No. 08-1042

In the Supreme Court of the United States

ERNST & YOUNG AND ERNST & YOUNG LLP,

Petitioners,

v.

BANKRUPTCY SERVICES, INC.,

Respondent.

On Petition for a Writ of Certiorari to The United States Court of Appeals for the Second Circuit

REPLY BRIEF FOR PETITIONERS

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REPLY BRIEF FOR PETITIONERS

BSI's opposition is most notable for the points it leaves unchallenged. BSI does not deny that the Second Circuit's decision effectively places creditors outside the reach of the Seventh Amendment, or that, if *Katchen* has become anachronistic, only this Court can repair the situation. Nor does BSI dispute that this Court has singled out Seventh Amendment cases for special scrutiny because of the importance of the fundamental right to a jury trial. See Pet. 10. And BSI does not contest that the decision below will have broad impact on the bankruptcy courts' rapidly growing dockets, applying in nearly all bankruptcy proceedings in which a trustee asserts a counterclaim against a creditor who has filed a claim. See Pet. 12. And BSI points to nothing about this case that would make it a poor vehicle for addressing these weighty constitutional issues.

Unable to contest the importance or scope of the issues implicated by the court of appeals' decision, BSI offers (Opp. 10–13) only a short discussion of prudence and circuit splits that is unconvincing in light of the significance and timeliness of the Seventh Amendment questions presented in E&Y's petition.

The balance of the opposition brief addresses the merits of the constitutional issues but suffers from misunderstandings about the Bankruptcy Act of 1898 and this Court's Seventh Amendment precedents. The questions are fairly debatable, and their authoritative resolution would enhance this Court's Seventh Amendment jurisprudence, as well as its impact upon the bankruptcy process.

A. Immediate Review Of The Decision Below Is Warranted.

BSI invokes the interlocutory status of the case and the possibility that E&Y would prevail on some other ground as a sufficient basis for denying E&Y's petition. Opp. 10–11. But the Court does grant review in such circumstances (see, *e.g.*, *Norfolk S. Ry.* v. *James N. Kirby, Pty Ltd.*, 543 U.S. 14, 22 (2004) (reviewing denial of summary judgment); *F. Hoffmann-La Roche Ltd* v. *Empagran S.A.*, 542 U.S. 155, 159–60 (2004) (reviewing denial of motion to dismiss)), and this is an instance where such action is appropriate.

While it is possible that E&Y will prevail on a separate, dispositive issue below, the greater likelihood is that the Seventh Amendment issues presented here will persist, and absent a ruling now by this Court, the parties will go through much wasted effort in this extraordinarily long-running case before the issues are again teed up for this Court's consideration. First, significant aspects of the district court's review on the remaining issues involve deference to the fact-finding of the bankruptcy judge on matters that should have been resolved by a jury. Second, if E&Y were to prevail on its challenges pending in the district court, any new trial that might be ordered would, under the Second Circuit's ruling, be conducted without a jury. And the already-awarded new trial on the TCW claims will take place under the shadow of the bench ruling on the CBI claims. Thus, if it was error to try the CBI claims without a jury, now is the time to resolve the point.

Moreover, even if E&Y prevails on one of its nonconstitutional challenges, the court of appeals' prob-

lematic Seventh Amendment ruling would bind district and bankruptcy courts in the Second Circuit and serve as persuasive authority in other circuits. The increase in bankruptcy filings reported in E&Y's petition continued apace through the remainder of 2008, and there are no signs that the trend is abating.[1] If this Court were to delay consideration of the questions presented, the result would be widespread impairment of jury trial rights and, once the jury trial right is ultimately vindicated, a flood of retrials. Immediate review would provide much needed guidance to lower courts as they grapple with their burgeoning bankruptcy caseloads, and to creditors who might otherwise be chilled from asserting claims in the bankruptcy courts by the prospect of forfeiture of jury trial rights as a consequence of filing a claim.

BSI also points to the absence of a circuit split as a reason to decline review. Opp. 12–13. But this consideration is not determinative,[2] especially in a case like this, which asks this Court to reconsider one of its prior decisions and thus cannot, almost by definition, result in a circuit split. As the Second Circuit noted, courts of appeals do "not have the dis-

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[1] See News Release, Admin. Office of the U.S. Courts, *Bankruptcy Filings up in Calendar Year 2008* (Mar. 5, 2009) (noting 31% increase in all filings, 60% increase in Chapter 11 filings, and 54% increase in business filings from calendar year 2007 to 2008).

[2] See, *e.g.*, *Crawford* v. *Marion County Election Bd.*, 128 S. Ct. 1610, 1615 (2008) (granting certiorari without any indication of split); *Florida* v. *Nixon*, 543 U.S. 175, 186 (2004) (same); *Pharm. Research & Mfrs. of Am.* v. *Walsh*, 538 U.S. 644, 650 (2003) (same); see also *Curtis* v. *Loether*, 415 U.S. 189, 191 (1974) (granting certiorari in absence of circuit split because of "the importance of the jury trial issue").

cretion to ignore Supreme Court precedent simply because the reasoning on which it is premised may seem no longer viable." Pet. App. 68a. Thus, there is no reason for this Court to delay review for the sake of "periods of 'percolation' in, and diverse opinions from, * * * federal appellate courts," *Arizona* v. *Evans*, 514 U.S. 1, 23 n.1 (1995) (Ginsburg, J., dissenting), for those courts are not free to rule independently on the first question presented in E&Y's petition.

B. But For *Katchen*, The *Beacon Theatres* Rule Would Apply.

BSI argues that the *Beacon Theatres* rule does not apply because this case supposedly involves "separate plaintiffs' legal and equitable claims arising from common facts against the same defendant * * * in separate actions." Opp. 21. But the premise of this argument is demonstrably false. There is just one plaintiff, BSI. Pet. App. 152a. Neither CBI nor TCW is, or has ever been, party to this action. And this manifestly is one action: BSI asserted both the CBI claims and the TCW claims at the same time in a single complaint.

While there are certainly differences in aspects of these closely related claims, the fact that they originally belonged to different entities is not relevant to the Seventh Amendment issue. It certainly supplies no basis for discarding E&Y's protections under *Beacon Theatres*. Not surprisingly, BSI offers no authority to support its notion that a single plaintiff's assertion of assigned legal and equitable claims constitutes the "imperative circumstances" necessary to defeat a party's right to a jury trial. See *Dairy Queen*, 369 U.S. at 472–73. Indeed, BSI cites no cases in which a court faced with overlapping legal and equi-

table claims from *actual* separate plaintiffs refused to apply the *Beacon Theatres* rule.

Parklane is certainly not such a case. Unlike this case, *Parklane* involved two different plaintiffs asserting claims in two wholly different cases commenced in different forums at different times. See 439 U.S. at 324. Here, in contrast, BSI was unquestionably a party to the bankruptcy proceeding, and the bankruptcy court's erroneous decision to proceed without a jury on the issues common to the CBI claims and the TCW claims was made at BSI's behest. Accordingly, this case falls squarely within *Lytle*. See *Lytle*, 494 U.S. at 555 ("We decline to extend *Parklane* * * * and to accord collateral-estoppel effect to a district court's determinations of issues common to equitable and legal claims where the court resolved the equitable claims first solely because it erroneously dismissed the legal claims.").

C. BSI Misunderstands The Bankruptcy Act Of 1898 And *Katchen*.

BSI asserts that "under the Bankruptcy Act of 1898 * * * a single forum (the district court) was available in which all the equitable and legal claims in *Katchen* could have been adjudicated."[3] Opp. 22. Consequently, BSI states, "*Katchen's* paramount concern in rejecting application of *Beacon Theatres* notwithstanding the existence of a district court forum for providing jury trials in bankruptcy proceedings on preference claims—that jury trials would interfere with the claims allowance process by causing 'delay and expense' and 'dismember[ing]' the Con-

[3] We assume that BSI is contending that there existed a single forum in which overlapping legal and equitable claims could have been tried *before a jury*. It is that proposition we dispute.

gressional scheme—remains as vital as ever." Opp. 24-25 (quoting *Katchen*, 382 U.S. at 339).

BSI's theory—that *Katchen* rejected the petitioner's Seventh Amendment claim because of the delay and expense of empanelling juries—misunderstands *Katchen* and, indeed, is expressly belied by what this Court actually said. Unquestionably, it was the substantial delay and expense of applying the *Beacon Theatres* rule in bankruptcy proceedings as they were structured at the time that drove the Court's conclusion in *Katchen*. But it is clear from the four corners of the Court's opinion that the costs at issue were not those associated with jury trials as such, but instead existed because adherence to *Beacon Theatres* would have resulted, in any substantial bankruptcy, in a *multiplicity of lawsuits* around the country.

BSI's confusion is surprising, as *Katchen* began its analysis by explicitly identifying that premise:

> The argument here is that the same issues * * * may be presented *either* as equitable issues in the bankruptcy court *or* as legal issues in a plenary suit and that the bankruptcy court should stay its own proceedings and direct the bankruptcy trustee to commence a plenary suit so as to preserve petitioner's right to a jury trial.

382 U.S. at 338 (emphases added). Indeed, in the very sentences that BSI selectively quotes, *Katchen* explained that it was the initiation of independent lawsuits—not the costs of consolidating overlapping claims before a single jury—that would lead to undue inefficiencies:

> [P]etitioner's argument would require that in every case where a § 57g objection is interposed and a jury trial is demanded the proceedings on allowance of claims *must be suspended and a plenary suit initiated*, with all the delay and expense that course would entail. * * * [T]o say that because the trustee could bring an *independent suit* against the creditor to recover his voidable preference, he is not entitled to have his statutory objection to the claim tried *in the bankruptcy court in the normal manner* is to dismember a scheme which Congress has prescribed.

Id. at 339 (emphases added).

BSI's position is also in direct conflict with *Granfinanciera*, which held that the delay and expense of providing jury trials "'are insufficient to overcome the clear command of the Seventh Amendment.'" 492 U.S. at 63 (quoting *Curtis*, 415 U.S. at 198). In support of that point, *Granfinanciera* quoted Professor Warner's article, which stated:

> "At a minimum, the delay and expense language of *Katchen* must be read in light of the 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 G. Ray Warner, *Katchen Up in Bankruptcy: The New Jury Trial Right*, 63 Am. Bankr. L.J. 1, 39 (1989)).[4]

Thus, regardless of how BSI chooses to interpret the Act of 1898, the only point that matters is that *Katchen's* holding was expressly predicated on a threat that no longer exists: the specter of multiple lawsuits in multiple forums.[5] BSI does not dispute that this is no longer a problem under the current Bankruptcy Code (see Pet. 18–20), and the Second Circuit recognized as much when it acknowledged that E&Y's argument "might very well be sound" (Pet. App. 68a).[6]

Today, *Katchen* has clearly outlived its rationale. Only this Court can remedy the damage that is being done by the continued application of *Katchen* in needless derogation of the Seventh Amendment rights of parties to bankruptcy proceedings.

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[4] We urge the Court to consult Professor Warner's thorough discussion of the jurisdictional provisions of the Bankruptcy Act of 1898—a discussion that fully supports E&Y's position but that BSI wholly ignores.

[5] For example, in contrast to the jurisdictional scheme in place when *Katchen* was decided, the current scheme facilitates the efficient resolution of bankruptcy matters in a single forum by providing (with some exceptions) that "a proceeding arising under title 11 or arising in or related to a case under title 11 may be commenced in the district court in which such case is pending," 28 U.S.C. § 1409(a), and by establishing nationwide service of process, Fed. R. Bank. P. 7004(d).

[6] BSI makes passing reference to *Langenkamp*, but as BSI acknowledges (Opp. 23 n.5), the question presented here was not addressed by the Court in that summary reversal.

D. The Avoiding-Powers Question Warrants Review.

BSI argues that the second question presented is unworthy of review because the decision below involved a straightforward application of *Katchen*, *Granfinanciera*, and *Langenkamp*, and because E&Y's avoiding-powers argument is unpersuasive. Opp. 13, 25–35. Neither claim is accurate.

In its most direct attack on E&Y's avoiding-powers argument, BSI asserts that the "theory has no doctrinal support and misapprehends the nature of preferences and fraudulent conveyances" because creditors can be forced to disgorge such transfers without any showing that they have done wrong. Opp. 29. BSI is guilty of an anachronism; whatever may be the case today, what is relevant here is the situation the *Katchen* Court faced: the 1898 Act that underlay the decision contained an express culpability requirement.

In the Bankruptcy Act of 1867, Congress expressly prohibited courts from allowing preference creditors' claims if such creditors accepted the preference "having reasonable cause[] to believe the [preference] was made or given by the debtor, contrary to any provision of this act." Ch. 176, § 23, 14 Stat. 517, 528. The Bankruptcy Act of 1898 amended the disallowance provision in a manner that left ambiguity as to whether Congress meant to dispense with the culpability requirement, and this Court held that the statute omitted that requirement. *Pirie* v. *Chi. Title & Trust Co.*, 182 U.S. 438 (1901). Congress thereupon amended the provision to make clear that only culpable creditors had to surrender preferences as a prerequisite to consideration of their claims. Act of Feb. 5, 1903, ch. 487, § 12, 32 Stat.

797, 799; see also Vern Countryman, *The Concept of a Voidable Preference in Bankruptcy*, 38 Vand. L. Rev. 713, 721–22 (1985).

When *Katchen* was decided, therefore, it was clear that a preference could be avoided only if the creditor, "at the time when the transfer is made, [has] reasonable cause to believe that the debtor is insolvent." 11 U.S.C. § 96(b) (1964); *id.* § 93(g) (disallowing claims of creditors who received preferences and transfers "void or voidable under this title"). Congress maintained the culpability requirement until the Bankruptcy Reform Act of 1978.

E&Y does not ask this Court to adopt an unclean-hands test that would "fundamentally alter the bankruptcy process." Opp. 30–31. The point, rather, is that there is a doctrinally material difference between the avoiding-powers claims at issue in *Katchen*, *Granfinanciera*, and *Langenkamp*,[7] and the tort and contract claims brought by BSI. In light of the 1898 Act's culpability requirement, the unclean-hands doctrine informs *Katchen's* holding that a preference creditor loses its right to a jury trial on the preference issue when it submits a proof of claim. But there is no theory of equity that satisfactorily explains how E&Y could lose its fundamental jury trial right on BSI's claims.[8] Consequently, the Second Circuit's decision was not a "straightforward application" of this Court's precedents, but a theoreti-

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[7] See *supra* note 6.

[8] BSI relies (Opp. 19 n.4) on Justice White's views on the meaning and significance of *Katchen*, but those views were expressly rejected by the Court in both *Granfinanciera* and *Northern Pipeline*. See, *e.g.*, *Granfinanciera*, 492 U.S. at 58; *Northern Pipeline*, 458 U.S. at 79 n.31 (plurality opinion).

cally unsound extension of them that drastically curtailed creditors' Seventh Amendment rights.

E. The Damages And *In Pari Delicto* Holdings Warrant Review.

E&Y's petition offered a contingent argument: even if both the *Lytle* and avoiding-powers arguments failed, E&Y should have been entitled to a jury trial on issues that did not affect the allowance or disallowance of its claim. See Pet. 33–34. BSI does not challenge that proposition, but argues (Opp. 33) that the two issues E&Y identified as erroneously tried without a jury were in fact bench-triable because they bore directly on the allowance or disallowance of E&Y's claim.

It suffices for present purposes to consider BSI's discussion of damages (Opp. 33–35), which can be rejected in short order. Although it might sometimes be necessary to calculate damages to determine the magnitude of an offset, here the counterclaim, if meritorious, served as a complete defense to E&Y's claim for unpaid auditing fees. And in fact E&Y's proof of claim was expunged at the close of the liability phase. See Pet. App. 12a n.3. Thus, when the parties proceeded to the damages phase of the bifurcated proceedings, E&Y's proof of claim had already been disallowed. At that point, the equitable nature of the claims-allowance process could not possibly justify denying E&Y its right to litigate damages to a jury.[9]

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[9] The damages issue is not just numbers. It raises the issue of loss causation, the resolution of which was not necessary to deny the audit fees claim.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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