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IN THE CIRCUIT COURT OF THE THIRTEENTH JUDICIAL CIRCUIT
IN AND FOR HILLSBOROUGH COUNTY, FLORIDA
CIVIL DIVISION

In re:

Laser Spine Institute, LLC	
CLM Aviation, LLC	Case No. 2019-CA-2762
LSI HoldCo, LLC	Case No. 2019-CA-2764
LSI Management Company, LLC	Case No. 2019-CA-2765
Laser Spine Surgery Center of Arizona, LLC	Case No. 2019-CA-2766
Laser Spine Surgery Center of Cincinnati, LLC	Case No. 2019-CA-2767
Laser Spine Surgery Center of Cleveland, LLC	Case No. 2019-CA-2768
Laser Spine Surgical Center, LLC	Case No. 2019-CA-2769
Laser Spine Surgery Center of Pennsylvania, LLC	Case No. 2019-CA-2770
Laser Spine Surgery Center of St. Louis, LLC	Case No. 2019-CA-2771
Laser Spine Surgery Center of Warwick, LLC	Case No. 2019-CA-2772
Medical Care Management Services, LLC	Case No. 2019-CA-2773
Spine DME Solutions, LLC	Case No. 2019-CA-2774
Total Spine Care, LLC	Case No. 2019-CA-2775
Laser Spine Institute Consulting, LLC	Case No. 2019-CA-2776
Laser Spine Surgery Center of Oklahoma, LLC	Case No. 2019-CA-2777
	Case No. 2019-CA-2780
Assignors,	
To:	Division L
Soneet Kapila,	
Assignee,	

SHIRLEY AND JOHN LANGSTON'S NOTICE OF FILING HIGHLIGHTED STATUTES AND CASE LAW FOR JUNE 27, 2019 HEARING

Shirley and John Langston, by and through undersigned counsel, now file the attached highlighted copies of statutes and case law that will be presented to the Court at hearing on June 27, 2019. Due to the number of parties and attorneys who are attending, some telephonically, copies of these statutes and cases will not be provided to counsel at the hearing.

Certificate of Service: I hereby certify that a copy of the foregoing has been filed and service will be made through the Court's efiling service this 24th day of June, 2019.

/s/Donald J. Schutz
Donald J. Schutz, Esq.
Fla Bar No. 382701
535 Central Avenue
St. Petersburg, FL 33701
727-823-3222
727-895-3222 Telefax
727-480-4425 Cell
donschutz@netscape.net
don@lawus.com
Attorney for John and Shirley Langston

458.320 Financial responsibility.—

(1) As a condition of licensing and maintaining an active license, and prior to the issuance or renewal of an active license or reactivation of an inactive license for the practice of medicine, an applicant must by one of the following methods demonstrate to the satisfaction of the board and the department financial responsibility to pay claims and costs ancillary thereto arising out of the rendering of, or the failure to render, medical care or services:

(a) Establishing and maintaining an escrow account consisting of cash or assets eligible for deposit in accordance with s. 625.52 in the per claim amounts specified in paragraph (b). The required escrow amount set forth in this paragraph may not be used for litigation costs or attorney's fees for the defense of any medical malpractice claim.

(b) Obtaining and maintaining professional liability coverage in an amount not less than $100,000 per claim, with a minimum annual aggregate of not less than $300,000, from an authorized insurer as defined under s. 624.09, from a surplus lines insurer as defined under s. 626.914(2), from a risk retention group as defined under s. 627.942, from the Joint Underwriting Association established under s. 627.351(4), or through a plan of self-insurance as provided in s. 627.357. The required coverage amount set forth in this paragraph may not be used for litigation costs or attorney's fees for the defense of any medical malpractice claim.

(c) Obtaining and maintaining an unexpired, irrevocable letter of credit, established pursuant to chapter 675, in an amount not less than $100,000 per claim, with a minimum aggregate availability of credit of not less than $300,000. The letter of credit must be payable to the physician as beneficiary upon presentment of a final judgment indicating liability and awarding damages to be paid by the physician or upon presentment of a settlement agreement signed by all parties to such agreement when such final judgment or settlement is a result of a claim arising out of the rendering of, or the failure to render, medical care and services. The letter of credit may not be used for litigation costs or attorney's fees for the defense of any medical malpractice claim. The letter of credit must be nonassignable and nontransferable. Such letter of credit must be issued by any bank or savings association organized and existing under the laws of this state or any bank or savings association organized under the laws of the United States which has its principal place of business in this state or has a branch office that is authorized under the laws of this state or of the United States to receive deposits in this state.

(2) Physicians who perform surgery in an ambulatory surgical center licensed under chapter 395 and, as a continuing condition of hospital staff privileges, physicians who have staff privileges must also establish financial responsibility by one of the following methods:

(a) Establishing and maintaining an escrow account consisting of cash or assets eligible for deposit in accordance with s. 625.52 in the per claim amounts specified in paragraph (b). The

required escrow amount set forth in this paragraph may not be used for litigation costs or attorney's fees for the defense of any medical malpractice claim.

(b) Obtaining and maintaining professional liability coverage in an amount not less than $250,000 per claim, with a minimum annual aggregate of not less than $750,000 from an authorized insurer as defined under s. 624.09, from a surplus lines insurer as defined under s. 626.914(2), from a risk retention group as defined under s. 627.942, from the Joint Underwriting Association established under s. 627.351(4), through a plan of self-insurance as provided in s. 627.357, or through a plan of self-insurance which meets the conditions specified for satisfying financial responsibility in s.766.110. The required coverage amount set forth in this paragraph may not be used for litigation costs or attorney's fees for the defense of any medical malpractice claim.

(c) Obtaining and maintaining an unexpired irrevocable letter of credit, established pursuant to chapter 675, in an amount not less than $250,000 per claim, with a minimum aggregate availability of credit of not less than $750,000. The letter of credit must be payable to the physician as beneficiary upon presentment of a final judgment indicating liability and awarding damages to be paid by the physician or upon presentment of a settlement agreement signed by all parties to such agreement when such final judgment or settlement is a result of a claim arising out of the rendering of, or the failure to render, medical care and services. The letter of credit may not be used for litigation costs or attorney's fees for the defense of any medical malpractice claim. The letter of credit must be nonassignable and nontransferable. The letter of credit must be issued by any bank or savings association organized and existing under the laws of this state or any bank or savings association organized under the laws of the United States which has its principal place of business in this state or has a branch office that is authorized under the laws of this state or of the United States to receive deposits in this state.

This subsection shall be inclusive of the coverage in subsection (1).

(3)(a) Meeting the financial responsibility requirements of this section or the criteria for any exemption from such requirements must be established at the time of issuance or renewal of a license.

(b) Any person may, at any time, submit to the department a request for an advisory opinion regarding such person's qualifications for exemption.

(4)(a) Each insurer, self-insurer, risk retention group, or Joint Underwriting Association must promptly notify the department of cancellation or nonrenewal of insurance required by this section. Unless the physician demonstrates that he or she is otherwise in compliance with the requirements of this section, the department shall suspend the license of the physician pursuant to ss. 120.569 and120.57 and notify all health care facilities licensed under chapter 395 of such action. Any suspension under this subsection remains in effect until the physician demonstrates compliance

with the requirements of this section. If any judgments or settlements are pending at the time of suspension, those judgments or settlements must be paid in accordance with this section unless otherwise mutually agreed to in writing by the parties. This paragraph does not abrogate a judgment debtor's obligation to satisfy the entire amount of any judgment.

(b) If financial responsibility requirements are met by maintaining an escrow account or letter of credit as provided in this section, upon the entry of an adverse final judgment arising from a medical malpractice arbitration award, from a claim of medical malpractice either in contract or tort, or from noncompliance with the terms of a settlement agreement arising from a claim of medical malpractice either in contract or tort, the licensee shall pay the entire amount of the judgment together with all accrued interest, or the amount maintained in the escrow account or provided in the letter of credit as required by this section, whichever is less, within 60 days after the date such judgment became final and subject to execution, unless otherwise mutually agreed to in writing by the parties. If timely payment is not made by the physician, the department shall suspend the license of the physician pursuant to procedures set forth in subparagraphs (5)(g)3., 4., and 5. Nothing in this paragraph shall abrogate a judgment debtor's obligation to satisfy the entire amount of any judgment.

(5) The requirements of subsections (1), (2), and (3) do not apply to:

(a) Any person licensed under this chapter who practices medicine exclusively as an officer, employee, or agent of the Federal Government or of the state or its agencies or its subdivisions. For the purposes of this subsection, an agent of the state, its agencies, or its subdivisions is a person who is eligible for coverage under any self-insurance or insurance program authorized by the provisions of s. 768.28(16).

(b) Any person whose license has become inactive under this chapter and who is not practicing medicine in this state. Any person applying for reactivation of a license must show either that such licensee maintained tail insurance coverage which provided liability coverage for incidents that occurred on or after January 1, 1987, or the initial date of licensure in this state, whichever is later, and incidents that occurred before the date on which the license became inactive; or such licensee must submit an affidavit stating that such licensee has no unsatisfied medical malpractice judgments or settlements at the time of application for reactivation.

(c) Any person holding a limited license pursuant to s. 458.317 and practicing under the scope of such limited license.

(d) Any person licensed or certified under this chapter who practices only in conjunction with his or her teaching duties at an accredited medical school or in its main teaching hospitals. Such person may engage in the practice of medicine to the extent that such practice is incidental to and a necessary part of duties in connection with the teaching position in the medical school.

(e) Any person holding an active license under this chapter who is not practicing medicine in this state. If such person initiates or resumes any practice of medicine in this state, he or she must notify the department of such activity and fulfill the financial responsibility requirements of this section before resuming the practice of medicine in this state.

(f) Any person holding an active license under this chapter who meets all of the following criteria:

1. The licensee has held an active license to practice in this state or another state or some combination thereof for more than 15 years.

2. The licensee has either retired from the practice of medicine or maintains a part-time practice of no more than 1,000 patient contact hours per year.

3. The licensee has had no more than two claims for medical malpractice resulting in an indemnity exceeding $25,000 within the previous 5-year period.

4. The licensee has not been convicted of, or pled guilty or nolo contendere to, any criminal violation specified in this chapter or the medical practice act of any other state.

5. The licensee has not been subject within the last 10 years of practice to license revocation or suspension for any period of time; probation for a period of 3 years or longer; or a fine of $500 or more for a violation of this chapter or the medical practice act of another jurisdiction. The regulatory agency's acceptance of a physician's relinquishment of a license, stipulation, consent order, or other settlement, offered in response to or in anticipation of the filing of administrative charges against the physician's license, constitutes action against the physician's license for the purposes of this paragraph.

6. The licensee has submitted a form supplying necessary information as required by the department and an affidavit affirming compliance with this paragraph.

7. The licensee must submit biennially to the department certification stating compliance with the provisions of this paragraph. The licensee must, upon request, demonstrate to the department information verifying compliance with this paragraph.

A licensee who meets the requirements of this paragraph must post notice in the form of a sign prominently displayed in the reception area and clearly noticeable by all patients or provide a written statement to any person to whom medical services are being provided. The sign or statement must read as follows: "Under Florida law, physicians are generally required to carry medical malpractice insurance or otherwise demonstrate financial responsibility to cover potential claims for medical malpractice. However, certain part-time physicians who meet state requirements are exempt from the financial responsibility law. YOUR DOCTOR MEETS THESE REQUIREMENTS AND HAS DECIDED NOT TO CARRY MEDICAL MALPRACTICE INSURANCE. This notice is provided pursuant to Florida law."

(g) Any person holding an active license under this chapter who agrees to meet all of the following criteria:

1. Upon the entry of an adverse final judgment arising from a medical malpractice arbitration award, from a claim of medical malpractice either in contract or tort, or from noncompliance with the terms of a settlement agreement arising from a claim of medical malpractice either in contract or tort, the licensee shall pay the judgment creditor the lesser of the entire amount of the judgment with all accrued interest or either $100,000, if the physician is licensed pursuant to this chapter but does not maintain hospital staff privileges, or $250,000, if the physician is licensed pursuant to this chapter and maintains hospital staff privileges, within 60 days after the date such judgment became final and subject to execution, unless otherwise mutually agreed to in writing by the parties. Such adverse final judgment shall include any cross-claim, counterclaim, or claim for indemnity or contribution arising from the claim of medical malpractice. Upon notification of the existence of an unsatisfied judgment or payment pursuant to this subparagraph, the department shall notify the licensee by certified mail that he or she shall be subject to disciplinary action unless, within 30 days from the date of mailing, he or she either:

a. Shows proof that the unsatisfied judgment has been paid in the amount specified in this subparagraph; or

b. Furnishes the department with a copy of a timely filed notice of appeal and either:

(I) A copy of a supersedeas bond properly posted in the amount required by law; or

(II) An order from a court of competent jurisdiction staying execution on the final judgment pending disposition of the appeal.

2. The Department of Health shall issue an emergency order suspending the license of any licensee who, after 30 days following receipt of a notice from the Department of Health, has failed to: satisfy a medical malpractice claim against him or her; furnish the Department of Health a copy of a timely filed notice of appeal; furnish the Department of Health a copy of a supersedeas bond properly posted in the amount required by law; or furnish the Department of Health an order from a court of competent jurisdiction staying execution on the final judgment pending disposition of the appeal.

3. Upon the next meeting of the probable cause panel of the board following 30 days after the date of mailing the notice of disciplinary action to the licensee, the panel shall make a determination of whether probable cause exists to take disciplinary action against the licensee pursuant to subparagraph 1.

4. If the board determines that the factual requirements of subparagraph 1. are met, it shall take disciplinary action as it deems appropriate against the licensee. Such disciplinary action shall include, at a minimum, probation of the license with the restriction that the licensee must make payments to the judgment creditor on a schedule determined by the board to be reasonable and

within the financial capability of the physician. Notwithstanding any other disciplinary penalty imposed, the disciplinary penalty may include suspension of the license for a period not to exceed 5 years. In the event that an agreement to satisfy a judgment has been met, the board shall remove any restriction on the license.

5. The licensee has completed a form supplying necessary information as required by the department.

A licensee who meets the requirements of this paragraph shall be required either to post notice in the form of a sign prominently displayed in the reception area and clearly noticeable by all patients or to provide a written statement to any person to whom medical services are being provided. Such sign or statement shall state: "Under Florida law, physicians are generally required to carry medical malpractice insurance or otherwise demonstrate financial responsibility to cover potential claims for medical malpractice. YOUR DOCTOR HAS DECIDED NOT TO CARRY MEDICAL MALPRACTICE INSURANCE. This is permitted under Florida law subject to certain conditions. Florida law imposes penalties against noninsured physicians who fail to satisfy adverse judgments arising from claims of medical malpractice. This notice is provided pursuant to Florida law."

(6) Any deceptive, untrue, or fraudulent representation by the licensee with respect to any provision of this section shall result in permanent disqualification from any exemption to mandated financial responsibility as provided in this section and shall constitute grounds for disciplinary action under s. 458.331.

(7) Any licensee who relies on any exemption from the financial responsibility requirement shall notify the department, in writing, of any change of circumstance regarding his or her qualifications for such exemption and shall demonstrate that he or she is in compliance with the requirements of this section.

(8) Notwithstanding any other provision of this section, the department shall suspend the license of any physician against whom has been entered a final judgment, arbitration award, or other order or who has entered into a settlement agreement to pay damages arising out of a claim for medical malpractice, if all appellate remedies have been exhausted and payment up to the amounts required by this section has not been made within 30 days after the entering of such judgment, award, or order or agreement, until proof of payment is received by the department or a payment schedule has been agreed upon by the physician and the claimant and presented to the department. This subsection does not apply to a physician who has met the financial responsibility requirements in paragraphs (1)(b) and (2)(b).

(9) The board shall adopt rules to implement the provisions of this section.

History.—ss. 27, 50, ch. 85-175; ss. 47, 67, ch. 86-160; s. 26, ch. 86-245; s. 22, ch. 88-1; s. 2, ch. 90-158; s. 184, ch. 91-108; s. 59, ch. 91-220; s. 4, ch. 91-429; s. 106, ch. 94-218; s. 217, ch. 96-410; s. 1089, ch. 97-103; s. 144, ch.

97-237; s. 104, ch. 97-261; s. 22, ch. 97-264; s. 20, ch. 97-273; s. 9, ch. 98-166; s. 116, ch. 2000-153; s. 20, ch. 2001-277; s. 23, ch. 2003-416; s. 75, ch. 2004-5.

727.101 Intent of chapter.—The intent of this chapter is to provide a uniform procedure for the administration of insolvent estates, and to ensure full reporting to creditors and equal distribution of assets according to priorities as established under this chapter.

History.—s. 1, ch. 87-174.

727.105 Proceedings against assignee.—Proceedings may not be commenced against the assignee except as provided in this chapter, but nothing contained in this chapter affects any action or proceeding by a governmental unit to enforce such governmental unit's police or regulatory power. Except in the case of a consensual lienholder enforcing its rights in personal property or real property collateral, there shall be no levy, execution, attachment, or the like in respect of any judgment against assets of the estate in the possession, custody, or control of the assignee.

History.—s. 5, ch. 87-174; s. 5, ch. 2007-185.

727.107 Duties of assignor.—The assignor shall:

(1) Assist the assignee in the administration of the estate and comply with all orders of the court;

(2) Upon delivery of the assignment to the assignee, deliver to the assignee all of the assets of the estate in the assignor's possession, custody, or control, including, but not limited to, all accounts, books, papers, records, and other documents; and

(3) Within 30 days after the filing date, submit to examination by the assignee, under oath, concerning the acts, conduct, assets, liabilities, and financial condition of the assignor or any matter related to the assignee's administration of the estate.

History.—s. 7, ch. 87-174.

727.108 Duties of assignee.—The assignee shall:

(1) Collect and reduce to money the assets of the estate, whether by suit in any court of competent jurisdiction or by public or private sale, including, but not limited to, prosecuting any tort claims or causes of action that were previously held by the assignor, regardless of any generally applicable law concerning the nonassignability of tort claims or causes of action.

(a) With respect to the estate's claims and causes of action, the assignee may:

1. Conduct discovery as provided under the Florida Rules of Civil Procedure to determine whether to prosecute such claims or causes of actions.

2. Prosecute such claims or causes of action as provided in this section.

3. Sell and assign, in whole or in part, such claims or causes of action to another person or entity on the terms that the assignee determines are in the best interest of the estate under s. 727.111(4).

(b) In an action in any court by the assignee or the first immediate transferee of the assignee, other than an affiliate or insider of the assignor, against a defendant to assert a claim or chose in action of the estate, the claim is not subject to, and any remedy may not be limited by, a defense based on the assignor's acquiescence, cooperation, or participation in the wrongful act by the defendant which forms the basis of the claim or chose in action.

(2) Within 30 days after the filing date, examine the assignor, under oath, concerning the acts, conduct, assets, liabilities, and financial condition of the assignor or any matter related to the assignee's administration of the estate, unless excused by the court for good cause shown.

(3) Give notice to creditors of all matters concerning the administration of the estate, pursuant to s. 727.111.

(4) Conduct the business of the assignor for a limited period not to exceed 45 calendar days, if doing so is in the best interest of the estate, or for a longer period if in the best interest of the estate, upon notice and until such time as an objection, if any, is sustained by the court. An assignee's authorization to conduct the business of the assignor may be extended for a period longer than 45 days upon service of negative notice. If no timely objection is filed with the court, the assignee may continue to operate the assignor's business for an additional 90 days. The court may extend the 90-day period if it finds an extension to be in the best interest of the estate.

(5) To the extent reasonable in the exercise of the assignee's business judgment, reject an unexpired lease of nonresidential real property or of personal property under which the assignor is the lessee.

(6) To the extent reasonable and necessary, pay administrative expenses of the estate, subject, however, to s. 727.114(1).

(7) To the extent necessary, employ at the expense of the estate one or more appraisers, auctioneers, accountants, attorneys, or other professional persons, to assist the assignee in carrying out his or her duties under this chapter.

(8) Keep regular accounts and furnish such information concerning the estate as may be reasonably requested by creditors or other parties in interest.

(9) File with the court an interim report of receipts and disbursements within 6 months after the filing date unless excused by the court or unless the estate has been sooner distributed in full.

(10) Examine the validity and priority of all claims against the estate.

(11) Abandon assets to duly perfected secured or lien creditors, where, after due investigation, he or she determines that the estate has no equity in such assets or such assets are burdensome to the estate or are of inconsequential value and benefit to the estate.

(12) Pay dividends and secured or priority claims as often as is compatible with the best interests of the estate and close the estate as expeditiously as possible.

(13) File with the court a final report of all receipts and disbursements and file an application for his or her discharge pursuant to s. 727.116.

History.—s. 8, ch. 87-174; s. 941, ch. 97-102; s. 6, ch. 2007-185; s. 3, ch. 2013-244.

727.109 Power of the court.—The court shall have power to:

(1) Enforce all provisions of this chapter.

(2) Set, approve, or reconsider the amount of the assignee's bond.

(3) Upon notice and a hearing, if requested, authorize the business of the assignor to be conducted by the assignee for longer than 45 calendar days, if in the best interest of the estate.

(4) Allow or disallow claims against the estate and determine their priority and establish a deadline, upon motion by the assignee, for the filing of all claims against the assignment estate arising on or after the date on which the assignor's petition for assignment was filed with the court. The deadline may not occur less than 30 days before notice is received by mail of the order establishing the deadline.

(5) Determine any claims of exemption by the assignor, if disputed.

(6) Authorize the assignee to reject an unexpired lease of nonresidential real property or of personal property under which the assignor is the lessee pursuant to s. 727.108(5).

(7) Upon notice as provided under s. 727.111 to all creditors and consensual lienholders, hear and determine a motion brought by the assignee for approval of a proposed sale of assets of the estate other than in the ordinary course of business, or the compromise or settlement of a controversy, and enter an order granting such motion notwithstanding the lack of objection if the assignee reasonably believes that such order is necessary to proceed with the action contemplated by the motion.

(8) Hear and determine any of the following actions brought by the assignee, which she or he is empowered to maintain:

(a) Enforce the turnover of assets of the estate pursuant to s. 727.106.

(b) Determine the validity, priority, and extent of a lien or other interests in assets of the estate, or to subordinate or avoid an unperfected security interest pursuant to the assignee's rights as a lien creditor under s. 679.3171.

(c) Avoid any conveyance or transfer void or voidable by law.

(9) Approve the assignee's final report and interim and final distributions to creditors.

(10) Approve reasonable fees and the reimbursement of expenses for the assignee and all professional persons retained by the assignee, upon objection of a party in interest or upon the court's own motion.

(11) Hear and determine any motion brought by a party in interest or by the court to close the estate after the passage of 1 year from the date of filing of the petition.

(12) Discharge the assignee and the assignee's surety from liability upon matters included in the assignee's final report.

(13) Reopen estates for cause shown.

(14) Punish by contempt any failure to comply with the provisions of this chapter or any order of the court made pursuant to this chapter.

(15) Exercise any other powers that are necessary to enforce or carry out the provisions of this chapter.

History.—s. 9, ch. 87-174; s. 942, ch. 97-102; s. 146, ch. 2007-5; s. 7, ch. 2007-185; s. 4, ch. 2013-244.

Bailey v. St. Louis

Court of Appeal of Florida, Second District

December 28, 2018, Opinion Filed

Case No. 2D17-895

Reporter
2018 Fla. App. LEXIS 18768 *; 268 So. 3d 197; 44 Fla. L. Weekly D 128; 2018 WL 6816180

JOE SAMUEL BAILEY, LASERSCOPIC SPINAL CENTERS OF AMERICA, INC.; LASERSCOPIC MEDICAL CLINIC LLC; LASERSCOPIC DIAGNOSTIC IMAGING AND PHYSICAL THERAPY LLC; LASERSCOPIC SPINAL CENTER OF FLORIDA, LLC; and LASERSCOPIC SURGERY CENTER OF FLORIDA, Appellants/Cross-Appellees, v. JAMES S. ST. LOUIS, D.O.; MICHAEL W. PERRY, M.D.; EFO HOLDINGS L.P.; EFO GENPAR, INC.; EFO LASER SPINE INSTITUTE, LTD.; LASER SPINE INSTITUTE, LLC; LASER SPINE MEDICAL CLINIC, LLC; LASER SPINE PHYSICAL THERAPY, LLC; and LASER SPINE SURGICAL CENTER, LLC, Appellees/Cross-Appellants.

Prior History: [*1] Appeal from the Circuit Court for Hillsborough County; Richard A. Nielsen, Judge.

Bailey v. St. Louis, 196 So. 3d 375, 2016 Fla. App. LEXIS 1375 (Fla. Dist. Ct. App. 2d Dist., Feb. 3, 2016)

Counsel: William J. Schifino of Burr & Forman LLP Tampa; Stuart C. Markman, Kristin A.

Norse, and Robert W. Ritsch of Kynes, Markman & Felman, P.A., Tampa; Jennifer G. Altman and Shani Rivaux of Pillsbury Winthrop Shaw, Pittman LLP, Miami, for Appellants/Cross-Appellees.

Stacey D. Blank and Joseph H. Varner, III of Holland & Knight LLP, Tampa, for Appellees/Cross-Appellants.

Judges: KELLY, Judge. CASANUEVA and CRENSHAW, JJ., Concur.

Opinion by: KELLY

Opinion

KELLY, Judge.

This is the second appeal from a final judgment entered in favor of the appellants/cross-appellees in an action against the appellees/cross-appellants for breach of fiduciary duty, conspiracy, defamation, slander per se, tortious interference, and violation of the Florida Deceptive and Unfair Trade Practices Act (FDUTPA). The factual background underlying this litigation is fully set forth in *Bailey v. St. Louis*, 196 So. 3d 375 (Fla. 2d DCA 2016) (*Bailey I*), and repeating it here is unnecessary. In Bailey I, we affirmed the final judgment but reversed the damages awarded by the trial court. On remand, with the exception of adding an award for punitive damages, the trial court awarded the same damages this court had previously

reversed. [*2] Again, we reverse those awards. As to the remaining issues raised in the appeal and in the cross-appeal, we affirm without further comment.

In *Bailey I*, the appellants had prevailed on claims for breach of fiduciary duty, conspiracy, slander per se, tortious interference, and violation of FDUTPA. We reversed the damages awarded for everything but slander per se because, as explained in our opinion, we could not square the awards with the evidence or the trial court's findings, which were quite limited with respect to damages. *See* 196 So. 3d at 377. We also reversed the trial court's decision not to award monetary damages for the appellees' FDUTPA violations and not to award punitive damages. *See id.* We determined that the trial court incorrectly ruled that it could not award monetary damages under FDUTPA and that it also erroneously found that the facts did not support an award of punitive damages. *See id.*

There were two components to the total damage award of $1,600,000 at issue in *Bailey I*. The first was an award of $300,000 to Laserscopic Spine Centers of America, Inc. (Spine), for out-of-pocket damages for tortious inference. With respect to this award we stated, "In its order, the trial court accepted [*3] the calculations of only one of the experts 'as to out of pocket losses,' and it found that the expert testified that the Appellants suffered out-of-pocket damages of $6,831,172." 196 So. 3d at 377 (footnote omitted). Yet, the *total* award of damages was only $1,600,000. The trial court offered no explanation as to how it ended up entering a total award that was less than one-fourth of the amount it cited for out-of-pocket damages alone, and the record provided no insight into the basis for the award.[1]

On remand, the trial court again awarded $300,000. By way of explanation, the court stated that it had rejected the appellants' expert's testimony as to out-of-pocket losses. However, as explained in *Bailey I*, the trial court had expressly accepted the expert's calculation regarding out-of-pocket losses. The court purports to explain how it determined that $300,000 was the proper award. Its reasoning, however, is nearly a verbatim repeat of the arguments the appellees unsuccessfully urged us to accept in *Bailey I*. Moreover, the court's explanation rests on the flawed premise that it had rejected the expert's calculations. Accordingly, we again reverse the trial court's award to Spine and remand for entry [*4] of an award in the amount of $6,831,172, which is the amount the trial court found was established by the appellants' expert's testimony.

The remaining $1,050,000 of the damage award was the second component at issue in *Bailey I*. Appellant Laserscopic Spinal Centers of America, Inc. (Spinal), was awarded damages for breach of fiduciary duty, conspiracy, and tortious interference, while appellant Laserscopic Medical Clinic, LLC (LMC), received an award on a claim for breach of fiduciary duty. The appellants had sought damages under various theories, including disgorgement. On appeal, the appellants argued that the trial court had awarded no disgorgement damages, while the appellees argued that the entire $1,050,000 was an award of "lost profits measured by the yardstick of [Laser Spine Institute's] allegedly ill-gotten profits, which [it] was similarly required to disgorge." Because of the way the trial court had prepared its order, it was not possible to determine with certainty whether all or a portion of the award was for disgorgement. What we could determine, however, was that if it was for disgorgement, it was "grossly insufficient." *Id.* at 378.

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[1] The appellees' argument to the trial court was not helpful in terms of understanding the award. Their approach to damages had been to simply argue that the appellants had not proved they suffered *any* damages as a result of the appellees' conduct. They did not challenge the appellants' out-of-pocket figure, nor did they offer any alternative theory upon which the trial court might have based its award of $300,000.

The appellants had sought disgorgement of approximately [*5] $264,000,000. This figure represented the value of Laser Spine Institute (LSI) in 2009 plus $77.5 million in distributions paid to the owners between 2005 and 2009.[2] In their argument to the trial court, the appellees had taken the position that even if the court found some wrongdoing, any profits LSI earned were attributable solely to the efforts of management and not to any wrongdoing; therefore, the court should not award anything to the appellants.[3] Because it was their position that the appellants were not entitled to any damages, the appellees did not put on any evidence as to what amount of LSI's profits short of $264,000,000 could be attributed to their wrongful conduct.

On appeal, and without explaining how the court might have arrived at $1,050,000 rather than $264,000,000, the appellees argued the award reflected the trial court's conclusion that only this portion of LSI's profits was attributable to the appellees' wrongdoing. In support of this, the appellees pointed to the "Damages" section of the trial court's order and specifically to the trial court's citation to *Pidcock v. Sunnyland America, Inc.*, 854 F. 2d 443, 447-48 (11th Cir.1988). The trial court cited *Pidcock* for the proposition that a plaintiff may only recover [*6] profits attributable to the underlying wrong and not profits attributable to a defendant's "special or unique efforts" and that "aggressive or enterprising" management activities "may break the causal chain" between the wrongdoing and the defendant's profits. This, according to the appellees, was the reason the trial court limited the award. We will not repeat our discussion of *Pidcock* here. Suffice it to say that we thoroughly analyzed its applicability to the facts as found by the trial court, and we concluded that the limiting principles *Pidcock* discusses were inapplicable. *See Bailey I*, 196 So. 3d at 378. Thus, we held that if the award was for disgorgement, it was "grossly insufficient." *See id.*

Although we did not address it in our opinion, the appellees also argued that "in cases involving the misappropriation of proprietary information, a court will limit the disgorgement of a defendant's profits 'to the amount of time it would have taken the defendant to independently develop its product without the benefit of the plaintiff's trade secrets—in other words, the "head start" period.'" Thus, they argued that the trial court awarded "lost profits/disgorgement damages in an amount equal to the profits LSI [*7] derived from this head start." However, the trial court had found the appellants' misappropriation claims were barred by the statute of limitations. Further, at trial the appellants' did not seek to recover lost profits, instead focusing on disgorgement, business destruction damages, and out-of-pocket damages. Accordingly, we rejected this argument as well.

On remand, the trial court confirmed it was awarding disgorgement damages but then entered the same award we had reversed as "grossly inadequate." This appears to have happened because the appellees convinced the trial court that we had not actually found the award to be inadequate, we had simply found

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[2] While the parties have referred to the recovery the appellants sought as disgorgement of profits, it would be more accurate to describe it as disgorgement of the appellees' wrongful gain. *See* Restatement (Third) of Restitution and Unjust Enrichment § 3 (Am. Law. Inst. 2011). A conscious wrongdoer is liable for the "net profit attributable to the underlying wrong." Restatement (Third) of Restitution and Unjust Enrichment § 51(4). As used in section 51(4), "[p]rofit includes any form of use value, proceeds, or consequential gains." Restatement (Third) of Restitution and Unjust Enrichment § 51(5)(a). The appellees have not challenged, nor have we considered, the use of these particular elements to calculate "profit" for the purposes of disgorgement. Nor have they challenged the accuracy of the amounts testified to by the appellants' expert. At trial they offered no alternative method by which to calculate the amount of profits subject to disgorgement because it was their position that *none* of the profits LSI earned were subject to disgorgement.

[3] In *Bailey I* we discussed at length the trial court's findings regarding the appellees' wrongful conduct. 196 So. 3d at 377-78. When we reference "wrongdoing" in this opinion we are referring to the conduct we detailed in *Bailey I*.

it to be inadequately explained. And as was the case with the out-of-pocket award, the appellees apparently convinced the trial court it could explain its award by adopting the arguments the appellees had made and we had rejected in *Bailey I*.

In explaining the award on remand, the trial court's overarching focus is on why it believed Spinal was not successful, which as we explain below, is not part of the equation for determining the degree to which a wrongdoer's profits are attributable to its wrongful conduct. First, the trial court [*8] points to the appellants' "lack of business skills" and states that because of their lack of skill and poor business decisions they "should not be awarded disgorgement damages beyond the amounts in the final judgment." It also states it is rejecting the appellants' demand for disgorgement damages equal to all the profits earned by LSI because there is no causal relationship between the appellees' tortious conduct and all the profits. The court elaborates, stating that the appellees succeeded because of a "unique combination of individual, skilled medical doctors; highly effective and inventive executives, managers and administrators; creative marketing and advertising programs; and the availability and use of proper capital" and that even though Spinal "followed the same business model, it was not able to succeed."

The trial court's focus on the appellants' supposed lack of business skills as a basis to limit disgorgement shows a complete misapprehension of the principles applicable to disgorgement. Disgorgement is a remedy designed to deter wrongdoers by making it unprofitable to engage in the wrongful behavior. *See Duty Free World, Inc. v. Miami Perfume Junction, Inc.*, 253 So. 3d 689, 698 (Fla. 3d DCA 2018) ("'Disgorgement is an equitable remedy intended to prevent unjust [*9] enrichment.'" (quoting *S.E.C. v. Monterosso*, 756 F. 3d 1326, 1337 (11th Cir. 2014))); Restatement (Third) of Restitution and Unjust Enrichment § 1 (Am. Law Inst. 2011) ("A person who is unjustly enriched at the expense of another is subject to liability in restitution."); Restatement (Third) of Restitution and Unjust Enrichment § 3 ("A person is not permitted to profit by his own wrong."). The point of disgorgement is to deter wrongdoers by stripping them of the gains from their conduct:

> Restitution requires full disgorgement of profit by a conscious wrongdoer, not just because of the moral judgment implicit in the rule of this section, but because any lesser liability would provide an inadequate incentive to lawful behavior. If A anticipates (accurately) that unauthorized interference with B's entitlement may yield profits exceeding any damages B could prove, A has a dangerous incentive to take without asking—since the nonconsensual transaction promises to be more profitable than the forgone negotiation with B. The objective of that part of the law of restitution summarized by the rule of § 3 is to frustrate any such calculation.

Id. § 3 cmt. c; *see also* § 51 cmt. e ("The object of the disgorgement remedy—to eliminate the possibility of profit from conscious wrongdoing—is one of the cornerstones of the law of restitution and unjust enrichment.").

This case is a classic example of what [*10] this comment from the Restatement describes. As we detailed in *Bailey I*, when the appellants did not accept the appellees' offer to invest in Spinal, the appellees told them "you're going to accept this offer or we're going to take your doctors and we're going to take your company. And we're going to go up the street and we're going to do it ourselves." 196 So. 3d at 380. When threatened with litigation, the appellees said they were not concerned because the business would make ten times whatever damages they might have to pay in a lawsuit. *See id.* at 380-81.

Had the appellants been limited to recovering under a lost profits theory, that prediction would unquestionably be accurate. However, the measure of damages for disgorgement is not the profits the

appellants might have made absent the wrongdoing—the measure of damages for conscious wrongdoing is the appellees' "net profit attributable to the underlying wrong." Restatement (Third) of Restitution and Unjust Enrichment § 51(4); *see also Duty Free*, 253 So. 3d at 698 ("The equitable remedy of disgorgement is measured by the defendant's ill-gotten profits or gains rather than the plaintiff's losses."). "When the defendant has acted in conscious disregard of the claimant's rights, the whole of the resulting gain is treated as unjust enrichment, even though [*11] the defendant's gain may exceed" the claimant's loss. Restatement (Third) of Restitution and Unjust Enrichment § 3 cmt. c. In fact, disgorgement may be awarded even if the claimant has not sustained any loss. Restatement (Third) of Restitution and Unjust Enrichment § 3, reporter's note a. ("[I]t is clear not only that there can be restitution of wrongful gain exceeding the plaintiff's loss, but that there can be restitution of wrongful gain in cases where the plaintiff has suffered an interference with protected interests but no measurable loss whatsoever."). The trial court's comments regarding the appellants' business acumen are misplaced in determining a disgorgement award.

To the extent the trial court's order can be read to rely on the limiting principles articulated in *Pidcock*, we specifically considered and rejected the applicability of those principles in *Bailey I*. *See* 196 So. 3d at 378-79. Our rejection of this as a basis to limit the award of disgorgement was the law of the case, and the trial court was bound by our determination. *See Specialty Rests. Corp. v. Elliott*, 924 So. 2d 834, 837 (Fla. 2d DCA 2005) ("[Q]uestions of law that have actually been decided on appeal must govern the case in the same court and in the trial court through all subsequent stages of the proceedings."). Moreover, the "business model" to which the court attributes the appellees' success is the one it stole from [*12] the appellants along with its doctors, key employees, and everything else. In other words, what the trial court said amounts to a finding that the appellees' success was in fact attributable to their wrongdoing.

Lastly, the trial court sets out the reasoning it used to arrive at the figure of $1,050,000. However, it relies on the "head start" formula the appellees unsuccessfully argued in support of the award in *Bailey I*. As explained above, we rejected that argument as inapposite. Further, the trial court took this "head start" concept and more or less turned it on its head. The trial court reasoned that Spinal's operations were interrupted for approximately six months; therefore, the appellants were only entitled to six months of LSI's profits. Again, the trial court misapprehends the nature of the disgorgement remedy by measuring the award based on what the *appellants lost*—six months of profits—not what the appellees gained. *See Guyana Tel. & Tel. Co., Ltd. v. Melbourne Int'l Commc'ns, Ltd.*, 329 F. 3d 1241, 1249 (11th Cir. 2003) (reversing where a jury was instructed to measure the plaintiff's right to restitution in terms of its loss rather than the benefit conferred on the defendants because "[r]estitution is a remedy that is often available to victims of a wrong. Restitution [*13] measures a plaintiff's recovery according to the defendant's, rather than the plaintiff's, rightful position").

Accordingly, we again reverse the awards for breach of fiduciary duty, conspiracy, and tortious interference and remand for the court to enter an award of disgorgement. Because the only testimony regarding the manner in which the disgorgement award should be measured came from the appellants' expert, the award should be calculated according to the formula he proposed. Specifically, the court should enter an award based on the total value of LSI in 2009 combined with the total of the distributions to the owners of LSI between 2005 and 2009.[4] We also reverse the award for out-of-pocket damages and remand for entry of an award of $6,831,172.

Reversed and remanded for entry of a judgment in accordance with this opinion.

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[4] It appears from the evidence in the record that the proper amount of the award at a minimum falls between $264,000,000 and $265,000,000.

CASANUEVA and CRENSHAW, JJ., Concur.

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Carlton Fields, P.A. v. LoCascio

Court of Appeal of Florida, Third District

March 30, 2011, Opinion Filed

Nos. 3D10-130 & 3D10-106

Reporter
59 So. 3d 246 *; 2011 Fla. App. LEXIS 4327 **; 36 Fla. L. Weekly D 677

Carlton Fields, P.A., Appellant, vs. Edward J. LoCascio, Appellee.

Subsequent History: Released for Publication May 4, 2011.

Rehearing denied by Carlton Fields, P.A. v. LoCascio, 2011 Fla. App. LEXIS 7787 (Fla. Dist. Ct. App. 3d Dist., May 4, 2011)

Related proceeding at LoCascio v. Estate of LoCascio, 2011 Fla. App. LEXIS 10170 (Fla. Dist. Ct. App. 3d Dist., June 29, 2011)

Prior History: [**1] Non-Final Appeals from the Circuit Court for Miami-Dade County, Valerie R. Manno-Schurr, Judge. Lower Tribunal Nos. 07-11384; 03-22688.

LoCascio v. Sharpe, 23 So. 3d 1209, 2009 Fla. App. LEXIS 16067 (Fla. Dist. Ct. App. 3d Dist., 2009)

Counsel: Carlton Fields, and Marsha G. Madorsky; Carlton Fields, and Sylvia H. Walbolt and Stephanie C. Zimmerman (St. Petersburg), for appellant.

Austin Carr, for appellee.

Judges: Before GERSTEN, WELLS and SALTER, JJ.

Opinion by: SALTER

Opinion

[*247] SALTER, J.

This is an appeal by a law firm, Carlton Fields, from two orders subordinating its judgment for attorney's fees and costs payable by its client to a later-entered judgment for damages against that client in a separate case. Finding that there is no basis to apply the equitable subordination doctrine, we reverse the orders.

Edward S. LoCascio (Father) was accused, and later convicted, of murdering his wife in 2001. The couple had a son, appellee Edward J. LoCascio (Son). Beginning in 2002, Carlton Fields represented the Father in the probate proceedings regarding his late wife's estate. Starting in 2003, it also represented the Father

in Slayer Statute [1] and wrongful death actions brought against him by the Son. In late 2001, the probate court froze assets jointly owned by the Father and his late wife.

The Father was convicted in February 2007 of arranging the murder of his wife by his brother. The firm sued the Father in April 2007 to recover its unpaid fees and costs. In May 2007, the Father agreed to a consent judgment which was in turn entered by the circuit court. The final judgment ($803,212.92) was recorded in Miami-Dade and Palm Beach Counties, and a judgment lien certificate was issued later that same month. Although the Son has asserted that the amount of unpaid attorney's fees and costs embodied in the Carlton Fields final judgment is "collusive," he provided no evidence that the law firm's attorneys did not provide the applicable legal services, actually expend the hours billed (at reasonable hourly rates), or incur the costs charged. [2] There is no evidence in the record to suggest that in filing its collection suit, and in obtaining and perfecting a judgment lien, Carlton Fields had any intention to harm the Son, benefit the Father, or accomplish anything other than the collection of actually-incurred fees and costs for legal services.

Eighteen months later, in November 2008, the Son obtained a compensatory and punitive damages judgment (for over $75 million) against the Father in the wrongful death action. In November 2009, the Son moved to subordinate the Carlton Fields fee judgment to his own judgment in the wrongful death action, so that he could levy against his Father's assets first, before the law firm. The trial court granted the motion and subordinated the law firm's fee judgment. This appeal followed.

Analysis

Equitable subordination is an "extraordinary remedy" typically sought in a bankruptcy proceeding to address "gross misconduct" or actions by a creditor that are "egregious and severely unfair to other creditors." *Toy King Dist. v. Liberty Sav. Bank*, 256 B.R. 1 (M.D. Fla. 2000). The elements of equitable subordination are:

> (1) "The claimant must have engaged in some type of [**4] inequitable conduct." (2) "The misconduct must have resulted in injury to the creditors of the bankrupt or conferred an unfair advantage on the claimant." (3) "Equitable subordination [*248] of the claim must not be inconsistent with the provisions of the Bankruptcy Code."

Id. 256 B.R. at 195 (quoting *Benjamin v. Diamond (In re Mobile Steel Co.)*, 563 F.2d 692, 699-705 (5th Cir. 1977)). In *Pepper v. Litton*, 308 U.S. 295, 311, 60 S. Ct. 238, 84 L. Ed. 281 (1939), the Supreme Court of the United States observed that the common thread in such cases is "the violation of rules of fair play and good conscience by the claimant . . . in disregard of the standards of common decency and honesty." There is simply no evidence of any of these elements in this case.

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[1] § 732.802, Fla. Stat. (2001). The Slayer [**2] Statute claims were addressed here in a prior appeal, *LoCascio v. Sharpe*, 23 So. 3d 1209 (Fla. 3d DCA 2009).

[2] The Son does not question [**3] the hours billed, the hourly rate, the costs charged, or the total billings. These topics could have been, but were not, questioned at the hearing on the motion to subordinate the Carlton Fields judgment. At oral argument, counsel for the Son acknowledged that the issue is the priority of the Carlton Fields judgment, not the amount.

The Father was entitled to retain legal counsel. Carlton Fields was entitled to agree to represent him. Any firm representing the Father would have been entitled to charge for its services. The firm took reasonable steps to legally protect and collect its claim for fees due. There is nothing inherently fraudulent or inequitable about these activities; they are not a "violation of the rules of fair play and good conscience." *Id.*

The Son's argument that Carlton Fields' judgment [**5] against his Father is a collusive agreement, a "misuse of court process," or a "sham," is not persuasive. The Son did not present any evidence to demonstrate that the Carlton Fields judgment represented anything other than a bona fide effort to collect upon a duly-incurred debt for services rendered. Similarly, allegations that Carlton Fields' collection lawsuit and judgment against the Father were "unbeknownst" to the Son and his counsel in the wrongful death case (and in the probate case regarding his late mother's estate) are unsupported by any legal authority imposing a duty upon Carlton Fields to give such notice to the Son. Nor can the consent judgment be considered a "fraud on the court," as the Son has called it. If anything, it promoted judicial economy by avoiding senseless litigation regarding an undisputed debt.

Finally, the Son argues that a reversal of the subordination orders (restoring the priority of the Carlton Fields judgment against the Father's remaining assets) would result in a "perversion of Florida law" by making the Son pay Carlton Fields' fees and costs incurred in representing the very man who murdered his Mother. But the Father was not and could not be prohibited [**6] from hiring and agreeing to pay an attorney to represent him. It follows that neither he nor his attorneys did anything inequitable in recording the amount owed Carlton Fields in a final judgment and lien.

The orders subordinating judgment are therefore reversed.

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Moffatt & Nichol, Inc. v. B.E.A. Int'l Corp.

Court of Appeal of Florida, Third District

October 20, 2010, Opinion Filed

No. 3D08-2089

Reporter
48 So. 3d 896 *; 2010 Fla. App. LEXIS 15828 **; 35 Fla. L. Weekly D 2315

Moffatt & Nichol, Inc., etc., Appellant, vs. B.E.A. International Corp., Inc., etc., Appellee.

Subsequent History: Released for Publication December 16, 2010.

Rehearing denied by Moffatt & Nichol, Inc. v. B.E.A. Int'l Corp., 2010 Fla. App. LEXIS 20162 (Fla. Dist. Ct. App. 3d Dist., Dec. 16, 2010)

Prior History: [**1] An Appeal from a non-final order from the Circuit Court for Miami-Dade County, Gerald D. Hubbart, Judge. Lower Tribunal No. 04-22836.

Counsel: Bush Ross and A. Christopher Kasten, II (Tampa), for appellant.

Fowler White Burnett, Ronald G. Neiwirth and Helaine S. Goodner, for appellee.

Judges: Before WELLS and SHEPHERD, JJ., and SCHWARTZ, Senior Judge.

Opinion by: SHEPHERD

Opinion

[*897] SHEPHERD, J.

This is an appeal of a non-final order denying a judgment creditor's Amended Motion for Proceedings Supplementary and Motion for Issuance of Writ of Execution, pursuant to Florida Rule of Appellate Procedure 9.130(a)(4). We have jurisdiction. The question presented is whether one particular creditor has standing to pursue derivative claims, alleging loss or damage to a person or entity, against a debtor company, which has made a statutory assignment for the benefit of creditors pursuant to Chapter 727 of the Florida Statutes after the assignment has been made. For the reasons set forth below, we answer the question in the negative.

FACTUAL AND PROCEDURAL BACKGROUND

This case arises from a thwarted effort by appellant, Moffatt & Nichol, Inc., etc. (Moffatt), to obtain a writ of execution [1] and conduct proceedings supplementary in furtherance [**2] of recovering $ 179,926.46 due it under the terms of an Amended Final Judgment rendered in its favor and against appellee, B.E.A. International Corporation, Inc., etc. (BEAI), on March 25, 2008, as a result of BEAI's breach of the payment terms of an architectural services agreement between the two entities ("the Contract Case"). On April 29, 2008, Moffatt executed a judgment lien certificate and sent it to the Secretary of State for recording. On that same date, BEAI made an Assignment for the Benefit of Creditors, pursuant to Chapter 727 of the Florida Statutes, to Michael Phelan, a fiduciary appointed by BEAI for the purpose of liquidating BEAI's assets for the benefit of all creditors. *See* § 727.101, Fla. Stat. (2008). Two days later, Michael Phelan timely filed a separate Petition Commencing Assignment for The Benefit of Creditors in the circuit court to facilitate the performance of his duties ("the Assignment Case"). *See* § 727.104, Fla. Stat. (2008).

Two [**3] weeks after that, on May 17, 2008, Moffatt filed a Motion for Proceedings Supplementary in the Contract Case against the assignor, BEAI, and a related third party, BEA Architects, Inc. ("BEAA"), which Moffatt alleges miraculously appeared to continue the business of BEAI in all respects-same location, employees, office equipment, telephone numbers, website, and President (Bruno Ramos) with the same $ 250,000 salary. On June 25, 2008, over Moffatt's objection, the trial court in the Assignment Case granted Assignee Michael Phelan's request for approval of a contract for the sale of certain specified assets of BEAI to BEAA, free and clear of all liens and encumbrances, including the judgment lien held by Moffatt, [*898] for the sum of $ 25,000. The order acknowledged Moffatt's position that the filing of the petition did not compromise Moffatt's right to engage in proceedings supplementary in the Contract Case.

Two days later, Moffatt filed an Amended Motion for Proceedings Supplementary and to Implead Third Parties in the Contract Case. The motion sought to add Art, Design & Construction, Inc. ("ADC"), River Property, a joint venture ("River Property"), 4111 Lejeune Road, Inc. ("4111 Lejeune [**4] Road"), Ahern-Plummer, Inc. ("Ahern-Plummer"), Addition Acquisitions, LLC ("Addition Acquisitions"), Bruno Ramos and his wife, Maritz Ramos, as additional third-party defendants. [2] Moffatt alleged that BEAA and the proposed additional corporate defendants were all majority owned by the Ramoses, and the Assignment for the Benefit of Creditors was nothing more than an elaborately planned fraudulent transfer scheme, orchestrated and executed by BEAI's hand-picked statutory assignee for the purpose of shielding BEAA from any successor liability claims the order approving the sale might offer. Moffatt further argued, based on but brief discovery, that it appeared BEAI failed to schedule significant assets on the Assignment, which were held by certain of the additional defendants as alter egos of BEAI, and BEAI had transferred hundreds of thousands of dollars in cash to ADC the day after the Assignment was executed, in contravention of section 726.106 of Florida's Uniform Fraudulent Transfers Act. Finally, Moffatt argued it was entitled to pursue all of these claims in its own name and capacity, separate and distinct from Michael Phelan, the Assignee. It is on this point the trial court [**5] disagreed and on which we affirm.

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[1] Under the decisional law of this district, the issuance of a valid writ of execution and its return unsatisfied are jurisdictional prerequisites for proceedings supplementary. *See* § 56.29, Fla. Stat. (2008); *Mejia v. Ruiz*, 985 So. 2d 1109, 1112 (Fla. 3d DCA 2008).

[2] 4111 Lejeune Road, Ahern-Plummer, and Addition Acquisitions are joint venture partners in River Property.

ANALYSIS

Moffatt's principal argument on appeal is that the trial court in the Contract Case erred by failing to appreciate that Moffatt does not seek to reach any assets in the "possession, custody or control of the assignee" in the Assignment Case within the meaning of Chapter 727 of the Florida Statutes, but only property in the hands of entities not parties to that case-i.e., the proposed additional third-party defendants named in the Amended Motion for Proceedings Supplementary. In support of its argument, Moffatt directs our attention to section 727.105 of the Florida Statutes (2008), which states, in relevant part, that "[e]xcept in the case of a consensual lienholder [3] enforcing its rights in personal property or real property collateral, there shall be no levy, execution, attachment or the like in respect of any judgment against assets of the estate in the possession, custody, or control of the assignee."

In former times, Moffatt's argument might have had merit. However, one year before the execution of the Assignment for the Benefit of Creditors in this case, Florida's legislature adopted its most extensive revision of Chapter 727, [*899] Florida Statutes, in a decade. *See* Ch. 2007-185, Laws of Fla. (eff. July 1, 2007). In this revision, the definition of "asset" in section 727.103(1), was expanded to include, for the first time, the phrase, "claims and causes of action, whether arising by contract or tort." As amended, the definition now reads:

> "Asset" means a legal or equitable interest [**7] of the assignor in property, which includes anything that may be the subject of ownership, whether real or personal, tangible or intangible, **including claims and causes of action, whether arising by contract or in tort**, wherever located, and by whomever held at the date of the assignment, except property exempt by law from forced sale.

§ 727.103(1), Fla. Stat. (2008) (emphasis added). In addition, the standard assignment form, found in section 727.104(1)(b), corresponds to the statute by specifically including "claims and choses in action." *See* § 727.104(1)(b), Fla. Stat. (2008). [4] Thus, under the terms of Florida's Assignment for the Benefit of Creditors law as it presently exists, the assignor conveys to the assignee **all** of its assets as defined in section 727.103(1), except such assets as are exempt by law from levy and sale under an execution. Collectively, these assets create an "estate." *See* § 727.103(9), Fla. Stat. (2008). The assignee, in turn, is required to take possession of, protect and preserve, and liquidate the assets of the estate and to convert the estate to money. *See* §§ 727.104(1)(b), .108, Fla. Stat. (2008). Under the statutory scheme as it now exists, only an assignee [**8] has standing to pursue fraudulent transfers, preferential transfers or other derivative claims. [5]

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[3] A "[c]onsensual lienholder" is defined in Chapter 727 as "a creditor that has been granted a security interest or lien in personal property [**6] or real property of the assignor prior to the date on which a petition is filed with the court and whose security interest or lien has been perfected in accordance with applicable law." § 727.103(6), Fla. Stat. (2008). In contrast to the analogous automatic stay provision of the United States Bankruptcy Code, *see* 11 U.S.C. § 362(a) (2008), the filing by a debtor of an Assignment for the Benefit of Creditors does not automatically stay the enforcement by a consensual lienholder of its legal rights in the security. *See* § 727.105, Fla. Stat. However, Moffatt is not a consensual lienholder within this section.

[4] This language also appears in the version of section 727.104(1)(b) prior to the 2007 revisions. *See* § 727.104(1)(b), Fla. Stat. (2006).

[5] This change brings the administration of estates under Florida's Assignment for the Benefit of Creditors law into conformity with the United States Bankruptcy Code, 11 U.S.C. §§ 101-1532. For more than fifty years, it has been settled law in bankruptcy that only a bankruptcy trustee has standing to bring derivative claims. *See, e.g., In re Gen. Dev. Corp.*, 179 B.R. 335 (S.D. Fla. 1995) (finding derivative claims are among the assets of an estate, which only the trustee has standing to prosecute). The same rule applies to preferential and fraudulent transfers.

Moffatt places primary reliance for its position that it has an independent right to pursue derivative claims against the proposed additional third-party defendants on *Seminole Boatyard v. Christoph*, 715 So. 2d 987 (Fla. 4th DCA 1998). *Seminole Boatyard* is inapposite. In *Seminole Boatyard*, Seminole obtained a $ 746,998 judgment for unpaid rent against its commercial tenant, Florida Atlantic Marine ("FAM"), after which FAM filed for bankruptcy. *Id*. at 988. Seminole then filed a separate action against Robert Christoph, the president of FAM, alleging he had diverted funds from FAM before the bankruptcy filing, and also had "intentionally used FAM to 'break' George Whitten, the president of Seminole, and force Seminole to lose its property through foreclosure." *Id*. In the meanwhile, Christophe purchased the bankruptcy estate's claims against himself, obtaining [**10] a general release from the trustee in bankruptcy that [*900] included all rights, claims and causes of action against him that accreted to the bankruptcy trustee by virtue of the filing. *Id*. Christophe then successfully deployed the release as a complete bar on summary judgment in the separate action brought by Seminole on the theory that Seminole's claim was among those accreted. *Id*. at 989. In its order approving Christophe's claims purchase, the bankruptcy court expressly declined to opine concerning whether Seminole's claim had, in fact, been released. *Id*. at 988.

On Seminole's appeal from the trial court's adverse summary decision, the Fourth District Court reversed, relying principally on *E.F. Hutton & Co. v. Hadley*, 901 F. 2d 979 (11th Cir. 1990), which involved a negligence claim against a broker, and which held that "nothing in the Bankruptcy Code authorizes a trustee to collect money owed to a creditor of the estate, but not to the estate." *Seminole Boatyard*, 715 So. 2d at 989 (citing *E.F. Hutton*, 901 F. 2d at 986). Based upon *E.F. Hutton*, the court found that Seminole, not the bankrupt estate, was the real party in interest to seek to pierce FAM's corporate veil and assert an alter [**11] ego claim or such other claims as existed for unpaid rent as against Christophe personally. *Seminole Boatyard*, 715 So. 2d at 990. In short, the district court of appeal concluded that Seminole's action was for money owed it as a distinct creditor and not to the estate as a whole.

The case before us is the obverse of *Seminole Boatyard*. Unlike Seminole in its case, Moffatt is not trying to collect money owed to it via an independent claim of misbehavior. Moffatt makes no allegation that any one of the proposed additional third-party defendants against whom it wishes to proceed has caused it a particularized harm separate and distinct from the detriment that may have befallen any other creditor of the assignment estate. Instead, Moffatt's proposed supplemental proceeding is nothing more than a collection action for the purpose of assembling assets to satisfy its own judgment. Since at least 2007, the right to pursue such "claims[,] causes of action" and "choses in action" has resided solely in a duly appointed assignee for the benefit of **all** creditors upon the appointment of the assignee. [6]

See 11 U.S.C. §§ 547(b), 548(a); *In re Curry & Sorenson, Inc*., 57 B.R. 824, 828-29 (B.A.P. 9th Cir. 1986) ("An action to set aside a fraudulent transfer must be brought in the name of the bankruptcy estate as the real party in interest."); *In re Fritz*, 88 B.R. 434, 435 (Bankr. S.D. Fla. 1988) (holding pursuant to 11 U.S.C. sections 544(b) and 548(a) of the Bankruptcy Code, a fraudulent transfer claim is [**9] "available only to a bankruptcy trustee, not to a creditor"); *In re Davidson Lumber*, 19 B.R. 871 (Bankr. S.D. Fla. 1982) (finding petitioning creditors lacked standing to challenge transfer as fraudulent or preferential because such statutory remedies could be asserted only by a bankruptcy trustee or debtor-in-possession).

[6] Citing to *Biloxi Casino Corp. v. Wolf*, 900 So. 2d 734 (Fla. 4th DCA 2005), and *Continental Cigar Corp. v. Edelman & Co*., 397 So. 2d 957 (Fla. 3d DCA 1981), [**12] Moffatt also argues the trial court had no discretion to deny proceedings supplementary to implead third parties. Although *Biloxi* states that "[u]pon a showing of the statutory prerequisites, the court has no discretion to deny the motion," 900 So. 2d at 734, *Biloxi* did not address any of the issues presented here. *Continental Cigar* is irrelevant for the same reason. Moffatt, however, failed to cite *Arellano v. Bisson*, 847 So. 2d 998 (Fla. 3d DCA 2003), in which this Court affirmed the trial court's denial of a judgment creditors' motion for proceedings supplementary and to implead a third party because the property the judgment creditors wished to attach was not property that could be reached to satisfy a debt. The same is true in this case.

We acknowledge Moffatt's concern that the Assignment for Benefit of Creditors statute may offer a larger window for collusion than might appear to be the case in a bankruptcy proceeding since, under the assignment statute as it exists, the assignor in an Assignment for the Benefit of Creditors action chooses the assignee. However, this concern is neither expressly included among Moffatt's points on appeal in this case, nor the true thrust of the [**13] argument Moffatt makes to us. We do note, however, that the assignee, upon appointment, is a fiduciary that is required to post a bond, the sufficiency of which is [*901] challengeable by any interested party, who must be given notice of the proceeding.

In the final analysis, Moffatt's stratagem is an impermissible end-run around the Assignment for the Benefit of Creditors statute, and an improper attempt to get to the head of the line, in front of all the other creditors of BEAI, in violation of the spirit, if not the letter, of the Assignment for the Benefit of Creditors statute. *See In re Prime Motor Inns, Inc.*, 135 B.R. 917, 920 (Bankr. S.D. Fla. 1992) ("To grant individual creditors . . . the right to prosecute avoidance actions . . . would unfairly enable individual creditors to pursue their own parochial or insular interests, to the detriment of all other creditors."). We hold that, like a bankruptcy trustee, an assignee for the benefit of creditors has the exclusive authority to pursue fraudulent transfers and other "choses in action" for the benefit of all creditors.

Affirmed.

End of Document

Pro Finish, Inc. v. Estate of Estate of All Am. Trailer Mfrs.

Court of Appeal of Florida, Fourth District

August 3, 2016, Decided

No. 4D15-2966

Reporter
204 So. 3d 505 *; 2016 Fla. App. LEXIS 11731 **; 41 Fla. L. Weekly D 1802

PRO FINISH, INC., Appellant, v. ESTATE OF ALL AMERICAN TRAILER MANUFACTURERS, INC., and JOHN ALAN MOFFA, as Assignee of the Estate of All American Trailer Manufacturers, Inc., Appellee.

Prior History: [**1] Appeal from the Circuit Court for the Seventeenth Judicial Circuit, Broward County; Jack B. Tuter, Judge; L.T. Case No. CACE13-026100(07).

Counsel: Justin C. Carlin of Golden Carlin, Fort Lauderdale, for appellant.

Stephen C. Breuer of Moffa, Bonacquisti & Breuer, PLLC, Plantation, for appellee.

Judges: MAY, J. GROSS and KLINGENSMITH, JJ., concur.

Opinion by: MAY

Opinion

[*505] MAY, J.

Failure to strictly adhere to chapter 727's requirements mandates a reversal in this case. A creditor appeals a trial court order approving the assignee's final report, and a second order denying reinstatement of the creditor's lien. We find merit in the creditor's argument that the debtor's assignee failed to comply with chapter 727, Florida Statutes (2013), and reverse.

Pro Finish, Inc. ("creditor") obtained a final judgment against All American Trailer Manufacturers, Inc. ("debtor") for breach of contract and fraud. The creditor filed a motion alleging that, in June 2012, it served a writ of garnishment on a bank holding an account titled in the debtor's name. On June 15, 2012, the debtor petitioned for Chapter 11 bankruptcy. The bankruptcy court ultimately dismissed the case on June 11, 2013.

On May 2, 2013, the creditor filed a judgment lien certificate with the Florida Secretary [**2] of State, Division of Corporations ("May 2, 2013 Lien"), on the debtor's assets. At 10:51 a.m. on November 26, 2013, the creditor filed a judgment lien certificate with the Florida Secretary of State, Division of Corporations ("November 26, 2013 Lien"), on the debtor's assets.

At 5:36 p.m. on November 26, 2013, the debtor's assignee petitioned the trial court for assignment for the benefit of creditors under section 727.104, Florida Statutes ("ABC Proceeding"). He alleged that he became the debtor's assignee, pursuant to a June 11, 2013, assignment ("June 11, 2013 Assignment"). The June 11, 2013 Assignment was not executed until July 15, 2013, but had a stated effective date of [*506] June 11, 2013.[1]

On March 6, 2014, the assignee moved to approve sale of assets free and clear of liens, encumbrances, and interests to Bad 2D Bone Trailers, Inc. ("Bad 2D Bone"). The assignee argued that the November 26, 2013 Lien was not secured by the debtor's assets because the creditor filed it months after the June 11, 2013 Assignment. On March 27, 2014, the creditor objected to the assignee's [**3] motion and moved to set aside the June 11, 2013 Assignment on the ground that it was invalid, fraudulent, and in contravention of chapter 727, Florida Statutes. It also moved to dismiss the ABC Proceeding.

On September 22, 2014, the trial court heard the assignee's motion to approve sale and the creditor's objections and motion to set aside or dismiss the ABC Proceeding. The creditor's counsel argued the June 11, 2013 Assignment was fraudulent because the assets had been transferred a month before the assignment, the assignee failed to properly record the June 11, 2013 Assignment, and the assignee failed to properly petition for the ABC Proceeding within the statutorily required time.

The assignee responded that the debtor properly assigned the assets to him on May 8, 2014, but the trial court dismissed the original assignment for the benefit of creditor's case due to the pending bankruptcy. The assignee then obtained another assignment on June 11, 2013. Bad 2D Bone was operating with the assets under an "Interim Operating Agreement," until the assignee could sell them. He admitted that a relative of the debtor's principal ran Bad 2D Bone.

The trial court orally overruled the creditor's objections to the sale, approved [**4] the proposed sale at the highest appraised price, and denied the creditor's motion to set aside and dismiss the ABC Proceeding. On September 29, 2014, the trial court entered a written order reflecting its oral ruling. The assignee then petitioned for approval of his final report and discharge as assignee. The creditor moved for reinstatement of its May 2, 2013 Lien and objected to the assignee's petition for approval of final report and discharge of assignee.

On June 29, 2015, the trial court entered the Approval Order, which included distributions to the assignee's counsel, the assignee, and the assignee's accountants. The trial court also entered the Order Denying Lien Reinstatement. From these orders, the creditor now appeals.

The creditor argues the trial court erred in entering the Approval Order and in failing to dismiss the ABC Proceeding as invalid and void. It emphasizes that chapter 727 procedures for a debtor's assignment of assets are strictly construed and the debtor's assignee failed to strictly follow the procedures, rendering the June 11, 2013 Assignment invalid. The assignee was required to record the assignment, and file a petition and bond with the trial court within [**5] ten days after delivery of the assignment, which it failed to do.

We have de novo review of the trial court's application and interpretation of Chapter 727, Florida Statutes. *Hillsborough Cty. v. Lanier*, 898 So. 2d 141, 143 (Fla. 2d DCA 2005).

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[1] The creditor also alleged the June 11, 2013 Assignment was not recorded until February 13, 2014, but the record provided fails to establish this fact.

Chapter 727 "provide[s] a uniform procedure for the administration of insolvent estates, and . . . ensure[s] full reporting to creditors and equal distribution of assets according to priorities as established under [chapter 727]." § 727.101, Fla. Stat. (2013). Section 727.104(1), Florida Statutes, provides [*507] the form of the assignment and requires compliance with it. § 727.104(1), Fla. Stat. (2013); *see Smith v. Effective Teleservices, Inc.*, 133 So. 3d 1048, 1050-51 (Fla. 4th DCA 2014). The June 11, 2013 Assignment did substantially follow the required form.

"Section 727.104 . . . [also] requires the assignee to record the assignment in the public records as well as to file a petition and bond in the circuit court." *Moecker v. Antoine*, 845 So. 2d 904, 910-11 (Fla. 1st DCA 2003). Subsection (2) requires that this be done within ten days after delivery of the assignment to the assignee. § 727.104(2), Fla. Stat.

Here, the record lacks evidence as to when the June 11, 2013 Assignment was recorded. The only record evidence of the June 11, 2013 Assignment is a copy attached to the ABC Proceeding petition. It does not indicate whether or when it was recorded. But, the creditor also argues the assignee failed to file the ABC Proceeding petition within the section 727.104(2) time limits. The creditor suggests the failure to timely petition the trial court for the [**6] ABC Proceeding "is in direct contravention of Chapter 727 and violates public policy, which favors the expedient payment of just debts to creditors and prompt notice to creditors of an assignment of the debtor's assets." We agree and reverse.

"There is little case law addressing chapter 727, and none addresses the issues presented here." *Lanier*, 898 So. 2d at 144. However, "the provisions of an assignment which are inconsistent with the applicable statute are void, and the assignment as a whole is void where it fails to comply with such a statute, or is against public policy." 21 C.J.S. Creditor and Debtor § 9 (footnotes omitted).

Here, the assignee failed to file the petition in the circuit court within ten days of delivery of the assignment. The assignee petitioned for the ABC Proceeding on November 26, 2013, and signed the acceptance of the June 11, 2013 Assignment on July 15, 2013. Although the June 11, 2013 Assignment met the section 727.104(1) form requirements, the untimely filing invalidated the ABC Proceeding under section 727.104(2).

Section 727.111, Florida Statutes (2013), required the assignee to also publish notice of the June 11, 2013 Assignment in the newspapers for four consecutive weeks, within ten days of filing the petition, and provide "notice to all known creditors [**7] within 20 days after filing the petition." § 727.111(1), Fla. Stat. While the creditor does not argue that the assignee failed to provide notice of the ABC Proceeding, we note that the record shows the publication took place on January 23, 2014, which also violated section 727.111's time limit.

The intent of chapter 727 is to provide a uniform procedure, ensure full reporting to creditors, and ensure equal distribution per priority. § 727.101, Fla. Stat. The assignee untimely petitioned for the ABC Proceeding, and failed to publish notice as required by section 727.111. The assignee's failure to strictly comply with the statutory requirements rendered the assignment invalid and void. The trial court erred in overruling the creditor's objections, approving the sale, and in its final order approving the distribution of assets.

We reverse based upon the debtor's failure to comply with sections 727.104 and 727.111, Florida Statutes. We do not reach the creditor's two remaining arguments.

Reversed and remanded.

GROSS and KLINGENSMITH, JJ., concur.

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Smith v. Effective Teleservices, Inc.

Court of Appeal of Florida, Fourth District

January 8, 2014, Decided

Nos. 4D12-3952 and 4D12-3957

Reporter
133 So. 3d 1048 *; 2014 Fla. App. LEXIS 144 **; 39 Fla. L. Weekly D 123; 2014 WL 51686

ALLERD CHARLES SMITH, Appellant, v. EFFECTIVE TELESERVICES, INC., a Florida corporation, n/k/a ETECH, INC., DILIP BAROT, individually, ETECH TEXAS, LLC, a Florida Limited Liability Company, ETECH TEXAS, LLC, a Delaware Limited Liability Company, and MATTHEW F. ROCCO, individually, Appellees.

Prior History: [**1] Consolidated appeals from the Circuit Court for the Fifteenth Judicial Circuit, Palm Beach County; Catherine M. Brunson, Judge; L.T. Case No. 502005CA006080XXXXMB AO.

Effective Teleservices, Inc. v. Smith, 16 So. 3d 256, 2009 Fla. App. LEXIS 11584 (Fla. Dist. Ct. App. 4th Dist., 2009)

Counsel: Erik Figlio, John Beranek, Robert N. Clarke, Jr., and Richard Doran of Ausley & McMuller, Tallahassee, and Peter M. Feaman, of Peter M. Feaman, P.A., Boynton Beach, for appellant.

Alan B. Rose and Roy E. Fitzgerald of Page Mracheck, Fitzgerald, Rose, Konokpa & Dow, P.A., West Palm Beach, for appellee, Etech Texas, LLC.

W. Chester Brewer, Jr. of W. Chester Brewer, Jr., P.A., West Palm Beach, for appellee, Matthew F. Rocco.

Judges: GROSS, J. WARNER and KLINGENSMITH, JJ., concur.

Opinion by: GROSS

Opinion

[*1049] GROSS, J.

The primary question presented in this case is as follows: After a judgment debtor files a Chapter 727 assignment for the benefit of creditors, may a judgment creditor separately pursue a Chapter 726 claim that the judgment debtor fraudulently transferred assets to a third party before making the Chapter 727 assignment? In [*1050] these circumstances, we hold that if a Chapter 727 assignee has abandoned or sold and assigned a judgment creditor's fraudulent transfer claim, the judgment creditor may pursue the Chapter 726 claim. The assignee's abandonment [**2] or sale and assignment of a claim is a condition precedent to a judgment creditor's ability to bring suit outside of a Chapter 727 assignment. Because the impleader complaint here at issue pleaded compliance with all conditions precedent to suit, we reverse the final judgment dismissing the judgment creditor's impleader complaint.

Allerd Smith filed an action against Effective Teleservices and its chairman Dilip Barot. Smith recovered judgments against Effective for $1.3 million and Barot for $8.7 million. Later, the circuit court entered a separate final judgment in favor of Smith, and against Effective and Barot, for $1.5 million in attorney's fees and $451,176.69 in costs.

Next, Smith filed an impleader complaint against appellees Etech Texas, LLC and Matthew Rocco, alleging that they participated in a scheme to defraud Smith out of the ability to collect on his two judgments. The operative complaint alleged that Effective's assets were transferred to Etech Texas, a company created by Barot, and that Etech Texas continued to run Effective's operations at the same location, with the same employees, using the same website, and with the same customers. Rocco worked as the chief executive [**3] officer of Effective and continued in the same capacity at Etech Texas. Alleging legal theories turning on the claim of a fraudulent transfer of assets under sections 726.105(1)(a), 726.105(1)(b)2, and 726.106(1), Florida Statutes (2010), the impleader complaint sought various remedies including the voiding of the transfer of assets to Etech Texas or the sale of Etech Texas's assets.

According to the complaint, after the transfer of assets to Etech Texas, Effective executed a Chapter 727 assignment for the benefit of creditors, assigning Effective's remaining assets to an assignee. Relying upon the assignment for the benefit of creditors, Etech Texas and Rocco filed motions to dismiss the impleader complaint, claiming that Smith lacked standing to pursue the causes of action; they relied on *Moffatt & Nichol, Inc. v. B.E.A. International Corp.*, 48 So. 3d 896, 899 (Fla. 3d DCA 2010), to argue that "only an assignee has standing to pursue fraudulent transfers, preferential transfers or other derivative claims." The circuit court granted the motions and dismissed the impleader complaint with prejudice.

Resolution of this case requires examination of two chapters of the Florida Statutes—Chapter 727, [**4] involving assignments for the benefit of creditors, and Chapter 726, the Uniform Fraudulent Transfer Act.

"An assignment for the benefit of creditors is an alternative to bankruptcy and allows a debtor to voluntarily assign its assets to a third party [assignee] in order to liquidate the assets to fully or partially satisfy creditors' claims against the debtor." *Hillsborough Cnty. v. Lanier*, 898 So. 2d 141, 143 (Fla. 2d DCA 2005); *see also* § 727.104(1)(b), Fla. Stat. (2010). The stated intent of Chapter 727 "is to provide a uniform procedure for the administration of insolvent estates, and to ensure full reporting to creditors and equal distribution of assets according to priorities as established under this chapter." § 727.101, Fla. Stat. (2010).

The mechanics of Chapter 727 are that the assignor assigns to the assignee "all of its assets, except such assets as are exempt by law from levy and sale under an execution"; the assets so assigned become the "estate" of the assignor. § 727.104(b), Fla. Stat. [*1051] (2010); § 727.103(9), Fla. Stat. (2010) (defining an "estate" as including "all of the assets of the assignor"). A mandatory duty of the assignor is to "deliver to the assignee all of [**5] the assets of the estate in the assignor's possession, custody, or control." § 727.107(2), Fla. Stat. (2010). Among the duties of the assignee are to "[c]ollect and reduce to money the assets of the estate." § 727.108(1), Fla. Stat. (2010). The assignee is authorized to prosecute the "estate's claims and causes of action," including actions to "recover money or other assets of the estate" and to "avoid any conveyance or transfer void or voidable by law under s. 727.109(8)(c)." §§ 727.108(1)(a), 727.110(1)(a), (c), Fla. Stat. (2010).

Significant to this appeal is Chapter 727's definition of "asset":

> "Asset" means a legal or equitable interest of the assignor in property, which includes *anything that may be the subject of ownership, whether real or personal, tangible or intangible,* including claims and causes of action, whether arising by contract or in tort, *wherever located, and by whomever held* at the date of the assignment, except property exempt by law from forced sale.

§ 727.103(1), Fla. Stat. (2010) (emphasis added).

The central question here is whether the property Effective transferred to Etech Texas prior to the assignment fits within the above definition of an estate's "asset." [**6] To the extent that these transfers are voidable under Chapter 726, the Uniform Fraudulent Transfer Act, we hold that the assignor's equitable interest in the property so transferred is an asset of the estate under section 727.103(1).

The concern of both Chapter 726 and Chapter 727 is to protect the rights of creditors. Fraudulent transfer laws such as Chapter 726 "generally attempt[] to protect creditors from transactions which are designed to, or have the effect of, unfairly draining the pool of assets available to satisfy creditor claims or which dilute legitimate creditor claims at the expense of false or lesser claims." 37 Am. Jur. 2d *Fraudulent Conveyances and Transfers* § 1 (updated Nov. 2013). Chapter 726 "prevents debtors from placing property beyond reach of their creditors when those assets should legitimately be made available to satisfy creditor demands." *Id.*

A fraudulent transfer of property is voidable at the instance of a creditor. *See* § 726.109(1), Fla. Stat. (2010) (using the word "voidable" to describe the application of § 726.105(1)(a)). Where the fraudulent transfer act applies, a "transferor retains equitable ownership of assets that are fraudulently transferred to [**7] a third party, and those assets remain subject to attachment by the transferor's creditors." 37 Am. Jur. 2d *Fraudulent Conveyances and Transfers* § 77 (updated Nov. 2013). Such an "equitable ownership" is contemplated within the section 727.103(1) definition of "asset"; it is an "equitable interest of the assignor in property . . . wherever located, and by whomever held at the date of the assignment." Because the impleader complaint alleged a fraudulent transfer of assets, Effective retained equitable ownership of the property transferred to Etech Texas, so that the equitable interest was an asset of the estate under sections 727.104(1)(b), 727.103(9), and 727.103(1).

Chapter 726 thus works hand in hand with Chapter 727, which authorizes an assignee to bring an action to "avoid any conveyance or transfer void or voidable by law." §§ 727.110(1)(c), 727.109(8)(c), Fla. Stat. (2010). The assignee is authorized to bring a Chapter 726 action because the assignee is a Chapter 726 "creditor."

[*1052] Sections 726.105 and 726.106, Florida Statutes (2010), define the circumstances where a transfer by a debtor is fraudulent as to a creditor.[1] Under Chapter 726, it is the "creditor" who may

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[1] Section 726.105 provides, in pertinent part:

> (1) A transfer made or obligation incurred by a debtor is fraudulent as to a creditor, whether the creditor's claim arose before or after the transfer was made or the obligation was incurred, if the debtor made the transfer or incurred the obligation:
>
> (a) With actual intent to hinder, delay, or defraud any creditor of the debtor; or
>
> (b) Without receiving a reasonably equivalent value in exchange for the transfer or obligation, and the debtor:
>
> . . . .
>
> 2. Intended to incur, or believed or reasonably should have believed that he or she would incur, debts beyond his or her ability to pay as they became due.

"obtain" the [**8] remedies provided by the statute against a transferee. § 726.108(1), Fla. Stat. (2010). Chapter 726 broadly defines a "creditor" as "a person who has a claim." § 726.102(4), Fla. Stat. (2010). Authorized by section 727.110(1)(c) to avoid a voidable transfer, the assignee is a "creditor" who may bring a Chapter 726 claim.

A separate section of Chapter 727 operates to bar Smith's fraudulent transfer claim outside of the Chapter 727 proceeding. Section 727.105 provides, in pertinent part,

> Except in the case of a consensual lienholder enforcing its rights in personal property or real property collateral, there shall be no levy, execution, attachment, or the like in respect of any judgment against assets of the estate in the possession, custody, or control of the assignee.

Assuming the occurrence of a fraudulent transfer, Smith's Chapter 726 proceedings against the property in the possession of Etech Texas would amount to an impairment of the equitable interest in that property "in the possession, custody, or control of the assignee."

In sum, in the context of a Chapter 727 assignment for the benefit of creditors, only the assignee may bring a Chapter 726 fraudulent transfer claim. This conclusion is consistent with the underlying rationale of both statutes, which seek to protect the rights [**10] of creditors. To allow creditors to bring their own fraudulent transfer claims, without the consent of the assignee, would undermine Chapter 727 by depleting assets of the estate and disregarding the priorities established under that statute.

This is not to say that a judgment creditor may *never* bring its own fraudulent transfer claim after the filing of a Chapter 727 assignment. The duties of an assignee include the decision whether to pursue or abandon a fraudulent transfer claim or "sell and assign, in whole or in part, such claims or causes of action to another person or entity on the terms that the assignee determines are in the best interest of the estate." § 727.108(1)(a), Fla. Stat. (2010). If the assignee has determined that it is in the best interest of the estate to abandon or to sell and assign a fraudulent transfer claim, a judgment creditor may then prosecute the claim outside of the Chapter 727 assignment. An assignee's decision to abandon or to sell and assign a claim is a condition precedent to a judgment creditor's ability to bring a separate lawsuit.

[*1053] In this case, Smith's impleader complaint generally pleaded compliance with all conditions precedent. *See* Fla. R. Civ. P. 1.120(c). [**11] Thus, the pleading suggests the assignee's acquiescence in Smith's impleader lawsuit. If this is not the case, then that factual issue can be reached on a motion for summary judgment. At the motion to dismiss stage of the proceedings, Smith adequately pleaded the ability to pursue his fraudulent transfer claim outside of the Chapter 727 proceeding and the circuit court erred in granting the motion to dismiss.

Smith argues that his Chapter 726 fraudulent transfer *claims* were never an asset of Effective or Etech Texas so they were not an asset of the estate in the control of the assignee. This argument misses the point. The object of Smith's claims is the property transferred. For the purpose of Chapter 727, the equitable interest Effective retained in the property fraudulently transferred was an asset of the assignor that became part of the estate that the assignee was obligated to marshal on behalf of the creditors. To set

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Section 726.106 states:

> (1) A transfer made or obligation incurred by a debtor is fraudulent as to a creditor whose claim arose before the transfer was made or the obligation was incurred if the debtor made the transfer or incurred [**9] the obligation without receiving a reasonably equivalent value in exchange for the transfer or obligation and the debtor was insolvent at that time or the debtor became insolvent as a result of the transfer or obligation.

aside the fraudulent transfer, the assignee would not pursue Smith's Chapter 726 claims. Rather, section 727.110(1)(c) separately authorizes the assignee to bring a section 726 action to avoid any conveyance or transfer.

We disagree with the third district in *Moffatt* [**12] to the extent that *Moffatt* appears to hold that a judgment creditor's Chapter 726 fraudulent transfer claim is an "interest of the assignor in property" under section 727.103(1). The cause of action is the judgment creditor's, not the assignor's. For the reasons stated above, we agree with *Moffatt's* conclusion that "[u]nder the statutory scheme as it now exists, only an assignee has standing to pursue fraudulent transfers, preferential transfers or other derivative claims," *Moffatt*, 48 So. 3d at 899, with the proviso that an assignee may abandon or sell and assign the claims so that they may be pursued outside of a Chapter 727 proceeding.

Finally, we reject Smith's argument that *Seminole Boatyard, Inc. v. Christoph*, 715 So. 2d 987 (Fla. 4th DCA 1998), is controlling. That case involves a bankruptcy trustee's ability to pursue an alter ego claim in the attempt to recover money owed by a bankrupt corporation from the corporation's president. The case does not involve the interplay between Chapters 726 and 727.

Reversed and remanded for further proceedings consistent with this opinion.

WARNER and KLINGENSMITH, JJ., concur.

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Pepper v. Litton

Supreme Court of the United States

November 9, 10, 1939, Argued ; December 4, 1939, Decided

No. 39

Reporter
308 U.S. 295 *; 60 S. Ct. 238 **; 84 L. Ed. 281 ***; 1939 U.S. LEXIS 971 ****

PEPPER v. LITTON

Prior History: [****1] CERTIORARI TO THE CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT.

CERTIORARI, 307 U.S. 620, to review the reversal of a judgment disallowing a claim in bankruptcy.

Disposition: 100 F.2d 830, reversed.

Syllabus

1. The overruling by a state court of a motion made by the trustee of a bankrupt corporation to set aside a judgment against the corporation, where such motion was based exclusively upon the ground that the state practice governing confession of judgments was not followed in obtaining the judgment, and upon the ground that the agent purporting to act for the corporation in the matter was not authorized, does not bar the trustee, acting in the bankruptcy court on behalf of other creditors, from attacking the validity or priority of the claim underlying the judgment, -- matters which were not in issue and could not have been decided in the state court proceeding. P. 302.

2. Courts of bankruptcy, in passing upon the validity and priority of claims, exercise equity powers and have not only the power but the duty to disallow or subordinate claims if equity and fairness so require. [****2] That power and duty are especially clear where the claim seeking allowance accrues to the benefit of an officer, director or stockholder of the bankrupt. P. 303.

3. Merger of a claim in a judgment does not change its nature in so far as provability in bankruptcy is concerned; the court of bankruptcy may look behind the judgment to the essence of the liability. P. 305.

4. A dominant and controlling stockholder has a fiduciary duty to creditors in dealing with the corporation and with them, and when his transactions are challenged must prove the good faith of the transactions and their inherent fairness from the viewpoint of the corporation and those interested therein. This obligation is enforceable by the trustee in bankruptcy of the corporation. P. 306.

5. A dominant or controlling stockholder or group of stockholders are fiduciaries, as are directors. Their powers are powers in trust. P. 306.

6. The dominant and controlling stockholder of a corporation, scheming to defraud one of its creditors, sued the corporation on accumulated unpaid salary claims, the amounts of which were fixed by himself, and which he sought to collect only when the corporation was in financial difficulties; [****3] caused the corporation to confess judgment; used the judgment to delay the other creditor; levied on part of the corporate property and bought it in at sheriff's sale for much less than his judgment or the other claim; transferred the property to a second "one-man" corporation for six times what it cost him at the sale, payable in stock; caused the first corporation to go into voluntary bankruptcy for the sole purpose of avoiding payment of the other creditor's claim; bought up other debts; and presented his judgment as a claim, preferred in part, against the remaining assets of the bankrupt. *Held*, that the judgment claim was properly disallowed by the court of bankruptcy either as a secured or as an unsecured claim. P. 310.

7. The fact that the judgment lien was perfected more than four months preceding bankruptcy can not affect the result. P. 312.

Counsel: Mr. M. M. Heuser, with whom Mr. Geo. M. Warren was on the brief, for petitioner.

Mr. Henry Roberts for respondent.

Judges: Hughes, McReynolds, Butler, Stone, Roberts, Black, Reed, Frankfurter, Douglas

Opinion by: DOUGLAS

Opinion

[*296] [**240] [***283] MR. JUSTICE DOUGLAS delivered the opinion of the Court.

The case [****4] presents the question of the power of the bankruptcy court to disallow either as a secured or as a general or unsecured claim a judgment obtained by the dominant and controlling stockholder of the bankrupt corporation on alleged salary claims. The judgment of the District Court disallowing the claim was reversed by the Circuit Court of Appeals (100 F.2d 830). We granted certiorari because of an apparent restriction imposed by that decision on the power of the bankruptcy court to disallow or to subordinate [***284] such claims in exercise of its broad equitable powers.

The findings of the District Court, amply supported by the evidence, reveal a scheme to defraud creditors reminiscent of some of the evils with which 13 Eliz. c. 5 was designed to cope. But for the use of a so-called [*297] "one-man" or family corporation, Dixie Splint Coal Company, of which respondent was the dominant and controlling stockholder, that scheme followed an ancient pattern.

In 1931 Pepper, the petitioner, brought suit in a state court in Virginia against Dixie Splint Coal Company and Litton, the respondent, for an accounting of royalties due Pepper under a lease. [1] While this [****5] suit was pending and in anticipation that Pepper would recover, Litton caused Dixie Splint Coal Company to confess a judgment in Litton's favor in the amount of $ 33,468.89, representing alleged accumulated salary claims dating back at least five years. This was done by P. H. Smith, secretary and treasurer of Dixie Splint Coal Company, who, according to the District Court, was "an employee of Litton and subservient to the latter's will." This was on June 2, 1933. Execution was issued on this judgment the

[1] During this litigation A. P. Pepper, the plaintiff, died and the suit was continued in the name of Jean McNeil Pepper, as his executrix.

same day but no return was made thereon, Litton waiting "quietly until the outcome of the Pepper suit was definitely known." On February 19, 1934, Pepper obtained a judgment against Dixie Splint Coal Company for $ 9,000. On motion of the company, execution on the judgment was suspended for ninety [**241] days to permit an appeal. But defendant in that suit did not appeal. [2] Instead, on March 19, 1934, while execution on the Pepper judgment was suspended, Litton caused an execution to issue on his confessed judgment and levy to be made thereunder. Yet Litton "had no intention of trying to satisfy his confessed judgment" against his corporation "unless and until it became [****6] necessary to do so"; he was using it "only as a shield against the Pepper debt." Thus, when execution and levy were made March 19, 1934, no steps were [*298] taken for over two months towards a sale of the property on which levy had been made. On May 31, 1934, Pepper caused an execution to issue on her judgment, and levy was made June 2, 1934. On this latter date the sheriff "who seems to have been cooperating with Litton" advertised the property for sale under the Litton levy made in the previous March. On June 14, 1934, the sale was held and Litton became the purchaser of the property sold at the sum of $ 3,200.

The next step in the "planned and fraudulent scheme" was the formation by Litton [****7] of "another of his one-man corporations," Dixie Beaver Coal Company, to which Litton transferred the property he had acquired at the execution sale at a valuation of $ 20,135.36 to be paid for in stock of the new company. [3]

On September 4, 1934, the third step in Litton's scheme was taken. On that date Dixie Splint Coal Company, pursuant to a resolution of the board of directors, passed June 16, 1934, (two days after the Litton execution sale) filed a voluntary petition in bankruptcy. This step, according to the findings below was "plainly for the sole purpose of avoiding payment of the Pepper debt." The bankrupt at that time had $ 4,500 on bank deposit and $ 12,000 [***285] in accounts [****8] receivable, most of which was good. The cash on deposit was then more than sufficient to pay all creditors with the exception of Pepper. And Litton caused the voluntary petition to be filed "feeling confident that his confessed judgment would cover and consume" the remaining assets. Adjudication followed on September 7, 1934.

[*299] Litton's next step in his scheme to defeat the Pepper claim was to purchase wage claims against the bankrupt and to cause "in some manner" other claims to be withdrawn. This was done, according to the District Court, so that Pepper might be made to appear as the only general creditor -- a situation designed to give Litton a decided technical advantage, as we shall see.

On June 13, 1934, Pepper had instituted suit in the Virginia state court to have the Litton judgment declared void. On June 15, 1934, the day following the sale under the Litton execution, the sheriff instituted an interpleader action joining Litton, Pepper and the Clinchfield Coal Corporation and alleging, *inter alia*, that that corporation had a prior lien on all the property sold for a debt of $ 2,153. Litton and Pepper both answered admitting the prior lien of the corporation, [****9] Pepper answering "without prejudice to her rights" asserted in the chancery cause to have the Litton judgment set aside. On July 18, 1934, an order in the interpleader suit was entered directing payment of $ 2,153.00 to the Clinchfield Coal Corporation.

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[2] Plaintiff, however, did appeal on certain phases of the case. See *Pepper* v. *Dixie Splint Coal Co*., 165 Va. 179; 181 S. E. 406.

[3] The resolution of the board of directors of this new company certified that in their opinion the property "formerly owned by Dixie Splint Coal Company and now owned by Scott Litton is worth $ 20,135.36 in current money of the United States and we fix the value of the same at this sum, which is to be paid for in stock."

Thereafter the trustee, with the authority of the bankruptcy court, moved in the state court to set aside the judgment and to quash the execution thereof on the ground that the judgment was void since it had not been confessed in the manner required by the Virginia statute. [4] [*300] [***286] The court concluded that the Litton judgment was void but denied the motion on the [**242] grounds that the trustee was estopped to challenge it. The court held that Pepper in the interpleader suit had treated the fund derived from the execution sale under the Litton judgment as valid and consequently had elected to recognize the validity of the judgment. Since Litton had acquired, or caused to have withdrawn, all the remaining claims against the [*301] estate, the trustee in this suit was representing only Pepper. Therefore, since Pepper was estopped, so was the trustee. On appeal that judgment was affirmed on those grounds. [****10] *Smith* v. *Litton*, 167 Va. 263; 188 S. E. 214.

[****11] Thereafter the question of the allowance of the Litton judgment came before the bankruptcy court on exceptions previously made by Pepper. That court concluded that the decision by the state court that the trustee was estopped to attack the Litton judgment there, did not prevent the bankruptcy court from considering its validity. It therefore reviewed all the facts and concluded (1) that Litton and the Dixie Splint Coal Company had made a "deliberate and carefully planned attempt" to avoid "the payment of a just debt"; (2) that Litton and the Dixie Splint Coal Company were "in reality the same"; and (3) that the alleged salary claims underlying the Litton judgment did not represent an "honest debt" of the bankrupt corporation, being merely bookkeeping entries for the double purpose of lessening income taxes and of enabling Litton to appear as a creditor of the corporation in case it became financially involved. [5]

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[4] At the first meeting of creditors held on September 26, 1934, the strategic position of Litton was further improved by two other events which later the District Court quite properly denounced. In the first place, P. H. Smith, secretary and treasurer of Dixie Splint Coal Company and the one who had caused the entry of the Litton judgment on June 2, 1933, by confession against the company, was elected trustee. In the second place, Smith was authorized to employ, and did in fact employ, as attorney for the trustee, one I. M. Quillen. Quillen, or his firm, was attorney for Dixie Splint Coal Company. As such he or his firm had prepared and filed the petition in bankruptcy for the company. And he appeared at the first meeting of creditors as counsel for the bankrupt and yet at that time, as attorney for Litton, filed the claim of Litton for $ 33,468.89 as a preferred or secured claim. And at the time these appointments were made the controversy between Pepper and Litton over the latter's judgment was known and recognized, although formal proof of the Pepper claim was not filed until November 8, 1934. The grave impropriety of these appointments became striking as administration of the estate was commenced.

On October 6, 1934, Pepper moved in her state court action to quash all execution issued and outstanding on the Litton judgment. Quillen, attorney for the bankruptcy trustee, appeared in opposition to the motion, acting as attorney for Litton, and contended that the intervention of bankruptcy had deprived the state court of jurisdiction. The state court reserved decision. On October 15, 1934, Pepper petitioned the referee to direct the trustee to contest the Litton judgment in the state court proceeding. Quillen, stating that he acted as attorney for Litton, opposed the petition. After some delay, new counsel for the trustee were obtained who soon asked the court for authority to institute a new and independent suit in the state court to have the Litton judgment declared void. This authority was granted.

The District Court, though condemning such steps, stated it did not suggest that Smith and Quillen were acting "with any fraudulent plan or intention of utilizing their positions in aid of Litton and to the detriment of the estate." Yet he denounced the impropriety of such conduct and emphasized the incompatible and conflicting positions which these persons occupied. On the professional ethics of the conduct of Quillen, the District Court aptly observed: "It is generally accepted that an attorney for the bankrupt should not be chosen attorney for the trustee in any case. And it is even more evident that an attorney who represents a creditor whose claim is under attack should not be chosen as attorney for the trustee who, on behalf of other creditors, is charged with the duty of making that attack."

[5] This conclusion was based on the history and nature of the claims for salary. Litton's alleged claim of $ 33,468.89 represented $ 7,427.25 owed Litton and $ 26,041.64 owed P. H. Smith which the latter had assigned to Litton for $ 1 and "other considerations" which Litton was unable to recall. As we have noted, these claims date back over a number of years. The regular salaries paid Litton and Smith were entered on the corporation's books under a "payroll" account; the salary claims here in question were carried under separate accounts, "P. H. Smith -- Personal" and "Scott Litton -- Personal." No sums were paid Smith from that personal account. The District Court concluded that it was hard to believe that Smith, a bookkeeper and clerk, who had been paid $ 2,700 a year, should, with no change in the nature of his work, receive a sudden increase in salary to $ 8,000 a year, except upon an understanding that it was merely for record purposes and not to be paid. This conclusion was strengthened by the fact that the $ 26,041.64 accumulated for over five years with no effort on Smith's part to collect it and by

Accordingly, the [*302] District Court disallowed the Litton claim either [**243] as a secured or unsecured claim and directed the trustee to recover for the benefit of the estate the property or its value which Litton purchased at the execution sale on June 14, 1934. [****12] On appeal the Circuit Court of Appeals reversed that judgment holding that the decision in the state court was *res judicata* in the bankruptcy proceedings.

[****13] [***287] We think that the Circuit Court of Appeals was in error in reversing the judgment of the District Court.

[1][2A]In the first place, *res judicata* did not prevent the District Court from examining into the Litton judgment and disallowing or subordinating it as a claim. When that claim was attacked in the bankruptcy court Litton did not show that the proceeding in the state court was anything more than a proceeding under Virginia practice to set aside the judgment in his favor on the ground that it was irregular or void upon its face. He failed to show that the judgment in the state court was conclusive in his favor on the validity or priority of the underlying claim, as respects the other creditors of the bankrupt corporation -- a duty which was incumbent on him. On the pleadings in the state court the validity of the underlying claim was not in issue. Nor was there presented to the state court the question of whether or not the Litton judgment might be subordinated to the claims of other [*303] creditors upon [****14] equitable principles. The motion on which that proceeding was based challenged the Litton judgment on one ground only, viz., that it was void *ab initio* because it was not confessed by Dixie Splint Coal Company in the manner required by the Virginia statute and because P. H. Smith did not have either an implied or express power to confess it. In other words, in the state court under the pleadings and practice, the only decree which was asked or could be given in the plaintiff's favor was for cancellation of the judgment as a record obligation of the bankrupt. It is therefore plain that the issue which the bankruptcy court later considered was not an issue in the trial of the cause in the state court and could not be adjudicated there. [6] Hence, the failure on the part of Litton to establish that the state judgment was *res judicata* plus his submission of his judgment to the bankruptcy court for allowance (as a preferred claim to the extent that it was secured by the alleged lien and as a common claim as respects the deficiency) plainly left the bankruptcy court with full authority to follow the course it took and to determine the validity of Litton's alleged secured claim [****15] and the priority which should be accorded it in the distribution of the bankrupt estate. In the second place, even though we assume that the alleged salary claim on which the Litton judgment was based was not fictitious but actually existed, we are of the opinion that the District Court properly disallowed or subordinated it.

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the fact that shortly before bankruptcy he assigned the claim to Litton for a nominal consideration. As to the $ 7,427.25 alleged to be owed Litton the court likewise concluded that it had been entered on the books for income tax purposes and was not a "bona fide obligation" of the company. Furthermore, a substantial part of these claims was barred by the statute of limitations. On the most tolerant assumption that could be made, according to the court, the salaries credited to Litton and Smith were merely contingent or conditional obligations not provable since they were intended to be paid only whenever the profits of the company permitted. Hence they were not fixed liabilities absolutely owing. See § 63 (a) (1).

[6] It should be noted that there is authority for the conclusion that the trustee is not necessarily precluded from questioning a judgment in the bankruptcy proceedings merely because he attacked it in a state court proceeding, where the state court did not pass upon the validity of the underlying claim. *In re James A. Brady Foundry Co.*, 3 F.2d 437; Gilbert's Collier on Bankruptcy (4th ed.) § 1247.

[**244] [3][4]Courts of bankruptcy are constituted by §§ 1 and 2 of the Bankruptcy Act (30 Stat. 544) and by the latter [****16] [*304] section are invested "with such jurisdiction at law and in equity as will enable them to exercise original jurisdiction in bankruptcy proceedings." Consequently this Court has held that for many purposes "courts of bankruptcy are essentially courts of equity, and their proceedings inherently proceedings in equity." *Local Loan Co.* v. *Hunt*, 292 U.S. 234, 240. By virtue of § 2 a bankruptcy court is a court of equity at least in the sense that in the exercise of the jurisdiction conferred upon it by the Act, it applies the principles and rules of equity jurisprudence. *Larson* v. *First State Bank*, 21 F.2d 936, 938. [***288] Among the granted powers are the allowance and disallowance of claims; [7] the collection and distribution of the estates of bankrupts and the determination of controversies in relation thereto; [8] the rejection in whole or in part "according to the equities of the case" of claims previously allowed; [9] and the entering of such judgments "as may be necessary for the enforcement of the provisions" of the Act. [10] In such [****17] respects the jurisdiction of the bankruptcy court is exclusive of all other courts. *United States Fidelity & Guaranty Co.* v. *Bray*, 225 U.S. 205, 217.

[5]The bankruptcy courts have exercised these equitable powers in passing on a wide range of problems arising out of the administration of bankrupt estates. [11] [****19] They [*305] have been invoked to the end that fraud will not prevail, that substance will not give way to form, that technical considerations will not prevent substantial justice from being done. By reason of the express provisions of § 2 these equitable powers are to be exercised on the allowance of [****18] claims, a conclusion which is fortified by § 57 (k). [12] For certainly if, as provided in the latter section, a claim which has been allowed may be later "rejected in whole or in part, according to the equities of the case," disallowance or subordination in light of equitable considerations may originally be made.

[2B]Hence, this Court has held that a bankruptcy court has full power to inquire into the validity of any claim asserted against the estate and to disallow it if it is ascertained to be without lawful existence. *Lesser* v. *Gray*, 236 U.S. 70. And the mere fact that a claim has been reduced to judgment does not prevent such an inquiry. [**245] As the merger of a claim into a judgment does not change its nature so

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[7] § 2 (2). The sections are cited as they were at the time of the bankruptcy in this case. But the amendments made by the Chandler Act (52 Stat. 840), approved June 22, 1938, are not material so far as the issues here involved are concerned.

[8] § 2 (7).

[9] § 57 (k).

[10] § 2 (15).

[11] Thus the bankruptcy court has been held to have jurisdiction over a supplemental and ancillary bill to enjoin a creditor, after adjudication and discharge of the bankrupt, from prosecuting his claim in a state court. *Local Loan Co.* v. *Hunt, supra.* As a court in equity it has been held to have the power to protect the bankrupt estate against a fraudulent assessment, *Cross* v. *Georgia Iron & Coal Co.*, 250 F. 438; to compel execution of a deed to make the bankrupt's equitable title a complete legal title, *Dearborn Electric Light & Power Co.* v. *Jones*, 299 F. 432; to recover assets of the estate which have been used to pay dividends under a composition order later reversed, *In re Lily-knit Silk Underwear Co.*, 73 F.2d 52. And even though the act provides that claims shall not be proved against a bankrupt estate subsequent to six months after the adjudication, the bankruptcy court in the exercise of its equitable jurisdiction has power to permit claims to be proved thereafter in order to prevent a fraud or an injustice. *Williams* v. *Rice*, 30 F.2d 814; *In re Pierson*, 174 F. 160; *Larson* v. *First State Bank, supra; Burton Coal Co.* v. *Franklin Coal Co.*, 67 F.2d 796.

[12] Section 57 (k) provides: "Claims which have been allowed may be reconsidered for cause and reallowed or rejected in whole or in part, according to the equities of the case, before but not after the estate has been closed."

far as provability is concerned, *Boynton* v. *Ball*, 121 U.S. 457, so the court may look behind the judgment to determine the essential nature of the liability [*306] for purposes of proof and allowance. *Wetmore* v. *Markoe*, 196 U.S. 68. [****20] [***289] It may ascertain the validity of liens, marshal them, and control their enforcement and liquidation. *Isaacs* v. *Hobbs Tie & Timber Co.*, 282 U.S. 734. And the bankruptcy trustee may collaterally attack a judgment offered as a claim against the estate for the purpose of showing that it was obtained by collusion of the parties or is founded upon no real debt. [13]

[6A][7][8][9]That equitable power also exists in passing on claims presented by [****21] an officer, director, or stockholder in the bankruptcy proceedings of his corporation. The mere fact that an officer, director, or stockholder has a claim against his bankrupt corporation or that he has reduced that claim to judgment does not mean that the bankruptcy court must accord it *pari passu* treatment with the claims of other creditors. Its disallowance or subordination may be necessitated by certain cardinal principles of equity jurisprudence. A director is a fiduciary. *Twin-Lick Oil Co.* v. *Marbury*, 91 U.S. 587, 588. So is a dominant or controlling stockholder or group of stockholders. *Southern Pacific Co.* v. *Bogert*, 250 U.S. 483, 492. Their powers are powers in trust. See *Jackson* v. *Ludeling*, 21 Wall. 616, 624. Their dealings with the corporation are subjected to rigorous scrutiny and where any of their contracts or engagements with the corporation is challenged the burden is on the director or stockholder not only to prove the good faith of the transaction but also to show its inherent fairness from the viewpoint of the corporation and those interested [****22] therein. *Geddes* v. *Anaconda Copper Mining Co.*, 254 U.S. 590, 599. The essence of the test is whether or not under all the circumstances the transaction carries the earmarks of an [*307] arm's length bargain. [14] [****23] If it does not, equity will set it aside. While normally that fiduciary obligation is enforceable directly by the corporation, or through a stockholder's derivative action, [15] it is, in the event of bankruptcy of the corporation, enforceable by the trustee. [16] For that standard of fiduciary obligation is designed for the protection of the entire community of interests in the [***290] corporation [17] -- creditors as well as stockholders.

[6B] [****24] As we have said, the bankruptcy court in passing on allowance of claims [**246] sits as a court of equity. Hence these rules governing the fiduciary responsibilities of directors and stockholders come into play on allowance of their claims in bankruptcy. In the exercise of its equitable [*308] jurisdiction the bankruptcy court has the power to sift the circumstances surrounding any claim to see that

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[13] *Chandler* v. *Thompson*, 120 F. 940; *In re Thompson*, 276 F. 313; *In re Continental Engine Co.*, 234 F. 58. This is of course in absence of a plea of *res judicata*.

[14] This Court said in *Twin-Lick Oil Co.* v. *Marbury*, *supra*, p. 590: "So, when the lender is a director, charged, with others, with the control and management of the affairs of the corporation, representing in this regard the aggregated interest of all the stockholders, his obligation, if he becomes a party to a contract with the company, to candor and fair dealing, is increased in the precise degree that his representative character has given him power and control derived from the confidence reposed in him by the stockholders who appointed him their agent. If he should be a sole director, or one of a smaller number vested with certain powers, this obligation would be still stronger, and his acts subject to more severe scrutiny, and their validity determined by more rigid principles of morality, and freedom from motives of selfishness."

[15] *Converse* v. *United Shoe Machinery Co.*, 209 Mass. 539; 95 N. E. 929. *Davenport* v. *Dows*, 18 Wall. 626. It is also clear that breach of that fiduciary duty may also give rise to direct actions by stockholders in their own right. *Strong* v. *Repide*, 213 U.S. 419. Cf. *Green* v. *Victor Talking Machine Co.*, 24 F.2d 378.

[16] § 70 (a) (6); *Manning* v. *Campbell*, 264 Mass. 386; 162 N. E. 770; *Stephan* v. *Merchants Collateral Corp.*, 256 N. Y. 418; 176 N. E. 824; *Dean* v. *Shingle*, 198 Cal. 652; 246 P. 1049.

[17] See *Wyman* v. *Bowman*, 127 F. 257, 274; *Burnes* v. *Burnes*, 137 F. 781; *Texas Auto Co.* v. *Arbetter*, 1 S. W. 2d 334, 339; *McCandless* v. *Furlaud*, 296 U.S. 140; *Jackson* v. *Ludeling*, *supra*, pp. 624 *et seq.*

injustice or unfairness is not done in administration of the bankrupt estate. [18] And its duty so to do is especially clear when the claim seeking allowance accrues to the benefit of an officer, director, or stockholder. That is clearly the power and duty of the bankruptcy courts under the reorganization sections. In *Taylor* v. *Standard Gas & Electric Co.*, 306 U.S. 307, this Court held that the claim of Standard against its subsidiary (admittedly a claim due and owing) should be allowed to participate in the reorganization plan of the subsidiary only in subordination to the preferred stock of the subsidiary. This was based on the equities of the case -- the history of spoliation, mismanagement, and faithless stewardship of the affairs of the subsidiary [****25] by Standard to the detriment of the public investors. Similar results have properly been reached in ordinary bankruptcy proceedings. Thus, salary claims of officers, directors, and stockholders in the bankruptcy of "one-man" or family corporations have been disallowed or subordinated where the courts have been satisfied that allowance of the claims would not be [*309] fair or equitable to other creditors. [19] [****27] And that result may be reached even though the salary claim has been reduced to judgment. [20] It is reached where the claim asserted is void or voidable because the vote of the interested director or stockholder helped bring it into being or where the history of the corporation [***291] shows dominancy and exploitation on the part of the claimant. [21] It is also reached where on the facts the bankrupt has been used merely as a corporate pocket of the dominant stockholder, who, with disregard of the substance or form of corporate management, has treated its affairs as his own. [22] And so-called loans or advances by the dominant or controlling stockholder will be subordinated to claims of other creditors [*310] and thus treated in effect as capital contributions by [****26] the stockholder not only in the foregoing types of situations but also where the paid-in capital is purely nominal, [**247] the capital necessary for the scope and magnitude of the operations of the company being furnished by the stockholder as a loan. [23]

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[18] Thus in *National Cash Register Co.* v. *Dallen*, 76 F.2d 867, the bankrupt, prior to bankruptcy, turned in to petitioner an old cash register as a credit on account of the purchase of a new one. Pending delivery of the new machine, petitioner loaned the bankrupt another one and after the bankruptcy adjudication sought to reclaim the loaned machine. The court affirmed an order of the District Court allowing the reclamation on condition that petitioner first deliver to the bankrupt the old machine or pay the amount of its agreed value. The court said, p. 868, "We do not think it necessary to determine whether the contract for the purchase of the new cash register amounted to a bailment lease or a conditional sale. Bankruptcy courts may apply rules regulating equitable actions."

[19] *In re Burntside Lodge, Inc.*, 7 F.Supp. 785. In that case the court said, p. 787:

"The relations of a stockholder to a corporation and to the public require good faith and fair dealing in every transaction between the stockholder and the corporation which may injuriously affect the rights of creditors and the general public, and a careful examination will be made into all such transactions in the interests of creditors.

. . . .

"If the business had not been incorporated and the Cooks had conducted the enterprise personally, they would not have been allowed compensation for services in the event of bankruptcy, and there is no cogent reason why they should be paid when the same service is rendered as an officer and manager of a corporation of their own creation and to serve their own interests. To allow claims under such circumstances in effect would permit bankrupts to collect on claims against their own bankrupt estate. It would give effect to form rather than to substance, to the letter of the law rather than the spirit and purpose of it."

[20] *In re Wenatchee-Stratford Orchard Co.*, 205 F. 964.

[21] *In re McCarthy Portable Elevator Co.*, 196 F. 247, aff'd 201 F. 923.

[22] *In re Chas. K. Horton, Inc.*, 22 F.Supp. 905; *In re Kentucky Wagon Mfg. Co.*, 71 F.2d 802; *Forbush Co.* v. *Bartley*, 78 F.2d 805; *Clere Clothing Co.* v. *Union Trust & Savings Bank*, 224 F. 363.

[23] *Albert Richards Co.* v. *Mayfair, Inc.*, 287 Mass. 280; 191 N. E. 430. Cf. *Erickson* v. *Minnesota & Ontario Power Co.*, 134 Minn. 209; 158 N. W. 979; *Oriental Investment Co.* v. *Barclay*, 64 S. W. 80 (Tex. Civ. App.); *Joseph R. Foard Co.* v. *State*, 219 F. 827.

[10]Though disallowance of such claims will be ordered where they are fictitious or a sham, [24] these cases do not turn on the existence or non-existence of the debt. Rather they involve simply [****28] the question of order of payment. [25] At times equity has ordered disallowance or subordination by disregarding the corporate entity. [26] [****30] That is to say, it has treated the debtor-corporation simply as a part of the stockholder's own enterprise, consistently with the course of conduct of the stockholder. But in that situation as well as in the others to which we have referred, a sufficient consideration may be simply the violation of rules of fair play and good conscience by the claimant; [*311] a breach of the fiduciary standards of conduct which he owes the corporation, its stockholders and creditors. He who is in such a fiduciary position cannot serve himself first and his *cestuis* second. He cannot manipulate the affairs of his corporation to their detriment and in disregard of the standards of common decency and honesty. He cannot by the intervention of a corporate entity violate the ancient precept against serving two masters. [27] He cannot by the use of the corporate device avail himself of privileges normally permitted outsiders in a race of creditors. He cannot utilize his inside information and his strategic position for his own preferment. He cannot violate [****29] rules of fair play by doing indirectly through the corporation what he could not do directly. He cannot use [***292] his power for his personal advantage and to the detriment of the stockholders and creditors no matter how absolute in terms that power may be and no matter how meticulous he is to satisfy technical requirements. For that power is at all times subject to the equitable limitation that it may not be exercised for the aggrandizement, preference, or advantage of the fiduciary to the exclusion or detriment of the *cestuis*. Where there is a violation of those principles, equity will undo the wrong or intervene to prevent its consummation.

[11]On such a test the action of the District Court in disallowing or subordinating Litton's claim was clearly correct. Litton allowed his salary claims to lie dormant for years and sought to enforce them only when his debtor corporation was in financial difficulty. Then he used them so that the rights of another creditor were impaired. Litton as an insider utilized his strategic position for his own preferment to the damage of Pepper. Litton as the dominant influence over Dixie Splint Coal Company used his power not to deal fairly with the [*312] creditors of that company but to manipulate its affairs in such a manner that when one of its creditors came to collect her just debt the bulk of the assets had disappeared into another Litton company. Litton, though a fiduciary, was enabled by astute legal manoeuvering to acquire most of the assets of the bankrupt not for cash or other consideration of value to creditors but for

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[24] *New York Trust Co.* v. *Island Oil & Transport Corp.*, 34 F.2d 655; *In re H. Hicks & Son, Inc.*, 82 F.2d 277.

[25] See comment in 45 Yale L. Journ. 1471.

[26] *In re Otsego Waxed Paper Co.*, 14 F.Supp. 15. The court said, p. 16, "The applicable principle is that, where a corporation is so organized and controlled as to make it a mere instrumentality or adjunct of another, and the subsidiary becomes bankrupt, the parent corporation cannot have its claim paid until all other claims are first satisfied." See also *Hunter* v. *Baker Motor Vehicle Co.*, 225 F. 1006; *Henry* v. *Dolley*, 99 F.2d 94.

The same result has been reached in equity receiverships. *Central Vermont Ry. Co.* v. *Southern New England R. Corp.*, 1 F.Supp. 1004, aff'd 68 F.2d 460; *S. G. V. Co.* v. *S. G. V. Co.*, 264 Pa. 265; 107 A. 721.

A fortiori that result is reached where there is a fraudulent purpose. *E. E. Gray Corp.* v. *Meehan*, 54 F.2d 223.

[27] See *Alexander* v. *Theleman*, 69 F.2d 610, 613.

bookkeeping [****31] entries representing at [**248] best merely Litton's appraisal of the worth of Litton's services over the years.

This alone would be a sufficient basis for the exercise by the District Court of its equitable powers in disallowing the Litton claim. But when there is added the existence of a "planned and fraudulent scheme," as found by the District Court, the necessity of equitable relief against that fraud becomes insistent. No matter how technically legal each step in that scheme may have been, once its basic nature was uncovered it was the duty of the bankruptcy court in the exercise of its equity jurisdiction to undo it. Otherwise, the fiduciary duties of dominant or management stockholders would go for naught; exploitation would become a substitute for justice; and equity would be perverted as an instrument for approving what it was designed to thwart.

[12]The fact that Litton perfected his lien more than four months preceding bankruptcy is no obstacle to equitable relief. In the first place, that lien was but a step in a general fraudulent plan which must be viewed in its entirety. The subsequent [****32] sale cannot be taken as an isolated step unconnected with the long antecedent events, all designed to defeat creditors. *Buffum* v. *Peter Barceloux Co.*, 289 U.S. 227, 232-233. In the second place, Litton is seeking approval by the bankruptcy court of his claim. The four months' provision of the bankruptcy act is certainly not a statutory limitation on equitable defenses arising out of a breach of fiduciary duties by him who seeks allowance of a claim.

[*313] In view of these considerations we do not have occasion to determine the legitimacy of the "one-man" corporation as a bulwark against the claims of creditors. [28]

[****33] Accordingly the judgment of the Circuit Court of Appeals is reversed and that of the District Court is affirmed.

Reversed.

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[28] On this point the District Court said: "An examination of the facts disclosed here shows the history of a deliberate and carefully planned attempt on the part of Scott Litton and Dixie Splint Coal Company to avoid the payment of a just debt. I speak of Litton *and* Dixie Splint Coal Company because they are in reality the same. In all the experience of the law, there has never been a more prolific breeder of fraud than the one-man corporation. It is a favorite device for the escape of personal liability. This case illustrates another frequent use of this fiction of corporate entity, whereby the owner of the corporation, through his complete control over it, undertakes to gather to himself all of its assets to the exclusion of its creditors."