

**IN THE UNITED STATES BANKRUPTCY COURT FOR THE
EASTERN DISTRICT OF TENNESSEE**

In re

Case No. 00-30531

DONALD A. TANGWALL

Debtor

DEAN B. FARMER, TRUSTEE

Plaintiff

v.

Adv. Proc. No. 01-3083

BUTCH FAMILY PRESERVATION TRUST;
MARK PLOE, DONALD A. TANGWALL and
GOODRICH MANUFACTURING COMPANY

Defendants

**MEMORANDUM ON MOTION TO DISMISS COUNTER-COMPLAINT
AND MOTION TO AMEND ANSWER AND COUNTER-COMPLAINT**

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**RICHARD STAIR, JR.
UNITED STATES BANKRUPTCY JUDGE**

On June 26, 2001, Dean B. Farmer, Trustee (Trustee), filed a Complaint involving the Butch Family Preservation Trust (BFPT or the Trust),¹ in which the Debtor is purportedly a beneficiary and former trustee. The Complaint in part seeks to recover one half of BFPT's present value.

In response, Defendant Mark Ploe (Ploe) filed an Answer and Counter-Complaint (Counter-Complaint) on August 31, 2001. The Counter-Complaint is filed by Ploe individually and in his capacities as both a beneficiary and a trustee of BFPT.² The Counter-Complaint prays for a judgment against the Debtor individually as well as in his capacities as a trustee of BFPT and as an officer of Goodrich Manufacturing, Inc. (Goodrich).³

On September 5, 2001, the Trustee filed a Motion to Dismiss Counter-Complaint (Motion to Dismiss). The Motion to Dismiss asserts that the Counter-Complaint must fail because the counterclaims are all stated against the Debtor, who is not an "opposing party" as required by FED. R. CIV. P. 13.⁴ The Motion to Dismiss further asserts that the counterclaims are time-barred.⁵

¹ According to its Deed and Declaration of Trust, BFPT was formed under the laws of the state of Michigan.

² Despite this procedural stance, Ploe reserves as an affirmative defense the position that BFPT is not a validly-created trust under Michigan law. For purposes of this Memorandum only, the court will presume that BFPT is a properly-formed trust.

³ Goodrich is a Michigan corporation in which BFPT allegedly owns stock.

⁴ Rule 13, made applicable to this adversary proceeding by FED. R. BANKR. P. 7013, provides in material part:

(a) Compulsory Counterclaims. A pleading shall state as a counterclaim any claim which at the time of serving the pleading the pleader has against any opposing party, if it arises out of the transaction or occurrence that is the subject matter of the opposing party's claim and does not require for its adjudication the presence of third parties of whom the court cannot acquire jurisdiction. . . .

(b) Permissive Counterclaims. A pleading may state as a counterclaim any claim against an opposing party not arising out of the transaction or occurrence that is the subject matter of the

(continued...)

Ploe then filed, on October 12, 2001, a Motion to Amend Answer and Counter-Complaint (Motion to Amend). The proposed Amended Answer and Counter-Complaint (Amended Counter-Complaint), also filed on October 12, 2001, restates “[a]ll claims and counts contained herein” against the Trustee instead of the Debtor. Additionally, the Amended Counter-Complaint recharacterizes “[a]ll claims and counts contained herein” as rights of setoff under 11 U.S.C.A. § 553 (West 1993 & Supp. 2001). Ploe contends that these amendments, if allowed, would cure the Trustee’s objections to the Counter-Complaint.

This is a core proceeding. 28 U.S.C.A. § 157(b)(2)(A), (E) (West 1993).

I

The amendment of pleadings is governed by FED. R. CIV. P. 15, which provides in pertinent part:

A party may amend the party’s pleading once as a matter of course at any time before a responsive pleading is served or, if the pleading is one to which no responsive pleading is permitted and the action has not been placed upon the trial calendar, the party may so amend it at any time within 20 days after it is served. Otherwise a party may amend the party’s pleading only by leave of court or by written consent of the adverse party; and leave shall be freely given when justice so requires.

⁴(...continued)
opposing party’s claim.

FED. R. CIV. P. 13(a)-(b).

⁵ The deadline for filing a proof of claim was June 19, 2000. The only claim timely filed by Ploe involves litigation against the Debtor relating to certain real property located in Blount County, Tennessee.

FED. R. CIV. P. 15(a) (made applicable to this adversary proceeding by FED. R. BANKR. P. 7015). Rule 7 of the Federal Rules of Civil Procedure in turn sets forth the seven types of pleadings permitted in federal practice:

There shall be a complaint and an answer; a reply to a counterclaim denominated as such; an answer to a cross-claim, if the answer contains a cross-claim; a third-party complaint, if a person who was not an original party is summoned under the provisions of Rule 14; and a third-party answer, if a third-party complaint is served. No other pleading shall be allowed, except that the court may order a reply to an answer or a third-party answer.

FED. R. CIV. P. 7(a) (made applicable to this adversary proceeding by FED. R. BANKR. P. 7007). In response to Ploe's Answer and Counter-Complaint, the Trustee has filed only his Motion to Dismiss. A motion to dismiss is not a responsive pleading for purposes of FED. R. CIV. P. 15(a) and 7(a). *See Ohio Cas. Ins. Co. v. Farmers Bank of Clay, Ky.*, 178 F.2d 570, 573 (6th Cir. 1949). Accordingly, because no responsive pleading has been filed, Ploe is entitled to amend his Answer and Counter-Complaint as a matter of right. *See* FED. R. CIV. P. 15(a). As he filed his Amended Answer and Counter-Complaint on October 12, 2001, he need take no further action.

II

Contrary to Ploe's assertion, however, the amendment of his Answer and Counter-Complaint does not wholly eliminate the Trustee's objections. The nine counts of the Counter-Complaint, as amended, relate to actions by the Debtor individually and in his fiduciary capacities with Goodrich and BFPT. The Trustee argues that the fiduciary claims are not eligible for setoff under § 553. He additionally contends that Count Nine of the Counter-Complaint fails to state a valid claim under any theory of recovery. The court will address these arguments in turn.

(a) Fiduciary Claims

Section 553 of the Code recognizes that bankruptcy generally does not affect any right of a creditor to offset a mutual debt owing by such creditor to the debtor that arose before the commencement of the case under this title against a claim of such creditor against the debtor that arose before the commencement of the case[.]” 11 U.S.C.A. § 553(a) (West Supp. 2001). This section preserves, by statute, the common law right to offset mutual debts, in the face of other statutory provisions which might arguably take away those rights.” *United States v. Gordon Sel-Way, Inc. (In re Gordon Sel-Way, Inc.)*, 239 B.R. 741, 750 (E.D. Mich. 1999), *aff’d*, No. 99-2203, 2001 WL 1297674 (6th Cir. Oct. 26, 2001). Setoff is proper under § 553 when the debtor and creditor have mutual prepetition obligations for which a right to setoff exists under nonbankruptcy law. *See Kentucky Cent. Ins. Co. v. Brown (In re Larbar Corp.)*, 177 F.3d 439, 445 (6th Cir. 1999); *In re Bourne*, 262 B.R. 745, 749 (Bankr. E.D. Tenn. 2001).

The Trustee does not dispute that the Debtor, Ploe, and BFPT potentially have prepetition obligations to one another, or that the right to offset those obligations would exist outside of bankruptcy. He instead argues that debts resulting from the Debtor’s fiduciary capacities are not “mutual,” for purposes of § 553, and thus cannot be utilized as an offset.

It is generally true that to satisfy § 553's mutuality requirement “the parties must each owe the other something in his or her own name, and not as a fiduciary.” 5 KING, COLLIER ON BANKRUPTCY ¶ 553.03[3][c], at 553-32 (15th ed. rev. 2001). However, this rule is most frequently applied where the fiduciary seeks to offset his liability against one who has been harmed

by a breach of the fiduciary duty. See, e.g., *Ducker v. Lohrey (In re Williams)*, 33 B.R. 973, 976 n.1 (Bankr. S.D. Ohio 1983) (collecting cases). The purpose of this “capacity requirement” is to hold fiduciaries to their trust obligations. See 5 KING, COLLIER ON BANKRUPTCY, at 553-35.

Extending the capacity requirement to cases like the one at bar, where the object of the fiduciary relationship is the party seeking to assert the right of setoff, exalts form over substance. See *Williams*, 33 B.R. at 976-77. To allow a fiduciary accused of wrongdoing to use his status as a shield “is clearly at odds with any notions of equity of which [the court is] aware.” *Id.* at 977.

“If the asserted right of setoff would not violate any special trust between the parties, then setoff should be permitted notwithstanding that the claim or debt is of a fiduciary character[.]” 5 KING, COLLIER ON BANKRUPTCY, at 553-35; see also *Weems v. United States (In re Custom Ctr., Inc.)*, 163 B.R. 309, 318 (Bankr. E.D. Tenn. 1994). To the extent that it seeks dismissal of Counts One through Eight of the Amended Counter-Complaint for failure to satisfy § 553's mutuality requirement, the Trustee's Motion to Dismiss will therefore be denied.

(b) Count Nine

By Count Nine of the Amended Counter-Complaint, Ploe seeks offset for damages resulting from the Debtor's “fraudulent claim to be a beneficiary” of BFPT. The Trustee argues that this allegation fails to state a claim upon which relief can be granted. His theory is expressed in two parts:

1. If the Debtor is found not to be a beneficiary, then the Trustee is not entitled to any recovery against which Ploe and BFPT could effectuate a setoff.

2. If the court finds that the Debtor is a beneficiary, then Count Nine will fail because it is based on the premise that the Debtor is not a beneficiary.

In the Trustee's eyes, Count Nine is unsound under any scenario.

The Trustee's position presumes that the Debtor either always was or always was not a beneficiary of the Trust. However, BFPT's Deed and Declaration of Trust indicates that the Debtor's name was handwritten into the document as a beneficiary sometime after it was prepared. Whether the Debtor is or ever was a beneficiary is, of course, not presently before the court, but the Deed at least suggests that there was both a time when the Debtor was not a beneficiary and a time when he may have been a beneficiary.

It is therefore possible that the Debtor could have "fraudulently claimed to be a beneficiary" before he actually attained that status, causing harm that could give a right of setoff to Ploe and BFPT. It is also possible that the Debtor later became a beneficiary, and that the Trustee is entitled to recover from Ploe and BFPT subject, potentially, to setoff. Accordingly, the Trustee's Motion to Dismiss, to the extent that it seeks dismissal of Count Nine for failure to state a claim upon which relief can be granted, must be denied.

An order consistent with this Memorandum will be entered.

FILED: November 6, 2001

BY THE COURT

RICHARD STAIR, JR.
UNITED STATES BANKRUPTCY JUDGE

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ORDER

For the reasons stated in the Memorandum on Motion to Dismiss Counter-Complaint and Motion to Amend Answer and Counter-Complaint filed this date, the court directs the following:

1. The Motion to Dismiss Counter-Complaint filed by the Plaintiff on September 5, 2001, is DENIED.
2. The Motion to Amend Answer and Counter-Complaint filed by the Defendant Mark Ploe on October 12, 2001, being unnecessary under FED. R. CIV. P. 15(a), is DENIED.

SO ORDERED.

ENTER: November 6, 2001

BY THE COURT

RICHARD STAIR, JR.
UNITED STATES BANKRUPTCY JUDGE