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Bankruptcy—Jury Trial

Debtor Doesn't Have Right to Jury Trial In Action Seeking Turnover of Property

Debtors do not have a right to jury trials in actions by trustees seeking the turnover of property during bankruptcy proceedings, the U.S. Court of Appeals for the First Circuit held June 26 (*Braunstein v. McCabe*, 1st Cir., No. 08-1690, 6/26/09).

Addressing an issue of apparent first impression at the appellate level, the opinion by Chief Judge Sandra L. Lynch explained that turnover proceedings under Section 542 of the Bankruptcy Code are not subject to the Seventh Amendment right to trial by jury under *Granfinanciera SA v. Nordberg*, 492 U.S. 33 (1989), and its progeny because they are not akin to any actions under common law and because the nature of the remedy is equitable.

Mark W. Corner and Peter Sutton, Riemer & Braunstein, Boston, who represented the trustee in this case, told BNA that the holding makes it easier in turnover cases for bankruptcy trustees to pursue assets of debtors and to cut down on delays and expenses in bankruptcy proceedings. The debtor's attorney had no comment.

The debtor, McCabe, and his wife lived on a houseboat that was owned by a limited liability company, TMG Holdings LLC, which was primarily controlled by McCabe and his law practice.

In September 2003, McCabe filed for protection under Chapter 11 of the Bankruptcy Code. Holdings filed for protection in February 2004. In December 2003, however, the houseboat was damaged by the wake of a tugboat. McCabe and his wife recovered \$77,572 from the tugboat's insurer for damages. Without notifying the bankruptcy court, McCabe then arranged to have repairs done on the houseboat. The work done on the boat actually reduced its value.

In February 2005, McCabe converted his bankruptcy petition to one under Chapter 7 and a trustee was appointed. The repair work on the houseboat was stopped, and the trustee took possession. The trustee filed a complaint against McCabe under Section 542

seeking a turnover of the insurance proceeds, and McCabe demanded a jury trial.

The court denied the request for a jury trial, but it found that expenses incurred by McCabe to fix the houseboat were reasonable and made in the ordinary course of business by a debtor in possession. It ordered McCabe to turn over \$30,262 to the trustee, which was left from the insurance settlement after the repairs were deducted.

No Right to Jury Trial. The court rejected McCabe's argument that he had a right to a jury trial for the turnover action under Section 542. The statute states that "an entity, other than a custodian, in possession, custody, or control during the case of property" of the estate "shall deliver to the trustee, and account for, such property or the value of such property." The property referred to in the statute is property that the trustee may "use, sell, or lease" or that the debtor may exempt. The statute "requires everyone holding property of the estate on the date of filing from which the trustee may benefit the estate under § 363 to deliver the property to the trustee," the court said.

According to the court, no statute gives a jury trial right in a Section 542 turnover action by the trustee. Thus, it said that McCabe's claim in this case was "purely constitutional."

Under *Granfinanciera* and its progeny, courts deciding whether a plaintiff is entitled to a jury trial must compare the statutory action to 18th-century actions brought in the courts of England before the merger of law and equity courts, they must examine the remedy sought and determine whether it is legal or equitable, and, if the first two factors indicate a jury trial right, they must decide if Congress assigned resolution of the relevant claim to a non-Article III adjudicative body that does not use a jury as factfinder.

McCabe's claim for a jury trial in this case foundered on the first two factors. Looking at the first factor, the court said that a "turnover action is not an action to recover damages for the taking of estate property but an action to recover possession of property belonging to the estate at the time of the filing. . . . It evokes the court's most basic equitable powers to gather and manage property of the estate."

As for the second factor, the court said that it also “supports the conclusion that there is no jury trial right.” Among other things, it explained that the “statutory cause of action expressly calls for an accounting remedy.” That “is enough to establish that the plaintiff would not, at common law, have had an adequate legal remedy and would have proceeded in equity,” it said.

Ordinary Course of Business. McCabe argued that the costs incurred in towing the houseboat and dismantling it for repairs were in the ordinary course of business for Holdings. Section 363 states that the trustee “may use, sell, or lease” property of the estate without notice and a hearing if doing so is “in the ordinary course of business.” Section 1107(b) of the Bankruptcy Code grants debtors in possession nearly all of the rights, powers, and duties of a trustee, it added.

There are two tests for determining whether a transaction was in the ordinary course of business, the court said. Under the horizontal test, courts ask whether, from an industry-wide perspective, the transaction is of the sort commonly undertaken by companies in the industry. The lower court looked at the corporate structure under which the houseboat was owned and rented by Holdings to McCabe and his wife as a commercial real estate transaction, but the First Circuit said that analogy failed because the rental transactions were not designed to make a profit. “The houseboat was not owned or operated in a way common to the commercial real estate industry,” it said.

Under the vertical test for determining the ordinary course of business, courts analyze the challenged transaction from a hypothetical creditor’s point of view and ask whether it subjects a creditor to economic risks of a nature different from those he accepted when he decided to extend credit. The primary focus of this test is on the debtor’s prepetition business practices and conduct, the court said.

The district court said that Holdings’s creditors were on notice that the company might order repairs of the houseboat because its operating agreement allowed it to contract with third parties to maintain the vessel and because of the natural desire to repair the damaged property. The court here said, however, that the question is not whether a transaction is unexpected, but whether it is ordinary within the context of the debtor/creditor relationship. “The record discloses no prepetition activity by Holdings that is comparable to the refurbishment of the [houseboat],” the court said. It held that the proper turnover amount was \$77,572 plus prejudgment interest.

Judges Juan R. Torruella and Kermit V. Lipez joined the opinion.

Joseph H. Reinhardt, Boston, argued for McCabe. Mark W. Corner, Riemer & Braunstein, Boston, argued for the trustee.

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Full text at <http://pub.bna.com/lw/081690.pdf>.