG LLP,

*Defendants–Appellees–Cross-Appellants.*

*On Appeal from the United States District Court for the Southern District of New York*

## REPLY BRIEF FOR DEFENDANTS–APPELLEES–CROSS-APPELLANTS


Richard F. Broude
RICHARD F. BROUDE, P.C.
400 East 84th Street, #22-A
New York, New York 10028
917-301-3468

Irwin J. Sugarman
Harry S. Davis
SCHULTE ROTH & ZABEL LLP
919 Third Avenue
New York, New York 10022
212-756-2000

Andrew L. Frey
Sanford I. Weisburst
MAYER, BROWN, ROWE & MAW LLP
1675 Broadway
New York, New York 10019
212-506-2500

*Attorneys for Defendants–Appellees–Cross-Appellants*

**TABLE OF CONTENTS**

Page

INTRODUCTION ........................................................................................ 1

ARGUMENT........................................................................................ 2

I. THE CBI AND TCW CLAIMS ARE NOT CORE PROCEEDINGS THAT MAY BE ADJUDICATED BY A BANKRUPTCY JUDGE. ............................ 2

A. The CBI Claims Are "Related" Proceedings, Not "Core" Proceedings..... 2

1. Subsection B: Allowance Or Disallowance Of Claims Against The Estate ........................................................................................ 2

2. Subsection C: Counterclaims By The Estate Against Persons Filing Claims Against The Estate ........................................................................ 4

3. Subsections A and O: The Catch-All Core Categories.......................... 9

B. The TCW Claims are "Related" Proceedings, Not "Core" Proceedings...10

II. THE DISTRICT COURT ERRED IN HOLDING THAT E&Y WAS NOT ENTITLED TO A JURY TRIAL ON THE CBI CLAIMS. .......................13

A. E&Y Is Entitled To A Jury Trial On The CBI Claims. ............................14

B. In Any Event, E&Y's Conceded Entitlement To A Jury Trial On The TCW Claims Requires That The CBI Portion Of The Judgment Be Vacated .17

CONCLUSION ........................................................................................23

## TABLE OF AUTHORITIES

Page(s)

**CASES**


*Agudas Chasidei Chabad* v. *Gourary*,
833 F.2d 431 (2d Cir. 1987) ....................21

*Germain* v. *Connecticut Nat'l Bank*,
988 F.2d 1323 (2d Cir. 1993)....................14, 16

*Granfinanciera, S.A.* v. *Nordberg*,
492 U.S. 33 (1989) ....................14, 16, 20, 21

*Gulf States Exploration Co.* v. *Manville Forest Prods. Corp.*,
896 F.2d 1384 (2d Cir. 1990)....................10

*Hirsch* v. *Arthur Andersen & Co.*,
72 F.3d 1085 (2d Cir. 1995) .................... 3

*In re 131 Liquidating Corp.*,
222 B.R. 209 (S.D.N.Y. 1998)....................12

*In re Ben Cooper, Inc.*,
896 F.2d 1394 (2d Cir.), cert. granted, 497 U.S. 1023,
vacated and remanded, 498 U.S. 964 (1990),
opinion reinstated on remand, 924 F.2d 36 (2d Cir. 1991) ....................passim

*In re Best Prods. Co.*,
68 F.3d 26 (2d Cir. 1995) ....................10

*In re Castlerock Props.*,
781 F.2d 159 (9th Cir. 1986) .................... 9

*In re Complete Mgmt., Inc.*,
No. 02 CIV. 1736, 2002 WL 31163878 (S.D.N.Y. Sept. 27, 2002) ....................6, 7, 10

*In re Ecam Publications, Inc.*,
131 B.R. 556 (Bankr. S.D.N.Y. 1991) ....................12, 13

# TABLE OF AUTHORITIES (continued)

Page(s)

*In re Frost, Inc.*,
145 B.R. 878 (Bankr. W.D. Mich. 1992) ....................................................... 17

*In re Hooker Invs., Inc.*,
937 F.2d 833 (2d Cir. 1991) ....................................................................... 15

*In re Leslie Fay Cos.*,
No. 97 Civ. 2244, 1997 WL 555607 (S.D.N.Y. Sept. 4, 1997) ........................... 3

*In re Marshall*,
264 B.R. 609 (C.D. Cal. 2001) ..................................................................... 6, 7

*In re Mindeco Corp.*,
212 B.R. 447 (E.D.N.Y. 1997) ..................................................................... 17

*In re Orion Pictures Corp.*,
4 F.3d 1095 (2d Cir. 1993) ................................................................ 5, 6, 9, 14

*In re S.G. Phillips Constructors, Inc.*,
45 F.3d 702 (2d Cir. 1995) ......................................................................... 10

*In re United States Lines, Inc.*,
197 F.3d 631 (2d Cir. 1999) ....................................................................... 10

*Irwin* v. *Gavit*,
268 U.S. 161 (1925) .................................................................................... 8

*Katchen* v. *Landy*,
382 U.S. 323 (1966) ............................................................................ passim

*Langenkamp* v. *Culp*,
498 U.S. 42 (1990) ................................................................................ 14, 16

*Lytle* v. *Household Mfg., Inc.*,
494 U.S. 545 (1990) .................................................................................... 17

## TABLE OF AUTHORITIES (continued)

Page(s)

*Northern Pipeline Constr. Co.* v. *Marathon Pipe Line Co.*,
458 U.S. 50 (1982) ....................................................................passim

*Parklane Hosiery Co.* v. *Shore*,
439 U.S. 322 (1979) ....................................................................21

*Peachtree Lane Assocs.* v. *Granader*,
175 B.R. 232 (N.D. Ill. 1994) ....................................................................17

*State Farm Mut. Auto. Ins. Co.* v. *Campbell*,
538 U.S. 408 (2003) .................................................................... 7

## STATUTES

11 U.S.C. § 502 ....................................................................15, 16

28 U.S.C. § 157 ....................................................................passim

28 U.S.C. § 158 ....................................................................10

28 U.S.C. § 1359....................................................................11

Bankruptcy Act § 57g (repealed 1979)....................................................................15

## OTHER AUTHORITIES

COLLIER ON BANKRUPTCY (15th ed. rev. 2005) .................................... 11, 15, 16, 18

G. Ray Warner, Katchen *Up In Bankruptcy: The New Jury Trial Right*,
63 Am. Bankr. L. J. 1, 43 (1989) ....................................................................19, 20

## INTRODUCTION

In E&Y's cross-appeal, which this Court need reach only if it reverses the district court's judgment on the main appeal, E&Y makes three arguments: (1) the CBI claims should be classified as related, not core; (2) the TCW claims should be classified as related, not core; and (3) both sets of claims, even if core, should be tried before a jury.[1]

BSI's selective quotations and mischaracterizations cannot mask the fact that neither this Court nor any other of which we are aware has ever held that counterclaims of the type filed in this case are core or that a defendant such as E&Y loses its right to a jury trial by filing a claim to which the counterclaims bear some relation.[2] The reason is simple: the Constitution forbids any other result. As we demonstrated in our opening brief and reiterate now, this Court has carefully contained the authority of non-Article III bankruptcy courts under *Northern Pipeline Construction Co.* v. *Marathon Pipe Line Co.*, 458 U.S. 50 (1982), and

---

[1] BSI does not challenge the district court's holding (311 B.R. at 366-67) that at least the TCW portion of the judgment must be vacated (and the TCW claims re-tried) because the bankruptcy court erroneously denied E&Y's right to jury trial on those claims.

[2] As we discuss below, the problem for BSI is compounded by the fact that these counterclaims were filed after the bar date for filing objections to E&Y's claim in the bankruptcy proceeding, and therefore no longer could serve as a valid basis for disallowance of that claim.

assiduously guarded the jury-trial rights afforded by the Seventh Amendment. BSI's brief barely gives lip-service to these constitutional principles.

## ARGUMENT

## I. THE CBI AND TCW CLAIMS ARE NOT CORE PROCEEDINGS THAT MAY BE ADJUDICATED BY A BANKRUPTCY JUDGE.

### A. The CBI Claims Are "Related" Proceedings, Not "Core" Proceedings.

The district court initially held that the CBI claims qualify as core proceedings under four of the categories enumerated in 28 U.S.C. § 157(b)(2): (1) proceedings that go to the "allowance or disallowance" of E&Y's claim against the estate (subsection B); (2) "counterclaims" to E&Y's proof of claim (subsection C); (3) the catch-all category of "matters concerning the administration of the estate" (subsection A); and (4) another catch-all category of "other proceedings affecting the * * * adjustment of the debtor-creditor * * * relationship" (subsection O). 11/13/98 Order at 10. In its most recent opinion on this matter, the district court relied only on the first two of these. 311 B.R. at 363. In fact none of these categories can be applied in this case without running afoul of *Marathon*.

#### 1. Subsection B: Allowance Or Disallowance Of Claims Against The Estate.

We begin with this category because it is the most plainly inapplicable here. It is beyond dispute that neither the CBI nor the TCW claims were asserted before the bar date set by the Plan of Liquidation for objections to proofs of claim.

Accordingly they may not, even if meritorious, provide a ground for disallowance of E&Y's claim.

BSI relies (BSI XAP Br. 34-35)[3] upon the district court's approval of the *post facto* assignment to BSI by the Creditors' Committee of the latter's objection to E&Y's claim. As we pointed out (E&Y Br. 62, 74-75 & n.36, 82), however, the only objection made by the Committee was that E&Y's claim was excessive in amount; that objection carried not the least suggestion that E&Y had committed malpractice or that such malpractice furnished a defense to E&Y's claim. BSI unpersuasively attempts to justify tacking to the timely-filed objection of the Committee its belatedly-filed complaint, which raises an entirely new objection (*i.e.*, malpractice) and counterclaims (*i.e.*, malpractice-based, see *Hirsch* v. *Arthur Andersen & Co.*, 72 F.3d 1085, 1092 (2d Cir. 1995)) to E&Y's claim. BSI offers no response to our citation (E&Y Br. 82-83), by analogy, of the rule precluding such amendment of timely proofs of claim after the bar date.

BSI does lean heavily upon *In re Leslie Fay Cos.*, No. 97 Civ. 2244, 1997 WL 555607 (S.D.N.Y. Sept. 4, 1997), apparently because, in that case, objections were filed almost three years after proofs of claim had been filed. It is unclear

[3] "BSI XAP Br." refers to BSI's answering brief on the conditional cross-appeal, which was bound and paginated together with BSI's reply brief on the main appeal. "E&Y Br." refers to E&Y's opening brief on the conditional cross-appeal, which was bound and paginated together with E&Y's answering brief on the main appeal.

what a case in which a bar date—if there was one (the opinion does not refer to a bar date at all)—played no part in resolving a dispute concerning withdrawal of the reference has to do with the instant matter. Timeliness was simply not raised as an issue in *Leslie Fay*. Here it was, and BSI cannot, by ignoring the existence of a bar date, wish it away. The fact is that the CBI claims simply came too late to qualify for core treatment under subsection B.

2. Subsection C: Counterclaims By The Estate Against Persons Filing Claims Against The Estate.

The untimeliness of the CBI (malpractice-based) counterclaims not only precludes characterizing them as objections to E&Y's proof of claim under subsection B, but also undermines the district court's theory that they are core under subsection C as "counterclaims by the estate against persons filing claims against the estate." The essential premise of the district court's characterization of the CBI claims as core was their supposed factual and legal relatedness to E&Y's proof of claim for fees in connection with the 1994 reaudit (and certain other 1994 consulting services). See 311 B.R. at 362 ("CBI's five other claims (alleging negligence, breach of contract, and fraud) are core because they are factually and legally interconnected with Ernst & Young's Proof of Claim and CBI's expungement claim."). The legal relatedness supposedly derives from the proposition that a finding of malpractice might be a defense to the E&Y claim; factual relatedness allegedly follows, because it would be necessary to determine

the facts relating to the malpractice claim in order to know whether to allow or disallow E&Y's proof of claim. There are two responses.

First, if, as we argue, the malpractice-based defense to E&Y's proof of claim is barred by the untimeliness of its assertion, then any factual and legal relatedness of the CBI counterclaims to E&Y's proof of claim is irrelevant. The CBI counterclaims raise the questions whether imputation bars their assertion and, if not, whether E&Y performed a competent audit. E&Y's proof of claim, by contrast, can be tested only against the one objection that was timely asserted—that E&Y's 1994 fees were excessive in amount. Adjudication of these two claims involves virtually no common issues of fact or law.

Second, the bar date aside, E&Y was entitled under *Marathon* to have the malpractice-based claims adjudicated in an Article III tribunal. See E&Y Br. 79-82. This is so because, even though the CBI claims might be argued to be "counterclaims" (28 U.S.C. § 157(b)(2)(C)) to E&Y's proof of claim, and even assuming *arguendo* that they are factually and legally connected thereto, (a) their size dwarfed E&Y's proof of claim ***and*** (b) they were not based on or arising under bankruptcy law. Cf. *In re Orion Pictures Corp.*, 4 F.3d 1095, 1102 (2d Cir. 1993) (holding that *Marathon* required deeming "related" a proceeding that appeared to qualify as core under the plain language of 28 U.S.C. § 157(b)(2)(A)). In addition

to *Orion* (which BSI ignores entirely), we cited two district court cases applying this same logic directly to the counterclaim provision.

BSI argues (BSI XAP Br. 31) that "[t]here is no basis in law or reason to arrive at a particular ratio of counterclaim to claim which would deprive the bankruptcy court of jurisdiction." The basis is in fact clear: Article III of the Constitution, as interpreted in *Marathon*. See *In re Complete Mgmt., Inc.*, No. 02 CIV. 1736, 2002 WL 31163878, at *3 (S.D.N.Y. Sept. 27, 2002) (relying on *Orion*[4] and holding that core treatment does not "extend[] to a counterclaim that is, as here, seventy times greater than the proof of claim"); *In re Marshall*, 264 B.R. 609, 632 (C.D. Cal. 2001) (relying on *Marathon* and holding counterclaim to be related because, *inter alia*, it "dwarfs" the claim).

BSI's attempted distinctions of these cases fall flat. As to *Complete Management*, whether its core/non-core discussion is holding (as we contend) or dictum (as BSI contends) is largely besides the point in this Court's consideration of a district court opinion; it is the persuasive force of the court's analysis that

---

4 To be precise, the *Complete Management* court cited *Orion* for the proposition that the constitutional inhibitions that preclude a literal interpretation of the first catch-all category (28 U.S.C. § 157(b)(2)(A)) apply equally to preclude a literal interpretation of the second catch-all category (*id.* § 157(b)(2)(O)). Having disposed of the argument that section 157(b)(2)(O) should be interpreted broadly, Judge Buchwald then turned to the "counterclaim" category (*id.* § 157(b)(2)(C)) and held it inapplicable, as discussed above.

matters.[5] As to *Marshall*, BSI unpersuasively seeks to distinguish it based upon that court's observation that it was "not certain" that the counterclaim arose from the same transaction as the proof of claim. 264 B.R. at 631. But the *Marshall* court proceeded to assume *arguendo* that the counterclaim and claim did arise from the same transaction and held that core treatment was not warranted. See *ibid*. ("In this case, the reasons for why counterclaims ***arising out of the same transaction*** should usually be considered core do not apply") (emphasis added).

Nor is there any merit to BSI's unsupported suggestion that it is "impractical" (BSI XAP Br. 31) to make the core/non-core determination turn upon the ratio of the counterclaim to the proof of claim. Use of ratios is hardly foreign to constitutional law. See, *e.g.*, *State Farm Mut. Auto. Ins. Co.* v. *Campbell*, 538 U.S. 408, 425 (2003) ("[F]ew [punitive damages] awards exceeding a single-digit ratio between punitive and compensatory damages * * * will satisfy due process."). Although the precise line at which the counterclaim becomes too disproportionate to permit core treatment may be indistinct, this Court need not

---

[5] BSI also contends (BSI XAP Br. 32) that the "efficiency" factors (apart from the core/non-core issue) considered by the *Complete Management* court in deciding to withdraw the reference are absent here, citing Judge Wood's finding that "at the time Ernst & Young moved to withdraw the reference * * *, considerations of efficiency strongly weighed in favor of not granting that motion." 311 B.R. at 364 n.7. But, because no pre-trial proceedings had yet occurred, the bankruptcy court was hardly more familiar than the district court with BSI's adversary proceeding against E&Y.

draw it in this case, where the ratio (330:1) stands far outside any conceivable line. Cf. *Irwin* v. *Gavit*, 268 U.S. 161, 168 (1925) (Holmes, J.) ("Neither are we troubled by the question where to draw the line. That is the question in pretty much everything worth arguing in the law.").[6]

We also pointed (E&Y Br. 79-82) to the state-law nature of the CBI counterclaims—*i.e.,* that the claims had independent existence rather than arising under federal bankruptcy law—as further support for treating them as "related" proceedings. BSI simply mischaracterizes our argument here. See BSI XAP Br. 33. We do ***not*** argue that the CBI claims are "related" ***solely*** because they do not arise under bankruptcy law but are instead based upon state law. Rather, we argue that the state-law nature of the claims may be taken into account as one relevant factor in support of deeming the CBI claims "related."[7]

---

[6] One clear line that is highly relevant to the purposes of granting bankruptcy-court "core" jurisdiction is whether the size of the counterclaim exceeds that of the claim to which it is counter and which it would, if successful, nullify or offset.

[7] Our position is entirely consistent with 28 U.S.C. § 157(b)(3), which recognizes that the state-law character of a claim is ***one*** factor to be considered in determining whether a proceeding is core or related (stating in part that the determination "shall not be made ***solely*** on the basis that its resolution may be affected by State law") (emphasis added). Moreover, the touchstone of our argument is not whether claims arise under state or federal law, but whether they have a foundation independent of federal ***bankruptcy*** law—be that state or federal law. Thus, the same Article III protections would attach to a claim arising under the Longshoremen and Harbor Workers Act or federal Superfund laws as to those arising under state law.

3. Subsections A and O: The Catch-All Core Categories.

Quoting *In re Castlerock Properties*, 781 F.2d 159, 162 (9th Cir. 1986), and citing the Collier treatise, we argued (E&Y Br. 83-84) that claims that do not fit within any of the categories enumerated in 28 U.S.C. § 157(b)(2)(B)-(N) cannot qualify for core treatment under the catch-all categories of 28 U.S.C. § 157(b)(2)(A) or (O).

BSI correctly points out (BSI XAP Br. 36) that this Court declined to follow the Ninth Circuit's "sweeping statement" on this point. See *In re Ben Cooper, Inc.*, 896 F.2d 1394, 1400 (2d Cir. 1990), cert. granted, 497 U.S. 1023, vacated and remanded, 498 U.S. 964 (1990), opinion reinstated on remand, 924 F.2d 36 (2d Cir. 1991). But it hardly follows that the catch-all categories are without bounds in this Circuit. This Court merely rejected, as a matter of statutory interpretation, the Ninth Circuit's notion that subparagraphs (A) and (O) are ***entirely*** superfluous; it did ***not*** hold that the text of Section 157 may be applied literally without regard to *Marathon*. Thus, since *Ben Cooper*, this Court has been vigilant in guarding the rights of litigants to non-core treatment (and to jury trials, a point considered hereinafter). *Orion*, 4 F.3d at 1095, sounded the clarion call in this regard, refusing to interpret 28 U.S.C. § 157(b)(2)(A) ("matters concerning the administration of the estate" are core) so broadly as to "contravene" the limits placed upon

bankruptcy court jurisdiction by *Marathon*.[8] The district court in *Complete Management* sensibly extended *Orion*'s approach to the other catch-all category, 28 U.S.C. § 157(b)(2)(O). 2002 WL 31163878, at *3. As discussed above and in E&Y's opening brief, *Marathon* requires that the CBI claims be deemed non-core, related proceedings.

### B. The TCW Claims are "Related" Proceedings, Not "Core" Proceedings.

The court below held, and it is not here disputed, that E&Y was entitled to a jury trial on the TCW claims. 311 B.R. at 366-67. It is nevertheless material whether the TCW claims are core or related because it affects whether the jury trial must occur in an Article III court (*i.e.*, the district court).[9]

---

[8] The cases cited by BSI (BSI XAP Br. 30, 33, 36) as indicating a more cavalier attitude toward the teaching of *Marathon* are inapplicable. *In re S.G. Phillips Constructors, Inc.*, 45 F.3d 702 (2d Cir. 1995), and *Gulf States Exploration Co.* v. *Manville Forest Products Corp.*, 896 F.2d 1384 (2d Cir. 1990), each held that a debtor's objection to a proof of claim was core; counterclaims were not involved. *In re Best Prods. Co.*, 68 F.3d 26 (2d Cir. 1995), held that the interpretation of an inter-creditor subordination agreement was core; nothing comparably intertwined with the bankruptcy adjudication function is involved here. Finally, *In re United States Lines, Inc.*, 197 F.3d 631 (2d Cir. 1999), involved an adversary proceeding alleging the postpetition breach of a prepetition contract and elicited three separate opinions from the three-judge panel, each of which advanced a separate rationale for the result reached by this Court. *United States Lines* involved neither a proof of claim nor a counterclaim.

[9] When CBI's chapter 11 case was filed, it was governed by this Court's holding in *Ben Cooper*, 896 F.2d at 1403-1404, that jury trials in core matters could be conducted in bankruptcy court. In every other circuit at that time, and in this circuit in any title 11 case filed after the enactment of 28 U.S.C. § 158(e) as

Even assuming *arguendo* that the CBI claims are core, the TCW claims are not. The crucial difference between the two sets of claims is that the former always belonged to the debtor, whereas the latter arrived in the hands of the debtor's successor (BSI) only by virtue of a post-petition assignment. BSI barely responds to our contention (E&Y Br. 85) that allowing such an assignment—whether or not embodied in a bankruptcy-court-approved Plan—to transform a claim from non-core to core would dramatically widen the bankruptcy court's core jurisdiction and tear an enormous hole in the fabric of *Marathon* and the principles underlying 28 U.S.C. § 1359.

The district court accepted that the TCW claims stand on a different footing from the CBI claims. Specifically, the court held that, "because Ernst & Young's Proof of Claim was filed solely against CBI, and not TCW, BSI's claim to expunge the Proof of Claim is brought on behalf of CBI alone. TCW's claims cannot, therefore, be core pursuant to Section 157(b)(2)(B), because they would not themselves directly affect the allowance or disallowance of the Proof of Claim."

---

part of the Bankruptcy Reform Act of 1994, a jury trial on the TCW claims, even if core, would have had to take place in the district court absent the consent of all parties to trial in the bankruptcy court. See 1 COLLIER ON BANKRUPTCY ¶ 3.08[3] (15th ed. rev. 2005). That the indisputably jury-triable TCW claims would have to be tried in the district court but for the idiosyncratic and now defunct *Ben Cooper* regime warrants especial wariness on the part of this Court before rendering a holding (deeming the TCW claims core) that would allow their trial in the bankruptcy court.

311 B.R. at 363. But the district court inexplicably ignored the history of the TCW claims (*i.e.*, that they came into BSI's hands only through a post-petition assignment) in holding (*id.* at 364) that the TCW claims were magically transformed into core "counterclaims" upon their assignment to BSI. *Marathon* and the rule against jurisdiction-by-assignment are equally offended whether such a scheme is sought to be justified under either subsection B or C of 28 U.S.C. § 157(b)(2).[10]

The one case cited by BSI in support of its position (BSI XAP Br. 38-39) is not remotely apposite. *In re Ecam Publications, Inc.*, 131 B.R. 556 (Bankr. S.D.N.Y. 1991), involved a motion for contempt filed by a chapter 11 trustee seeking to examine two witnesses under Bankruptcy Rule 2004. The witnesses failed to appear and the trustee sought to hold them in contempt; the court's opinion was mainly concerned with their cross-motion to limit the scope of the examination. It appeared that the trustee, as part of a sale of certain estate property to a third party, was to acquire claims against the witnesses that were owned by the

---

[10] BSI attempts unsuccessfully to distinguish *In re 131 Liquidating Corp.*, 222 B.R. 209 (S.D.N.Y. 1998), discussed in our Opening Brief at 84. Here, the TCW claims occupy the same position as the shareholders' claims in *131 Liquidating*, which the court deemed non-core. BSI offers no response to our argument (E&Y Br. 84 n.40) that it is immaterial that E&Y, unlike the creditor in *131 Liquidating*, filed a proof of claim, in light of the district court's correct recognition that the TCW claims were ***not*** part and parcel of the allowance process. 311 B.R. at 363-64.

buyer of that estate property. The witnesses argued that the trustee should not be allowed to examine them under Rule 2004 with respect to those claims. At the time the opinion was issued, the trustee had not yet acquired the claims.

The bankruptcy court rejected the witnesses' argument that the trustee should not be permitted to acquire claims from third parties against other third parties. One of the court's Conclusions of Law was that ***the motion for contempt was core***. 131 B.R. at 561. No argument had been made to the contrary; this conclusion was boilerplate. The court said nothing, as BSI would have this Court believe, about whether the claims owned by the buyer of the estate property would be treated as core if and when acquired by the trustee and asserted by the trustee against the witnesses.

## II. THE DISTRICT COURT ERRED IN HOLDING THAT E&Y WAS NOT ENTITLED TO A JURY TRIAL ON THE CBI CLAIMS.

BSI does not contest that a claim's status as core does not control whether the party has a right to jury trial on this claim. As this Court has explained:

> One aspect of the Supreme Court opinion [in *Marathon*] is clear—that is, when a party makes a jury demand for a claim that is inherently legal, "Congress cannot eliminate [that] party's Seventh Amendment right to a jury trial merely by relabeling the cause of action to which it attaches and placing exclusive jurisdiction in an administrative agency or a specialized court of equity." In other words, we are required to analyze the underlying nature of the claim without regard to Congress' designation of that claim as core.

*Ben Cooper*, 896 F.2d at 1400-1401 (internal citation omitted). We demonstrated in our opening brief (E&Y Br. 84-93) and reiterate here that, even if the CBI claims are core, E&Y has a right to trial by jury on those claims.

### A. E&Y Is Entitled To A Jury Trial On The CBI Claims.

Just as *Orion* represents this Court's acknowledgment that 28 U.S.C. § 157(b)(2)(B) is subject to *Marathon*'s constitutional predicates, *Germain* v. *Connecticut National Bank*, 988 F.2d 1323 (2d Cir. 1993), explains how the trial of bankruptcy claims is circumscribed by Seventh Amendment jury-trial rights.

We previously recounted (E&Y Br. 86-89) the facts of *Germain* and its relationship to this case, and need not embroider that discussion here. Our argument is not refuted in the least by BSI's out-of-context quotation (BSI XAP Br. 42) from *Germain*. Rather than rigorous intellectual analysis, BSI relies for its rebuttal not upon principle but upon bankruptcy mythology: "file-a-proof-of-claim-and-lose-your-right-to-a-jury-trial."

There is one, but only one, type of proceeding in which that mantra is true: a proceeding that involves a counterclaim based upon the bankruptcy avoiding powers found in 11 U.S.C. §§ 542-553. *Katchen* v. *Landy*, 382 U.S. 323 (1966), *Granfinanciera, S.A.* v. *Nordberg*, 492 U.S. 33 (1989), and *Langenkamp* v. *Culp*, 498 U.S. 42 (1990)—relied upon by the courts below and by BSI—without exception involved avoiding power causes of action. The instant case does not.

The reason for this dichotomy is simple and straightforward. Under the modern Bankruptcy Code, as under the old Bankruptcy Act, a claim filed by a creditor that has received a voidable transfer cannot be allowed until the transfer or its value is returned. 11 U.S.C. § 502(d) (Bankruptcy Code); Bankruptcy Act § 57g (repealed 1979). The latter provision was characterized by the Supreme Court in *Katchen* as an "important congressional directive around which much of this case turns." 382 U.S. at 330. Therefore, as the Supreme Court observed, determining the avoiding power counterclaim in the bankruptcy court without a jury trial right is "part and parcel of the allowance process." *Ibid.* By statutory mandate, the claim of the creditor cannot be allowed until and unless the creditor returns the avoidable transfer. The statute applies whether the proof of claim exceeds or is less than the counterclaim—until the transfer is returned, the claim cannot be allowed.[11] And the creditor cannot set off its obligation to the estate against amounts owed to it by the debtor. 5 COLLIER ¶ 553.03[3][e][v].

By contrast, the claim of a creditor against whom counterclaims based upon non-avoiding-power causes of action are asserted can be allowed irrespective of

[11] *In re Hooker Investments, Inc.*, 937 F.2d 833 (2d Cir. 1991), quoted by BSI (BSI XAP Br. 41-42), involved a pending adversary proceeding seeking to recover a preferential payment from a bank. The bank sought (unsuccessfully) an extension of the bar date to file a proof of claim until after the adversary proceeding was concluded because, by filing a claim, it would lose its jury trial right. Once again, it was the nature of the cause of action (which went to

how the litigation turns out. Suppose Creditor X files a proof of claim for $10 against a debtor growing out an unpaid invoice for the sale of shoes. The debtor counterclaims against X for breach of warranty for $5—the shoes were defective. Even if the debtor prevails upon the counterclaim, the creditor's claim can still be allowed in the net amount after setting off the estate's recovery on the counterclaim. *Id.* ¶ 553.03[7]. No statute prohibits allowance just because the estate has a counterclaim. By contrast, if the trustee's counterclaim were ***to recover a voidable preference*** from X (again, assume the amount is $5), X's proof of claim (again, assume $10) could not be allowed at all until X returned the preference.

It was in the context of a discussion of the *Katchen-Granfinanciera-Langenkamp* line of cases that the *Germain* Court made the statement quoted by BSI at XAP Br. 44. It was in the context of all other proceedings—those, such as in the example above and in the case at bar, in which the counterclaims do not implicate 11 U.S.C. § 502(d)—that this Court so strongly and fervently spoke in *Germain* of the importance of protecting defendants' jury-trial rights. A claim that can be allowed irrespective of how the counterclaims turn out is hardly "part and

---

allowance or disallowance of the proof of claim) that determined the right to a jury trial.

parcel of the allowance process." *Katchen*, 382 U.S. at 330. Consequently, the party's jury-trial right is preserved.[12]

**B. In Any Event, E&Y's Conceded Entitlement To A Jury Trial On The TCW Claims Requires That The CBI Portion Of The Judgment Be Vacated.**

We argued (E&Y Br. 90-93) that—whether or not E&Y would be entitled to a jury trial on the CBI claims standing alone—the bankruptcy court's denial of E&Y's (undisputed) right to a jury trial on the TCW claims requires, under *Lytle* v. *Household Manufacturing, Inc.*, 494 U.S. 545 (1990), that the CBI portion of the judgment be vacated and the issues common to the TCW and CBI claims be tried to a jury.

As we anticipated (E&Y Br. 92), BSI does not take issue with our account of *Lytle*, but argues instead (BSI XAP Br. 46) that *Katchen*, 382 U.S. 323, creates an exception to the *Lytle* rule in the bankruptcy context. BSI is wrong. Although *Katchen* did craft an exception, the rationale for that exception was integrally connected with the bankruptcy scheme in place at the time (1966). That scheme

[12] BSI's remaining case citations (BSI XAP Br. 45 n.9) do not support its position. Both *In re Mindeco Corp.*, 212 B.R. 447 (E.D.N.Y. 1997), and *Peachtree Lane Assocs.* v. *Granader*, 175 B.R. 232 (N.D. Ill. 1994), involved determinations of a creditor's interest in estate property; unlike here, no affirmative relief was sought from the creditor. In *In re Frost, Inc.*, 145 B.R. 878 (Bankr. W.D. Mich. 1992), the creditor did not even want a jury; it was the debtor that sought a jury trial when it filed a counterclaim to the creditor's proof of claim. The court held that the debtor lost his right to a jury by filing its bankruptcy petition. *Id.* at 883.

was thoroughly modified with the enactment of the Bankruptcy Reform Act of 1978, as supplemented by the Bankruptcy Reform Act of 1984, causing the rationale for the exception to disappear.

Specifically, as we explained in our opening brief (at 92) and elaborate presently, *Katchen* was decided under the Bankruptcy Act of 1898, which made a distinction between summary jurisdiction and plenary jurisdiction that is crucial to understanding its ruling. Summary jurisdiction was vested exclusively in the bankruptcy courts, and covered matters such as "adjudicat[ing] controversies relating to property over which [those courts] have actual or constructive possession * * * [and] questions between the bankrupt and his creditors, which are presented in the ordinary course of the administration of the bankrupt's estate." *Katchen*, 382 U.S. at 327. (Unlike today, there was no possibility of a district court asserting jurisdiction over such matters by withdrawing the reference.) All other proceedings fell within plenary jurisdiction, which was ***not*** vested in the bankruptcy courts; such actions therefore had to be brought as a "plenary suit" in a different court (state or federal). *Id.* at 338. See generally 1 COLLIER ¶ 3.08[1][a], p. 3-100 ("plenary actions were independent actions not within the summary jurisdiction of the bankruptcy court"). It was against this background of delay and expense resulting from having to wait for trial of the plenary action in a separate

tribunal that the *Katchen* Court concluded that the equitable proceeding to determine whether the creditor had received a voidable preference could go first.

The Bankruptcy Reform Act of 1978, as supplemented by the Bankruptcy Reform Act of 1984, replaced this regime and, among other things, discarded the 1898 Act's "dichotomy between summary jurisdiction and plenary jurisdiction[,] [which had led] to much wasteful litigation, expense and delay in bankruptcy cases." G. Ray Warner, Katchen *Up In Bankruptcy: The New Jury Trial Right*, 63 Am. Bankr. L. J. 1, 43 (1989). The enlarged jurisdiction thus conferred on district and bankruptcy courts "enabled a single court to resolve most matters involving the debtor." *Ibid.* Here, assuming *arguendo* that the CBI and TCW claims are core proceedings, that "single court" could be either the district court, through withdrawal of the reference, or the bankruptcy court, which could conduct a jury trial of a core proceeding under *Ben Cooper*. Assuming, on the other hand, that either the CBI claims or the TCW claims are non-core, the "single court" is the district court; unlike the regime in place when *Katchen* was decided, the district court can assert jurisdiction over both core and non-core proceedings.

Accordingly, it simply cannot be said today, as the Supreme Court said in *Katchen*, that application of the *Dairy Queen/Beacon Theatres*' requirement that legal claims be tried first "would require that * * * a plenary suit [be] initiated with all the delay and expense that course would entail." *Katchen*, 382 U.S. at 339. For

example, applying the current bankruptcy framework to the facts of *Katchen* itself, each of (1) the creditor's proof of claim; (2) the trustee's objection to the proof of claim on the ground that the creditor had received a voidable preference; and (3) the trustee's action to recover the voidable preference, would qualify as core proceedings and fall within the bankruptcy court's jurisdiction. See 28 U.S.C. § 157(b)(2)(B), (F). Thus, all could be litigated in that "single court" with a jury trial on (3) easily conducted prior to court adjudication of the equitable claims.

The Supreme Court made this point abundantly clear in *Granfinanciera*, 492 U.S. 33, a decision that BSI entirely ignores in this section of its brief (BSI XAP Br. 45-51). *Granfinanciera* was decided after the Bankruptcy Act of 1898's summary/plenary dichotomy had been repealed. Quoting approvingly from Professor Warner's article, the *Granfinanciera* Court explained:

> [T]he delay and expense language of *Katchen* must be read in light of petitioner's demand for a stay of the bankruptcy action and the institution of a separate suit in a different court. That is a qualitatively different type of delay and expense from the delay and expense of providing a jury trial in the same action. The latter could never override *Beacon* and *Dairy Queen*.

492 U.S. at 64 n.18 (quoting Warner, 63 Am. Bankr. L. J. at 39) (internal citations omitted). Here, as explained above, the jury trial can be provided in the same action and in the same forum, and the *Dairy Queen/Beacon* rule (and hence the remedial *Lytle* rule) is therefore fully applicable.

While ignoring this passage from *Granfinanciera* (which we quoted at E&Y Br. 93), BSI cites two cases that pre-date *Granfinanciera* and are in any event distinguishable. The first, *Agudas Chasidei Chabad* v. *Gourary*, 833 F.2d 431, 438 (2d Cir. 1987) (cited at BSI XAP Br. 46 n.10), did not arise in the bankruptcy context at all, and the defendant lost his right to have the legal claims tried first to a jury only because (unlike E&Y here) he failed to make a timely jury demand. As to the second, while *Parklane Hosiery Co.* v. *Shore*, 439 U.S. 322, 334-35 (1979) (cited at BSI XAP Br. 48-49), cited *Katchen* as an example of an exception to the *Dairy Queen*/*Beacon* rule, it did not purport to address whether the *Katchen* exception survived the fundamental post-*Katchen* changes to the bankruptcy framework. Rather, the Court proceeded to announce an entirely separate exception to *Dairy Queen/Beacon* in the circumstance where the equitable claim is one brought by the Securities and Exchange Commission; such a claim may be adjudicated prior to a related jury-triable claim without violating the Seventh Amendment. *Parklane Hosiery*, 439 U.S. at 337. *Granfinanciera*, by contrast, speaks directly to the post-1984 bankruptcy regime and holds that the *Katchen* exception indeed is no longer available.

In short, whether or not E&Y is entitled to a jury trial on the CBI claims standing alone, its unquestioned right to a jury trial on the TCW claims (which right was improperly denied by the bankruptcy court) requires that both the TCW

and CBI portions of the judgment be vacated and the issues common to the TCW and CBI claims be tried first to a jury.

## CONCLUSION

The judgment of the district court should be affirmed. In the event this Court reverses the judgment, it should also reverse the district court's holdings that (1) the CBI and TCW claims are core; and (2) E&Y is not entitled to a jury trial on the CBI claims. Even if E&Y would not be entitled to a jury trial on the CBI claims standing alone, this Court should hold that E&Y's undisputed right to jury trial on the TCW claims requires that issues common to the TCW and CBI claims be tried to a jury before any bench trial on the CBI claims.

Dated: June 7, 2005

Respectfully submitted,

**MAYER, BROWN, ROWE & MAW LLP**

By: ________________________

Andrew L. Frey
Sanford I. Weisburst
1675 Broadway
New York, NY 10019
(212) 506-2500

*Attorneys for Ernst & Young and Ernst & Young LLP*

Of Counsel:

Richard F. Broude
RICHARD F. BROUDE, P.C.
400 East 84th Street, #22-A
New York, NY 10028
(917) 301-3468

Irwin J. Sugarman
Harry S. Davis
SCHULTE ROTH & ZABEL LLP
919 Third Avenue
New York, NY 10022
(212) 758-2000

**CERTIFICATE OF COMPLIANCE**

Pursuant to Fed. R. App. P. 32(a)(7)(C) and this Court's Order dated February 9, 2005 (providing for a word limit of 8,000 words for E&Y's reply brief on the cross-appeal), I hereby certify that this brief was produced in Times New Roman (a proportionally spaced typeface), 14-point type and contains _____ words (based on the Microsoft Word word processing system word count function).

__________________________
Andrew L. Frey

## CERTIFICATE OF SERVICE

I, Andrew L. Frey, a member of the Bar of this Court, hereby certify that, on June 7, 2005, I caused to be served two copies of the foregoing Reply Brief for Appellees–Cross-Appellants Ernst & Young and Ernst & Young LLP upon counsel for Appellant BSI at the following address:

Jay Strum, Esq.
Kaye Scholer LLP
425 Park Avenue
New York, NY 10022

________________________
Andrew L. Frey