

# Exhibit B

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As of: Oct 14, 2011

**WILLIE B. KNIGHT, deceased LOUISE KNIGHT, executrix, Plaintiffs/Appellant  
v. NEW FARMERS NATIONAL BANK AND LEROND REYNOLDS AND JACK  
LONDON, Defendants/Appellees**

No. 90-6071

UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

1991 U.S. App. LEXIS 24819

October 15, 1991, Filed

**NOTICE:** [\*1] NOT RECOMMENDED FOR FULL-TEXT PUBLICATION. SIXTH CIRCUIT RULE 24 LIMITS CITATION TO SPECIFIC SITUATIONS. PLEASE SEE RULE 24 BEFORE CITING IN A PROCEEDING IN A COURT IN THE SIXTH CIRCUIT. IF CITED, A COPY MUST BE SERVED ON OTHER PARTIES AND THE COURT. THIS NOTICE IS TO BE PROMINENTLY DISPLAYED IF THIS DECISION IS REPRODUCED.

**SUBSEQUENT HISTORY:** Reported as Table Case at 946 F.2d 895, 1991 U.S. App. LEXIS 29050.

**PRIOR HISTORY:** On Appeal from the United States District Court for the Western District of Kentucky; District No. 85-00060; Siler, Jr., District Judge.

**CASE SUMMARY:**

**PROCEDURAL POSTURE:** In a foreclosure action, plaintiff debtors appealed a judgment of the United States District Court for the Western District of Kentucky, which granted the motion for summary judgment of defendants, a bank and related individuals.

**OVERVIEW:** The bank filed a foreclosure action against the debtors, seeking to collect on two promissory notes secured by the debtors' home. The debtors filed bankruptcy. The bankruptcy court discharged the case, but did not rule on the notes. The bank proceeded with the foreclosure action, and the state court found the debtors liable on the two promissory notes. The bank

foreclosed and sold the home. The debtors filed a complaint against the bank alleging fraud claims and that they did not discover the bank's unlawful actions until after bankruptcy proceedings concluded. The jury ruled in their favor. The trial court granted the bank's motion for new trial, and then granted its motion for summary judgment. On appeal, the court reversed and remanded. The court found that the debtors should have been aware of their claims at the time they filed their bankruptcy petition, but ruled that the district court erred in not allowing substitution of the trustee in the action as the real party in interest. The causes of action brought by the debtors were part of the bankruptcy estate, and the debtors lacked standing to raise them.

**OUTCOME:** The court vacated the district court's grant of the bank's motion for summary judgment and remanded the case with instructions to allow the debtors to substitute the trustee as the real party in interest.

**CORE TERMS:** real parties in interest, causes of action, summary judgment, substitution, ratification, mortgage, promissory notes, new trial, bankruptcy estate, filed suit, bankruptcy petition, discovery, default, joinder, vacate, foreclosure

**LexisNexis(R) Headnotes**

*Bankruptcy Law > Liquidations > Estate Property Distribution > General Overview*

*Civil Procedure > Judgments > Relief From Judgment > Motions for New Trials*

[HN1]All property that a debtor possesses as of the date a bankruptcy petition is filed, including causes of action, automatically becomes property of the bankruptcy estate.

*Civil Procedure > Parties > Capacity of Parties > General Overview*

*Civil Procedure > Parties > Joinder > General Overview*

*Civil Procedure > Parties > Real Parties in Interest > General Overview*

[HN2]Fed. R. Civ. P. 17(a) provides that no action shall be dismissed on the ground that it is not prosecuted in the name of the real party in interest until a reasonable time has been allowed after objection for ratification of commencement of the action by, or joinder or substitution of, the real party in interest.

**JUDGES:** Jones and Suhrheinrich, Circuit Judges and James D. Todd, District Judge. \*

\* The Honorable James D. Todd, District Judge for the Western District of Tennessee, sitting by designation.

**OPINION BY: PER CURIAM**

**OPINION**

Plaintiff Louise Knight, individually and on behalf of her deceased husband, Willie B. Knight ("Knights"), appeals the district court's grant of a new trial and subsequent summary judgment in favor of defendants New Farmers National Bank, Lerond Reynolds, and Jack London (collectively "Bank"). We agree with the district court that the Knights were not the real parties in interest, but we conclude that the district court erred in not allowing substitution of the trustee in this action. We therefore vacate the district court's [\*2] grant of summary judgment and remand with instructions to allow the plaintiff to substitute the real party in interest.

I.

This case arises out of a series of transactions between the Knights and the Bank. On June 17, 1982, the Bank filed a foreclosure action in the Barren County, Kentucky, Circuit Court seeking to collect two promissory notes allegedly executed by the Knights which were in default. Both notes were secured by an advance clause in the mortgage on the Knights' home in Glasgow, Kentucky. The mortgage was held by the Bank.

On March 3, 1983, the Knights filed for Chapter 7 bankruptcy. In their schedule of assets and liabilities, the

Knights admitted liability for the mortgage on their home, but denied liability for the two promissory notes. Their schedule of personal property filed with the bankruptcy court listed "None" in response to a question asking for "all contingent and unliquidated claims of every nature, including counterclaims of the debtors."

On July 13, 1983, the bankruptcy court discharged the Knights' case, reaffirming most of their debts, but not ruling on the Bank's claims that its debts were valid. The Bank proceeded with its foreclosure suit in state [\*3] court. The state court found the Knights liable for the two promissory notes. The Bank then foreclosed on the Knights' mortgage and sold their home.

The Knights filed suit against the Bank in the United States District Court for the Western District of Kentucky in March 1985, alleging discovery of the Bank's unlawful actions in December 1984. The jury returned a verdict for the Knights.

The district court granted the Banks request for a new trial, and subsequently granted the Bank's motion for summary judgment on the basis of this court's decision in In re Cottrell, 876 F.2d 540 (6th Cir. 1989). Cottrell holds that [HN1]all property that a debtor possesses as of the date a bankruptcy petition is filed, including causes of action, automatically becomes property of the bankruptcy estate. The district court determined that the Knights were not the real parties in interest because the causes of action were property of the bankruptcy estate which could only be pursued by the trustee. This appeal followed.

II.

The Knights contend the district court erred by finding that they were not the real parties in interest. The Knights claim that they had no property interest in [\*4] a cause of action against the Bank when they filed their petition with the Bankruptcy Court because they did not become aware of their cause of action until December 1984. The district court held that the Knights should have been aware of their cause of action against the Bank when they filed their bankruptcy petition on March 3, 1983. We agree. The Bank filed suit in state court on June 17, 1982 to enforce the Knights' obligations under the two notes in default, and the mortgage. The Knights, represented by counsel, answered this complaint and began discovery. If any fraud was involved in these promissory notes, the Knights had a duty to exercise reasonable diligence to discover it. By the time the Knights filed for bankruptcy in 1983, they should have been on notice of a potential cause of action for fraud. Drake v. B.F. Goodrich Co., 782 F.2d 638, 641 (6th Cir. 1986).

These causes of action were part of the bankruptcy estate, and thus the Knights lack standing to raise them now. <sup>1</sup> Cottrell, 876 F.2d at 543; Bauer v. Commerce Union Bank, 859 F.2d 438, 441 (6th Cir. 1988), cert. denied sub nom. Bauer v. Waldschmidt, 489 U.S. 1079 (1989). [\*5] However, the district court should have allowed the Knights an opportunity to seek ratification by, or substitution of, the bankruptcy trustee. See, e.g., Arabian American Oil Co. v. Scarfone, 713 F. Supp. 1420, 1423 (M.D. Fla. 1989) (ratification or joinder is the proper way to resolve real party in interest controversies), *aff'd.*, No. 90-3279, 1991 U.S. App. LEXIS 20176 (11th Cir. Aug. 30, 1991)(*per curiam*).

1 Because we agree with the district court that the Knights are not the real parties in interest, we need not determine whether the grant of a new trial was proper or whether summary judgment would be appropriate on the merits. Nor do we express any opinion on the *res judicata* effect of the prior state court judgment.

### III.

Rule 17(a) of the Federal Rules of Civil Procedure provides in pertinent part that [HN2]"no action shall be dismissed on the ground that it is not prosecuted in the name of the real party in interest until a reasonable time has been allowed after objection [\*6] for ratification of commencement of the action by, or joinder or substitution of, the real party in interest . . . ." Here the district court did not afford plaintiffs any time to substitute the trustee after determining that the trustee was the real party in interest. We believe the district court should first consider ratification or substitution by the trustee prior to dismissing plaintiffs' case. See Sun Refining and Marketing Co. v. Goldstein Oil Co., 801 F.2d 343, 345 (8th Cir. 1986); U-Haul Intern'l., Inc. v. Jartran, Inc., 793 F.2d 1034, 1038-40 (9th Cir. 1986). We therefore *VACATE* the district court's grant of summary judgment and *REMAND* with instructions to allow ratification or substitution by the trustee.