UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF MISSISSIPPI
SOUTHERN DIVISION

IN RE:	)	
THE CONSOLIDATED FGH	)	
LIQUIDATING TRUST	)	
	)	
f/k/a	)	**CASE NO. 01-52173 ERG**
	)	
FRIEDE GOLDMAN HALTER, INC.,	)	
***et al.*, Jointly Administered**	)	
_____	)	
	)	
LIQUIDATING TRUSTEE FOR THE	)	
CONSOLIDATED FGH LIQUIDATING	)	
TRUST	)	
Plaintiff	)	
v.	)	**ADVERSARY NO. 03-5296 ERG**
	)	
NATIONAL OILWELL, L.P.	)	
Defendant	)	

OPINION

The matter before the court is National Oilwell, Inc's Motion to Confirm its Entitlement to Assert Setoff Against Halter or, Alternatively, Motion for Leave to Amend Pleadings, (Dkt. #96), and the opposition filed thereto. Having considered the pleadings and memoranda submitted by the parties, the court concludes that the Motion to Confirm Entitlement to Assert Setoff should be granted.

I. FACTUAL BACKGROUND

Friede Goldman Halter, Inc. and certain affiliated companies and subsidiaries, including Halter Marine, Inc., filed voluntary petitions for relief under Chapter 11 of Title 11 of the United States Code in April and in June of 2001. The cases were consolidated under Case No. 01-52173 SEG.

On April 18, 2003, Friede Goldman Halter, Inc. and Halter Marine, Inc. filed their adversary complaint against National Oilwell, L.P. for breach of contract for late delivery, defective performance, warranty, breach of warranty of workmanlike performance, negligence, and fraud, in connection with a $2.8 million subcontract for electrical equipment and systems required for the debtors's contract with the United States Army Corps of Engineers to repower, upgrade and repair the Dredge "POTTER."[1]

On June 26, 2003, National OilWell, L.P., d/b/a Ross Hill Controls, filed its answer and affirmative defenses to the complaint in the above styled adversary proceeding, claiming that Halter's change orders, negligence, willful conduct and breaches of contractual and legal obligations were the sole and/or predominate causes of Halter's failure to timely complete the Potter and such conduct by Halter excuses any delays by National Oilwell in performing work on the Potter. In a subsequent brief that was submitted, the defendant National Oilwell asserted that Halter failed to pay all of National Oilwell's invoices and that any amount this court might award Halter must be offset and reduced by the amount owed to National Oilwell under its contract with Halter.[2] The plaintiff responded that National Oilwell's claim for setoff is a compulsory counterclaim that was not asserted in a timely manner and is waived, claiming that the defendant did not assert setoff as an affirmative defense and that since filing the pleading

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[1] The debtor's $18 million contract with the United States Army Corps of Engineers was entered into prior to the petition date. The work pursuant to the contract was not completed until after the filing of the petition in bankruptcy. Halter claims it is entitled to recover $3.1 from National Oilwell, with $1.9 million of that amount representing liquidated damages it owed the owner of the vessel for delayed performance of the project.

[2] National asserts that it was not paid for several invoices totaling in excess of $1.6 million for work performed as a subcontractor to Halter in connection with the re-powering and refurbishment of the Dredge Potter.

almost four years earlier had not sought to amend, had not sought in any other manner except in its pre-trial brief to argue that claims should be offset by alleged amounts owed under disputed invoices. The plaintiff further asserted that National Oilwell did not file a proof of claim for recovery of unpaid invoices and that any claims were expunged in the bankruptcy proceeding.[3]

The defendant National Oilwell filed subsequently, its Motion to Confirm Entitlement to Assert Setoff Against Halter, or, Alternatively, Motion for Leave to Amend Pleadings. The parties submitted memoranda on the issue.

II. CONCLUSIONS OF LAW

The court has jurisdiction over the parties and the subject matter pursuant to 28 U.S.C. § 1334 and § 157.[4]

National Oilwell claims it is entitled to assert a right of setoff, and requests in the alternative leave to amend its pleadings to assert setoff. In its reply brief, National Oilwell sets forth the following regarding its position:

> National Oilwell is entitled to assert offset, either through means of setoff or recoupment, in order to arrive at a just and proper liability of the breach of contract claims asserted by Halter. While National Oilwell has made argument for the defensive use of setoff, as stated in its brief, it believes that its defense is properly characterized as a claim for recoupment. Recoupment is defined as "the right of a defendant, in the same action, to cut down the plaintiff's demand either because the plaintiff has not complied with some cross obligation of the contract on which he sues or because he has violated some duty which the law imposes on him in the making or performance of that contract." *In re Smith,* 737 F. 2d 1549 (11th Cir. 1984); *see also Matter of Holford,* 896 F. 2d 176 (5th Cir. 1990).

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[3] National Oilwell states that it chose not to file a proof of claim and not to participate in the bankruptcy distribution process because its right to receive payment was protected by bond.

[4] The district court for the Southern District of Mississippi, determined, on the defendant National Oilwell's motion to withdraw reference, that the adversary proceeding is properly classified as a core proceeding.

> Setoff, on the other hand, is defined as ... "a counter demand which a defendant holds against a plaintiff, arising out of a transaction extrinsic to the plaintiff's cause of action." *Id.*
>
> It is undisputed that Halter's claims and National Oilwell's defenses to them arise out of the same transaction . . .
>
> Recoupment permits a determination of the "just and proper liability on the main issue," and involves "no element of preference." 4 Collier on Bankruptcy ¶553.03, p. 553-17 (15th ed. 1991). As explained by the Supreme Court in *Rothensies v. Electric Storage Battery Co.,* 329 U.S. 296, 67 S.Ct. 271, 91 L.Ed. 296 (1946), recoupment should be allowed to "permit a transaction which is made subject of suit by a plaintiff to be examined in all its aspects, and judgment to be rendered that does justice in view of the one transaction as a whole." Such is the case here. To prohibit National Oilwell from using offset as a defense to the adversary proceeding would mean examining only one party's obligations under a contract, while disregarding the obligations of the other . . .
>
> It is irrelevant whether National Oilwell failed to file a proof of claim in the bankruptcy case, because the right to recoupment does not constitute a debt which is dischargeable. Because no affirmative recovery is permitted and the right to recoupment gives no right to actual payment, recoupment is not a claim. *In re Baum,* 179 B.R. 824 (Bankr. N.D.Tex. 1995). If recoupment is neither a claim nor a debt, then it is also not dischargeable under the Bankruptcy Code and cannot be prohibited by a plan of reorganization. *Id.* "This policy is reasonable inasmuch as it prevents the debtor from obtaining the benefits of a contract without accepting its burdens." *In re Bram,* 179 B.R. at 827.
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> While National Oilwell was not obligated to file a proof of claim, it is entitled to defend itself against the claims of Halter by requesting a just determination of its liability on the claims asserted against it.

Reply Brief of National Oilwell at 11-12, 15-16.

Although defenses of setoff or recoupment may be considered affirmative defenses that may be waived if not raised in a responsive pleading pursuant to Federal Rule of Civil Procedure 8(c), made applicable by Federal Rule of Bankruptcy Procedure 7008, courts have not considered the failure to be fatal under justifiable circumstances. The Fifth Circuit has held that offset was not waived where the plaintiff was on notice and suffered no prejudice:

> As a threshold matter, Lubke argues that the City waived its offset argument by not pleading it as an affirmative defense, pursuant to Fed.R.Civ.P. 8(c). Regardless whether the City pled offset, however, both parties addressed the issue in their pretrial motions *in limine*. Lubke was on notice of the City's position and suffered no prejudice by the absence of a formal initial pleading. *Giles v. General Elec. Co.*, 245 F.3d 474, 494 n. 36 (5th Cir.2001).

Lubke v. City Of Arlington, 455 F.3d 489, 499 (5th Cir. 2006). In *Lucas v. U.S.*, 807 F.2d 414, (5th Cir. 1986), the Circuit Court stated the following regarding technical compliance with Rule 8(c):

> Fed.R.Civ.P. 8(c) requires that an affirmative defense be set forth in a defendant's responsive pleading. Failure to comply with this rule, usually results in a waiver. *Starcraft Co. v. C.J. Heck Co.*, 748 F.2d 982, 990 n. 11 (5th Cir.1984). "Where the matter is raised in the trial court in a manner that does not result in unfair surprise, however, technical failure to comply precisely with Rule 8(c) is not fatal." *Allied Chemical Corp. v. Mackay*, 695 F.2d 854, 855-56 (5th Cir.1983). That is, the defendant does not waive an affirmative defense if "[h]e raised the issue at a pragmatically sufficient time, and [the plaintiff] was not prejudiced in its ability to respond." *Id.* at 856.

Id. at 417-418. *See also, U.S. v. Shanbaum*, 10 F.3d 305, 312 (5th Cir. 1994).

In *Allied Chemical Corporation v. Mackay*, 695 F.2d 854 (5th Cir. 1983), the court held:

> Allied contends that Mackay waived the usury issue by failing to raise it as an affirmative defense in his initial responsive pleading. We agree that Fed.R.Civ.P. 8(c) requires affirmative defenses to be pled and that Mackay failed to plead usury. But under the circumstances here the failure was not fatal.
>
> Federal Rule of Civil Procedure 8(c) requires any matter constituting an affirmative defense to be set forth in a defendant's responsive pleading. Failure to follow this rule generally results in a waiver. Wright and Miller, Federal Practice and Procedure: Civil § 1278. Where the matter is raised in the trial court in a manner that does not result in unfair surprise, however, technical failure to comply precisely with Rule 8(c) is not fatal. *Jones v. Miles*, 656 F.2d 103, 107 n. 7 (5th Cir.1981). There was no surprise here. Although not pled, the usury defense was included in the trial court's pretrial order. Mackay did not "lie behind the log." *See Bettes v. Stonewall Ins. Co.*, 480 F.2d 92, 94 (5th Cir.1973). He raised the issue at a pragmatically sufficient time, and Allied was not prejudiced in its ability to respond. Construing the Rules to do substantial justice, we hold that the usury defense was not waived.

Id. at 855-56.

In *Giles v. General Electric Company,* 245 F.3d 474, (5th Cir. 2001), the Fifth Circuit concluded the following:

> GE failed to plead the offset as an affirmative defense under rule 8(c). GE concedes that it failed to assert the affirmative defense but argues that this should be excused. As we have said, a court may excuse a violation of rule 8(c) in the absence of prejudice to the other party.
>
> On appeal, Giles alleges no prejudice other than the assertion that his expert was "ambushed" by GE's questioning about benefits at trial. Giles was not unfairly prejudiced by the defense, however, because the parties each addressed the issue before trial.
>
> Giles raised the issue in a motion *in limine* and proceeded to object on the merits to several of GE's trial exhibits before trial. GE filed a brief before trial addressing Giles's objections and indicating its intention to seek an offset . . . Giles's motion *in limine* and GE's pretrial assertion belie his asserted prejudice. The court was well within its discretion to consider GE's affirmative defense of offset, notwithstanding GE's failure properly to plead the defense.

Id. at 494-95.

The plaintiff takes the position that the defendant National Oilwell has waived the right to assert the defenses of setoff or recoupment asserting that they were not raised as affirmative defenses. National Oilwell argues that the plaintiff was put on notice of possible defenses of setoff or recoupment in its answer,[5] which raised the plaintiff's breaches of contractual and legal obligations. The parties dispute whether the responsive pleading sufficiently raised setoff or recoupment defenses.

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[5] In its Answer to the Complaint, under paragraph 1 of Section IV designated as "National Oilwell's Affirmative Defenses, the defendant asserted that, "Halter's change orders, negligence, willful conduct and breaches of its contractual and legal obligations to National Oilwell and to the USACE were the sole and/or predominate cause(s) of Halter's failure to timely complete *the Potter*, and such conduct by Halter excuses any delays by National Oilwell in performing work on *the Potter."*

The court concludes that under the circumstances in this case, where the issue of setoff or recoupment regarding unpaid invoices owed National Oilwell has been raised in pleadings and in briefs prior to trial, has been raised by the plaintiff in prior proceedings before the court[6], and has been raised in discovery, that the plaintiff has been on notice of the possibility of a setoff or recoupment defense and should not be surprised by such defense. The court further concludes that the plaintiff would not be prejudiced in its abilities to defend on these issues relating to unpaid invoices at this juncture of proceedings. The court further concludes that even if the defenses were not pled sufficiently, they are not waived, under the circumstances here, where it is clear that the plaintiff was aware of unpaid invoices and the possibility of setoff or recoupment, and where the defense is being raised only in the context of reducing any possible recovery that may be awarded to the plaintiff and not in the context of an affirmative recovery against the debtors' estate.[7] The court determines that it would be appropriate to grant the requested relief to allow the defendant National Oilwell to assert defenses of setoff or recoupment against Halter in further proceedings in this matter, noting, however, that the court's decision herein is not a determination on the merits of the defenses.

The court does not find it necessary to require a formal amendment to the pleadings to assert the defenses. However, even if the court were to find that notice of the defenses was not

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[6] Specifically, as noted in the briefs submitted by the parties, the debtors made reference to the possibility of setoff of allegedly unpaid invoices against damages caused to the debtors in prior arguments before this court on its motion for extension of automatic stay and for an injunction prohibiting National Oilwell from proceeding against the bonding company, Fireman's Fund Insurance Company, in litigation in Louisiana, until after resolution of Halter's claims in this action.

[7] Because no affirmative recovery is sought, the court need not determine whether such recovery would be precluded by confirmation of the plan where no proof of claim was filed.

given sufficiently in the responsive pleading, the circumstances here would favor allowing the requested amendment to include the defenses. In *Hays v. Adam,*2007 WL 991207 (N.D.Ga. 2007), the court held:

> Federal Rule of Civil Procedure 15(a) states that "[a] party may amend the party's pleading once as a matter of course at any time before a responsive pleading is served." Thereafter, the rule provides that "a party may amend the party's pleading only by leave of court or by written consent of the adverse party." *Id.* Such leave "shall be freely given when justice so requires," and district courts are to generously allow amendments even when the plaintiff does not have the right to amend the complaint. *Rosen v. TRW, Inc.*, 979 F.2d 191, 194 (11th Cir.1992). However, the court may deny leave to amend (1) where there has been undue delay, bad faith, dilatory motive, or repeated failure to cure deficiencies by amendments previously allowed; (2) where allowing amendment would cause undue prejudice to the opposing party; or (3) where amendment would futile. *Bryant v. Dupree,* 252 F.3d 1161, 1163 (11th Cir.2001). "The mere passage of time, without anything more, is an insufficient reason to deny leave to amend." *Floyd v. Eastern Airlines, Inc.,* 872 F.2d 1462, 1490 (11th Cir.1989), *rev'd on other grounds,* 499 U.S. 530, 111 S.Ct. 1489, 113 L.Ed.2d 569 (1990).

Id. at 1. In *Dussouy v. Gulf Coast Investment Corporation,* 660 F. 2d 594 (5th Cir. 1981), the court stated:

> The types of reasons that might justify denial of permission to amend a pleading include undue delay, bad faith or dilatory motive on the part of the movant, repeated failure to cure deficiencies by amendments previously allowed, and undue prejudice to the opposing party. A court may weigh in the movant's favor any prejudice that will arise from denial of leave to amend. E. g., Foman v. Davis, 371 U.S. at 182, 83 S.Ct. at 230, 9 L.Ed.2d at 226; Bamm v. GAF, 5 Cir. 1981, 651 F.2d 389, 391. That consideration arises only if there are substantial reasons to deny the amendment. Otherwise, rule 15(a) requires the trial judge to grant leave to amend whether or not the movant shows prejudice. Finally, it is appropriate for the court to consider judicial economy and the most expeditious way to dispose of the merits of the litigation. See Zenith Radio v. Hazeltine Research, 401 U.S. 321, 329, 91 S.Ct. 795, 801, 28 L.Ed.2d 77, 87 (1971); Summit Office Park v. United States Steel, 5 Cir. 1981, 639 F.2d 1278, 1286 (Wisdom, J., dissenting); Lone Star Motor Import v. Citroen Cars, 5 Cir. 1961, 288 F.2d 69; see generally Fed.R.Civ.Pro. 1.
>
> On first consideration, it might appear that Dussouy did delay unduly and that granting leave to amend would prejudice Gulf Coast, for the amendment was

> proposed after dismissal of the action at the pre-trial conference and one week before the trial date. But mere passage of time need not result in refusal of leave to amend; on the contrary, it is only undue delay that forecloses amendment. Amendment can be appropriate as late as trial or even after trial; see 6 C. Wright & A. Miller, Federal Practice and Procedure s 1488 (1971); see also Fed.R.Civ.Pro. 15(b). Instances abound in which appellate courts on review have required that leave to amend be granted after dismissal or entry of judgment.

Id. at 598. *See also, In re Aureal, Inc*., 279 B.R. 573, 575 (Bankr. N.D.Cal.2002).

Based on the foregoing, the court concludes that National Oilwell's Motion to Confirm its Entitlement to Assert Setoff Against Halter should be granted. The court does not find it necessary at this time to make further determinations on any other specific issues or arguments that may have been raised.

An order will be entered consistent with these findings and conclusions pursuant to Federal Rule of Bankruptcy Procedure 9021 and Federal Rule of Civil Procedure 58. This opinion shall constitute findings and conclusions pursuant to Federal Rule of Bankruptcy Procedure 7052 and Federal Rule of Civil Procedure 52.

This the 20th day of February, 2008.

/s/ Edward R. Gaines
EDWARD R. GAINES
UNITED STATES BANKRUPTCY JUDGE

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