UNITED STATES BANKRUPTCY COURT
DISTRICT OF SOUTH DAKOTA
ROOM 211
FEDERAL BUILDING AND U.S. POST OFFICE
225 SOUTH PIERRE STREET
PIERRE, SOUTH DAKOTA 57501-2463

IRVIN N. HOYT
BANKRUPTCY JUDGE

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December 7, 2000

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Subject: ***In re Steven A. and Sharon M. Kotalik***
Chapter 12; Bankr. No. 00-40225

Dear Counsel:

The matter before the Court is the Motion for Modification of Automatic Stay for Setoff filed by the United States of America, acting through the Department of Agriculture, Commodity Credit Corporation ("CCC"), on September 1, 2000. This is a core proceeding under 28 U.S.C. § 157(b)(2)(G). This letter decision and the Court's subsequent order shall constitute the Court's findings and conclusions under F.R.Bankr.P. 7052. As set forth below, the Court concludes that CCC's motion must be denied.

Summary. The relevant facts are set forth in the parties' Stipulated Facts Between the United States of America's [*sic*] (Department of Agriculture, Commodity Credit Corporation) and Debtors and need not be repeated in detail herein. Briefly, Debtor Steven A. Kotalik ("Debtor") is indebted to CCC pursuant to a CCC Farm Storage Note and Security Agreement ("Agreement") that Debtor executed on October 20, 1999. In that Agreement, Debtor pledged his 1999 soybean crop as collateral for a $49,278.94 price support loan disbursement from CCC.

CCC is in turn obligated to make certain payments to Debtor pursuant to two Production Flexibility Contracts ("PFC") that the parties entered into on July 3, 1996. CCC is holding Debtor's 2000 PFC payment in the amount of $3,057.00. CCC estimates that Debtor will earn additional PFC payments of $4,221.00 in 2001 and $4,087.00 in 2002. By its motion, CCC seeks relief from the

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automatic stay to set off its obligation to make these payments against Debtor's indebtedness to it.

On March 17, 2000, Debtor and his spouse (collectively, "Debtors") filed a joint petition for relief under chapter 12 of the bankruptcy code. On April 3, 2000, CCC filed a proof of claim, in which it set forth a secured claim against Debtors for $50,630.76. CCC described its collateral as Debtor's 1999 soybean crop and a right of setoff.

In their original chapter 12 plan of reorganization, which they filed with their petition, Debtors treated CCC's claim as fully secured. However, Debtors failed to account for the claim of Tom Gordon, d/b/a Tri County Ag Service ("Gordon"), who also held a lien against Debtor's 1999 soybean crop, by reason of a crop lien filed on October 21, 1999, the day before CCC perfected its security interest. Consequently, on April 25, 2000, Gordon filed an objection to Debtors' plan.

The hearing on confirmation of Debtors' plan, which was originally scheduled for May 2, 2000, was continued to June 6, 2000, to permit CCC and Gordon to determine the relative priority of their liens against Debtor's 1999 soybean crop. At the continued hearing on June 6, 2000, the parties reported that all objections had been resolved. Debtors provided copies of a "First Restated Debtor's [*sic*] Chapter Twelve Plan of Reorganization as Confirmed." CCC reserved its right to object to this plan pursuant to Local Bankruptcy Rule 9072-1.

On June 8, 2000, CCC's attorney sent a letter to Debtors' attorney, requesting specific changes to the plan distributed at the June 6 hearing. On June 13, 2000, CCC formally objected to that plan. The sole basis of CCC's objection was that the plan failed to protect CCC in the event Debtor "elect[ed] to deliver the remaining soybeans and the quality or quantity of the collateral differ[ed] from that which Debtor received from CCC or that which ha[d] been agreed upon."

On June 20, 2000, CCC and Gordon filed a stipulation resolving their differences. Pursuant to that stipulation, CCC agreed that Gordon's lien against Debtor's 1999 soybean crop was superior to CCC's and that Debtors could amend their plan to reflect that fact.

On July 5, 2000, CCC and Debtors filed a stipulation resolving CCC's objection to Debtors' plan. Pursuant to that stipulation, if Debtor elected to deliver the remaining bushels, he would be liable for any shortfall in CCC's secured claim resulting from a loss in

quantity or quality of the soybeans.

On July 11, 2000, the Court entered its Order Confirming Plan. Pursuant to their Plan as Confirmed, Debtors are to permit Gordon to withdraw 4365.78 bushels of Debtor's soybeans in satisfaction of his secured claim. The remaining bushels are estimated to be worth significantly less than CCC's claim. As a result, CCC's claim is no longer fully secured. Debtors are to satisfy the secured portion of CCC's claim by delivering the remaining bushels to a government-approved storage facility or buying them back and paying over the proceeds to CCC. Debtors are to satisfy the unsecured portion of CCC's claim by paying CCC its pro rata share of the annual payments to be made to the chapter 12 trustee for distribution to the unsecured creditors.

On September 1, 2000, CCC filed its Motion for Modification of Automatic Stay for Setoff. On October 6, 2000, Debtors filed their Resistance to Motion for Modification of Automatic Stay and for Set Off & Motion to Turnover [*sic*]. On October 20, 2000, CCC filed the parties' Stipulated Facts Between the United States of America's [*sic*] (Department of Agriculture, Commodity Credit Corporation) and Debtors and a brief in support of its motion. On October 25, 2000, Debtors filed a brief in opposition to CCC's motion. At the hearing held on that same date, the parties were given the opportunity to submit additional authority in support of their respective positions on or before November 6, 2000. CCC filed a supplemental brief on November 3, 2000. Debtors filed a supplemental brief on November 6, 2000. The matter was then taken under advisement.

Discussion. The issue framed by the parties in their briefs is whether a creditor may exercise a right of setoff following confirmation of a plan of reorganization that makes no mention of the creditor's right of setoff.[1] CCC asks the Court to focus on 11 U.S.C. § 553(a), which provides in pertinent part:

> Except as otherwise provided in this section and in sections 362 and 363 of this title, this title does not affect any right of a creditor to offset a mutual debt owing by such creditor to the debtor that arose before

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[1] Debtors originally objected to CCC's motion on the additional ground that the parties' obligations were not mutual. Debtors did not, however, brief this argument and may have abandoned it. In any event, it does not appear to be well-taken in light of controlling authority. *See United States v. Gerth (In re Gerth)*, 991 F.2d 1428 (8th Cir. 1993).

> the commencement of the case under this title against a claim of such creditor against the debtor that arose before the commencement of the case . . .

In support of its position, CCC cites the Court to a number of cases holding that a creditor may exercise a right of setoff even after confirmation of a plan of reorganization that makes no mention of the creditor's right of setoff. *See, e.g., Carolco Television Inc. v. National Broadcasting Co.* (*In re De Laurentiis Entertainment Group Inc.*), 963 F.2d 1269 (9th Cir. 1992), *cert. denied, Carolco Television Inc. v. National Broadcasting Co., Inc.*, 506 U.S. 918 (1992). In general, these courts reason that the plain language of § 553(a) mandates that it take precedence over any other section of the bankruptcy code that would appear to abrogate the right of setoff, including §§ 1141, 1227, and 1327. *See, e.g., id.* at 1276.

Debtors, on the other hand, ask the Court to focus on 11 U.S.C. § 1227(a), which provides:

> Except as provided in section 1228(a) of this title, the provisions of a confirmed plan bind the debtor, each creditor, each equity security holder, and each general partner in the debtor, whether or not the claim of such creditor, such equity security holder, or such general partner in the debtor is provided for by the plan, and whether or not such creditor, such equity security holder, or such general partner in the debtor has objected to, has accepted, or has rejected the plan.

In support of their position, Debtors cite the Court to a number of cases holding that a creditor's right of setoff is extinguished by confirmation of a plan of reorganization that does not explicitly preserve that right. *See, e.g., United States v. Continental Airlines* (*In re Continental Airlines*), 134 F.3d 536 (3rd Cir. 1998), *cert. denied, U.S. v. Continental Airlines,* 525 U.S. 929 (1998). In general, these courts reason that the equally plain language of §§ 1141, 1227, and 1327 mandate that they take precedence over § 553. *See, e.g., id.* at 541-2.

It is clear from even the most casual reading that §§ 553 and 1227 are in direct conflict with each other. If § 553 is read literally, § 1227 cannot be applied to bar CCC's exercise of its right of setoff. If § 1227 is read literally, CCC is bound by the terms of Debtors' plan, which does not preserve CCC's right of setoff.

The two sections do not appear to be readily reconcilable. The Eighth Circuit has not addressed the issue. The Supreme Court has had the opportunity to do so, but in denying *certiorari* in both *Carolco* and *Continental*, it has chosen to let the conflicting decisions stand. *See also Citizens Bank of Maryland v. Strumpf*, 516 U.S. 16, 21 n. * (1995). It is not necessary to resolve the conflict in this case, however.

Debtors' plan provides for specific treatment of both CCC's secured claim and its unsecured claim. CCC objected to the treatment of its secured claim, but did not object to the treatment of its unsecured claim. The parties agreed to revise the treatment of CCC's secured claim. The parties' agreement was reduced to writing, approved by the Court, and incorporated in Debtors' Plan as Confirmed. Conspicuously absent from that agreement is any provision for a different treatment of CCC's unsecured claim than that provided for in Debtors' Plan as Confirmed.

CCC is bound by the terms of its agreement with Debtors. *See Grant County Savings & Loan Association, Sheridan, Arkansas v. Resolution Trust Corporation*, 968 F.2d 722 (8th Cir. 1992). In holding that a savings and loan association had waived its right of setoff in executing a release that made no mention of the right of setoff, the Eighth Circuit stated:

> Grant County accepted the receiver's certificate in full satisfaction of the Woodlake Manor lawsuit. Although Grant County owed Savers Federal for the expenses on the loan participations when it brought the Woodlake Manor lawsuit, Grant County did not assert any right to setoff in the lawsuit. Nor did Grant County seek to setoff the expenses when it negotiated the settlement and release. Grant County continues to hold the receiver's certificate and will recover its pro-rata distribution from the receivership estate along with the other creditors of Savers Federal. . . In short, the right to this pro-rata distribution is all Grant County bargained for when it agreed to the settlement and release, and "' wise or not, a deal is a deal.'"

Id. at 725 (quoting *Morta v. Korea Ins. Corp.*, 840 F.2d 1452, 1460 (9th Cir. 1988) (in turn quoting *United Food & Commercial Workers Union v. Lucky Stores, Inc.*, 806 F.2d 1385, 1386 (9th Cir. 1986))).

This is in keeping with the Eighth Circuit's holdings in cases specifically involving creditors' claims in bankruptcy. *See, e.g., First National Bank v. Allen (In re Allen)*, 118 F.3d 1289, 1294

Cir. 1997) (Creditors "waived their unsecured claims when they negotiated and then agreed to the confirmation of [Debtors'] amended plan."); *Federal Deposit Insurance Corporation v. Union Entities (In re Be-Mac Transport Company, Inc.)*, 83 F.3d 1020, 1025 (8th Cir. 1996) ("A secured creditor who participates in the reorganization may also lose its lien by confirmation of a reorganization plan which does not expressly preserve the lien.").

Thus, CCC has waived its right of setoff. With respect to its unsecured claim, CCC shall be paid "its pro rata share of the annual payments to be made to the chapter 12 trustee for distribution to the unsecured creditors." In this regard, it is important to emphasize that CCC lost its right of setoff, not by operation of any provision of the bankruptcy code, but by its own actions in negotiating the treatment of its claims under Debtors' Plan as Confirmed. Section 553 is therefore inapposite to the issue before the Court.

Finally, CCC did not violate the automatic stay in placing an "administrative freeze" on Debtor's 2000 PFC payment. *See Strumpf, supra*, 516 U.S. at 19 ("In our view, petitioner's action was not a setoff within the meaning of § 362(a)(7). Petitioner refused to pay its debt, not permanently and absolutely, but only while it sought relief under § 362(d) from the automatic stay."). Debtors' request for sanctions is therefore denied.

For the foregoing reasons, CCC's Motion for Modification of Automatic Stay for Setoff is denied. CCC shall immediately release Debtor's 2000 PFC payment in the amount of $3,057.00. The parties shall bear their own costs and attorney fees. Counsel for Debtors shall prepare an appropriate order.

Sincerely,

Irvin N. Hoyt
Bankruptcy Judge

INH:sh

cc: adversary file (docket original in adversary; serve copies on counsel)

UNITED STATES BANKRUPTCY COURT SEAL

I hereby certify that a copy of this document was mailed, hand delivered, or faxed this date to the parties on the attached service list

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U.S. Bankruptcy Court, District of South Dakota
By

NOTICE OF ENTRY
Under F.R.Bankr.P. 9022(a)
Entered

DEC 08 2000

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U.S. Bankruptcy Court
District of South Dakota

Case: 00-40225 Form id: 122 Ntc Date: 12/08/2000 Off: 4 Page : 1
Total notices mailed: 8

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