

IN THE UNITED STATES BANKRUPTCY COURT  
FOR THE SOUTHERN DISTRICT OF ILLINOIS

IN RE:	)	In Proceedings
	)	Under Chapter 7
DANIEL LEAVELL,	)	
	)	NO. BK 85-40274
Debtor,	)	
	)	
DANIEL R. LEAVELL and	)	
EVA LOVENE LEAVELL,	)	
	)	
Plaintiffs,	)	
	)	
v.	)	ADVERSARY NO.
	)	90-0085
GIBSON KARNES, et. al,	)	
	)	
Defendants.	)	

REPORT AND RECOMMENDATION

Before the Court is a consolidated case in which Daniel and Eva Leavell are seeking damages from Gibson Karnes, the Chapter 7 trustee of Daniel Leavell's bankruptcy estate, and Terry Sharp, his attorney, in their personal capacities. The Leavells contend that the defendants are personally liable for various alleged breaches of their fiduciary duties while representing the estate. This Court took up this matter on its own motion to consider the plaintiffs' demand for a jury trial. In analyzing the propriety of that demand and this Court's ability to hear a jury trial, it has become apparent that, regardless of the parties' rights to a jury trial, this Court lacks the necessary subject matter jurisdiction to hear this controversy.

A short recital of the procedural history of this case is necessary before a discussion of the jurisdictional issue. This consolidated case is composed of three individual complaints filed

by the Leavells, all alleging breach of fiduciary duties by Gibson Karnes and Terry Sharp. The Leavells' original action was a third party complaint filed on April 4, 1990 in a state court foreclosure proceeding brought by White County Bank. On April 10, 1990, the Leavells filed a complaint in state court asserting further counts against Karnes and Sharp. Simultaneously, the Leavells filed this adversary proceeding which restates all the counts in the two state court actions.<sup>1</sup>

The defendants removed both state court actions to the United States District Court for the Southern District of Illinois. By a September 26, 1990 order, the District Court referred those two cases to this Bankruptcy Court with directions to consolidate them with this adversary proceeding. The only counts remaining before this Court are those against Gibson Karnes and Terry Sharp and the original foreclosure action that had been removed to the District Court along with the Leavells' third party complaint. White County Bank's Motion to Sever the foreclosure action is also before the Court.

Bankruptcy courts exercise jurisdiction only under the authority granted by 28 U.S.C. §157. In addition to the bankruptcy case itself, bankruptcy courts may hear all "core" proceedings arising under or arising in a case under title 11. 28 U.S.C. §157(b)(1). Bankruptcy courts may also hear "noncore" proceedings that are "otherwise related

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<sup>1</sup>The Leavells' April 10th complaints included counts against the law firm of Bruegge and Becker, the attorneys that originally represented Daniel Leavell in his bankruptcy case. Those counts have been settled and Bruegge and Becker have been dismissed as defendants.

to" a bankruptcy case. 28 U.S.C. §157(c)(1).

"[A] proceeding is core under section 157 if it invokes a substantive right provided by title 11 or if it is a proceeding that, by its nature, could arise only in the context of a bankruptcy case." Barnett v. Stern, 909 F.2d 973, 981 (7th Cir. 1990), (citing Matter of Wood, 825 F.2d 90 (5th Cir. 1987)). The Wood court further stated that a proceeding that does not invoke a substantive right and that could exist outside bankruptcy is not a core proceeding. 825 F.2d at 97. In Barnett, the Seventh Circuit expressly rejected a broader interpretation of core proceedings as adopted by the Second Circuit in In re Ben Cooper, Inc., 896 F.2d 1394 (2d Cir. 1990), vacated on other grounds, remanded, \_\_\_\_\_ U.S. \_\_\_\_\_, 111 S.Ct. 425, (1990).

Under the Wood test, the Leavells' cause of action is not a core proceeding. None of the parties are invoking rights created by title 11. Rather, the plaintiffs' cause of action is based on the common law theory of breach of fiduciary duties. Although this controversy arose in a bankruptcy context, the cause of action could exist independently outside of bankruptcy. See In re G. Weeks Securities, Inc., 89 B.R. 697, 706 (Bankr. W.D. Tenn. 1988) (action against co-trustees and trustee's attorneys based on common law negligence is not a core proceeding).

Nor is the Leavells' cause of action related to Daniel Leavell's bankruptcy case. A proceeding is related to a bankruptcy case for purposes of §157(c) only when its resolution "affects the amount of property available for distribution or allocation of property among creditors of the estate." Home Insurance Co. v. Cooper, 889 F.2d 746,

749 (7th Cir. 1989); Matter of Xonics, 813 F.2d 127, 131 (7th Cir. 1987). The Leavell's action against the trustee and his attorney can in no way affect Daniel Leavell's bankruptcy estate.

The Leavells allege that they have been damaged by the defendants' breaches of fiduciary duties in four ways: First, the defendants purposely delayed closing the estate, increasing Daniel's personal liability for interest and penalties on nondischargeable tax claims. Second, the defendants allowed a mortgagee-in-possession, Northern Trust Bank, to manage oil producing real property in an unlawful manner, exposing Daniel to potential personal liability for the clean-up of that property. Third, Terry Sharp filed, and Gibson Karnes failed to object to an excessive administrative claim for fees that included services that did not benefit the estate. The effect of that was to displace funds which would have been used to decrease Daniel's personal liability for nondischargeable tax claims. Finally, the defendants failed to abandon two properties encumbered by mortgages until the values had declined below the mortgage balances, thereby subjecting both Daniel and Eva to increased personal liability for the deficiencies.

If the Leavells are successful on any of these theories, the estate will share neither in any liability of the defendants nor in any award to the plaintiffs. The Leavells are seeking a surcharge against the defendants in their personal capacities. Any recovery will be out of the pockets of the defendants rather than from estate assets. All four of the actions complained of allegedly damaged the Leavells by increasing their personal liability for claims that will survive Daniel

Leavell's bankruptcy. The estate will have no valid interest in any damages awarded to the Leavells.

Because this controversy is noncore and unrelated to Daniel Leavell's bankruptcy case, the Bankruptcy Court lacks jurisdiction to hear the proceedings. This Court therefore recommends that the District Court withdraw its reference of this case to this Court. This Court makes no recommendation as to the plaintiffs' entitlement to a jury trial. Nor does this Court make a recommendation as to how White County Bank's Motion to Sever should be decided.

Kenneth J. Meyers  
U.S. BANKRUPTCY JUDGE

ENTERED: March 29, 1991