UNITED STATES BANKRUPTCY COURT
DISTRICT OF SOUTH DAKOTA
Northern Division

In re:	)	Bankr. No. 00-10016
	)	Chapter 12
DALLAS A. WHEELER	)	
Soc. Sec. No. [redacted]-2822	)	DECISION RE: FSA'S
	)	MOTION FOR MODIFICATION OF
Debtor.	)	AUTOMATIC STAY FOR SETOFF

The matter before the Court is the Motion for Modification of Automatic Stay for Setoff filed by the Farm Service Agency and Debtor's response thereto. This is a core proceeding under 28 U.S.C. § 157(b)(2). This Decision shall constitute the Court's findings and conclusions under Fed.Rs.Bankr.P. 7052 and 9014. As set forth below, the Court concludes that the Motion must be granted.

I.

Dallas A. Wheeler ("Debtor") filed a Chapter 12 petition on February 3, 2000. A plan has not yet been confirmed.

On December 4, 2000, the Farm Service Agency ("FSA") filed a motion seeking a modification of the automatic stay so that it could exercise a right of setoff. It wants to offset current and future Conservation Reserve Program ("CRP") payments to be paid Debtor[1] against the unsecured portion of its claim. At the time of the Motion, the government stated it had a freeze on $10,672 in year 2000 payments and that Debtor would receive another $10,672 on

[1] Debtor has five 1997 CRP contracts that have been assumed with court approval in the bankruptcy. A final decision on whether Debtor may assume another ten 1998-2000 contracts will be made after resolution of Debtor's administrative appeal through the Department of Agriculture.

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October 1, 2001. It also said Debtor owed the government $22,777.66 in liquidated damages on CRP contracts that were canceled due to fraud by Debtor before 2000. FSA wants to offset against all these funds.

Debtor filed a response on December 26, 2000. He argued that the administrative freeze by FSA was a violation of the automatic stay. Debtor also argued that no relief should be granted to FSA until a final decision has been made on Debtor's appeal through the Department of Agriculture regarding repayment of the $22,777.66.

A hearing on FSA's relief from stay motion was held January 17, 2001. Appearances included (all telephonic) Assistant United States Attorney Cheryl Schrempp DuPris for FSA, Chan B. Masselink and Larry Dean Nelson for Debtor, and Trustee John S. Lovald. The matter was taken under advisement and a briefing schedule was issued.

In its brief, FSA argued that based on the facts of this case and applicable elements of 11 U.S.C. § 553, it is entitled to a setoff of its claim against the CRP funds. It also argued that under applicable regulations governing the CRP contracts, a final decision on Debtor's appeal of the government's repayment decision was not required before an offset could be made.

Debtor in his brief outlined how the appeal through the Department of Agriculture came about, the appeal status, and what further appeals could be taken. Regarding the liquidated damages of $22,777.66 that FSA claims arising from violations of the 1998-

2000 contracts, Debtor argued that this Court could not properly rule on the offset question until that appeal process was final. As to present and future payment on the assumed CRP contracts, Debtor argued that FSA had not shown that Debtor does not have equity in the payments or that the payments are not necessary for an effective reorganization. Debtor also challenged FSA's administrative freeze on certain post-petition payments Debtor will receive under the government's 2000 loan deficiency program and from production flexibility contracts where FSA has not requested relief from the stay to offset against these payments.

FSA filed a reply brief on February 7, 2001. It addressed Debtor's argument that FSA's claim for repayment of the $22,777.66 based on its fraud/contract violation claim against Debtor did not arise until August 9, 2000 when FSA advised Debtor how much was owed on the terminated contracts. Citing several cases, including *United States v. Gerth*, 991 F.2d 1428 (8th Cir. 1993), FSA argued that the majority view is that a claim based on a liquidated damages clause in a pre-petition contract arises when the contract is made.

In his reply brief, in addition to earlier arguments, Debtor contended that FSA had incorrectly cited applicable regulations or had not cited relevant portions in total. Debtor claimed 7 C.F.R. 792.7 applies and that FSA has failed to meet some of its requirements by not noting Debtor's bankruptcy in the August 9,

2000 claim letter and by not issuing a separate Notice of Intent.

II.

Section 553(a) of the Bankruptcy Code provides that a creditor may setoff mutual[2], pre-petition debts between the creditor and the debtor. *Gerth*, 991 F.2d at 1430-31. Section 553(a) Bankruptcy Code does not create a federal right of setoff. Rather, it preserves, with certain exceptions, whatever right of setoff otherwise existed between the debtor and creditor before the bankruptcy was filed. *Citizens Bank of Maryland v. Strumpf*, 116 S.Ct. 286, 289 (1995).

> Every setoff by its very nature is a preference. Yet § 553 allows the bankruptcy court to recognize setoffs in certain situations where there is mutuality of debt.

Bird v. Carl's Grocery Co. (In re NWFX, Inc.), 864 F.2d 593, 595 (8th Cir. 1989).

> For setoff purposes, the Court of Appeals has held that
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> a *debt* arises when all transactions necessary for liability occur, regardless of whether the claim was contingent, unliquidated, or unmatured when the petition was filed.

Gerth, 991 F.2d at 1433 (emphasis added); *see also Newberry Corp. v. Fireman's Fund Ins. Co.*, 95 F.3d 1392, 1398-99 (9th Cir. 1996)(setoffs under § 553 run contrary to the fundamental

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[2] Debtor has not asserted that the debts are not mutual, that is, that each party owns its claim and the right to collect against the other. *R.M. Taylor, Inc. v. H.M. White, Inc. (In re R.M. Taylor, Inc.)*, 257 B.R. 289, ___ (Bankr. W.D. Mo. 2000); *see Gerth*, 991 F.2d at 1435-36.

bankruptcy principle of equal treatment of creditors).

To be deemed a *pre-petition* debt, the claim must be "absolutely owed" pre-petition. *Gerth*, 991 F.2d at 1430-31 (quoting *Braniff Airways, Inc. v. Exxon Co.*, U.S.A., 814 F2d 1030, 1035 (5th Cir. 1987). However, a claim is absolutely owed "even though that debt would never have come into existence except for postpetition events." *Id.* at 1434 (cites therein).

In this Circuit, a claim is deemed a pre-petition claim even if the contract from which it arises, which the debtor and creditor entered into before the debtor filed bankruptcy, is assumed post-petition. *Id.* at 1432. Accordingly, pre-petition payments from a CRP contract with the federal government that a debtor signed pre-petition and assumed post-petition may be offset against a pre-petition claim that the debtor owes the government. *Id.* at 1432-33. Included as pre-petition claims are reach-back provisions in the contract allowing the government to recover past payments if the debtor should fail to perform as agreed. *Id.* at 1433.

III.

FSA has demonstrated that it is entitled to relief from the automatic stay to offset its pre-petition claims against the CRP funds it owes Debtor, both the $22,777.66 in liquidated damages and the present and future payments on the contracts that have been assumed to date. As discussed in *Gerth*, all the claims arose pre-

petition. *Gerth*, 991 F.2d at 1433-35. Regardless of the fact that Debtor's appeal of the $22,777.66 repayment claim by FSA is pending or that the amount was not liquidated on the petition date, the claim nonetheless arose from the pre-petition CRP contract between the parties. All the events giving rise to the debt, including the alleged acts that gave rise to the damages, also occurred before the bankruptcy. *In re Sauer*, 223 B.R. 715, 715 n.4 (cite therein).

By establishing its right to a setoff, FSA has established cause for relief. *In re Firestone*, 179 B.R. 148, 148 (Bankr. D. Neb. 1995)("A right to setoff under § 553 establishes a *prima facie* case of cause to lift the automatic stay.")(cites therein). In contrast, Debtor has not made any offer of adequate protection that would give FSA the same secured status that the right to setoff provides under § 506(a). Debtor also has not established any compelling circumstances that would justify a denial or delay in implementing FSA's setoff right. *See NWFX, Inc.*, 864 F.2d at 595-96; *compare Sauer*, 223 B.R. at 725-26 (Bankruptcy Code does not recognize equitable exceptions to setoffs that otherwise comply with § 553). Accordingly, relief from the stay is appropriate.

That relief is granted to allow the setoff does not mean that FSA can immediately apply the funds. To the extent that FSA has not yet complied with any setoff conditions established by

applicable regulations,[3] FSA must still fulfill those conditions. *See* 7 C.F.R. 1403.7.

Counsel for FSA shall prepare an appropriate order granting relief to the extent necessary to effectuate the setoff of the CRP funds described above. The Order shall acknowledge that the setoff is subject to the bankruptcy estate recouping any of the $22,777.66 not found on appeal to be owed by Debtor on the terminated contracts. 7 C.F.R. 1403.7(n). The Order shall also state that the relief granted is also subject to FSA's compliance with any applicable regulations.

Finally, Debtor complained in his brief that the government has frozen year 2000 loan deficiency program payments and production flexibility contract payment that were due Debtor post-petition. FSA replied that the 2000 production flexibility contract payment was disbursed to Debtor on January 10, 2000. If that is not accurate and FSA still holds the funds, FSA should immediately seek relief from the stay, *Strumpf*, 116 S.Ct. at 289, or the parties should deal with the issue in Debtor's plan. FSA has stated that Debtor may elect to receive his 2001 production flexibility contract payment any time before September 30, 2001 now that the contract has been assumed. The Court presumes this issue also may be addressed in Debtor's plan.

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[3] The Court, like Debtor, found it difficult to pinpoint the applicable regulations. For example, when does 7 C.F.R. 702.7 apply rather than 7 C.F.R. 1403.7?

As to the year 2000 loan deficiency payment, FSA claims it will be a post-petition program payment not based on a pre-petition contract that has yet to be paid out. FSA further states that Debtor's 2000 loan deficiency payment "would be available to offset any post-petition debt owed FSA, if any, pursuant to 31 U.S.C. § 3716." The Court notes, however, that these post-petition receipts are still property of the bankruptcy estate, 11 U.S.C. § 1207(a)(1) and are protected by the automatic stay, 11 U.S.C. § 362(a)(3). Accordingly, FSA should not assume it may automatically setoff these said post-petition payments against post-petition claims against Debtor while Debtor remains in Chapter 12. This, too, is a matter better addressed in Debtor's plan.

Dated this 20 day of February, 2001.

BY THE COURT:

Irvin N. Hoyt
Bankruptcy Judge

ATTEST:
Charles L. Nail, Jr., Clerk
By: Juanita Sarvis
Deputy Clerk

(SEAL)

NOTICE OF ENTRY
Under F.R.Bankr.P. 9022(a)
Entered
FEB 20 2001
Charles L. Nail, Jr., Clerk
U.S. Bankruptcy Court
District of South Dakota

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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Charles L. Nail, Jr., Clerk
U.S. Bankruptcy Court, District of South Dakota
By

Case: 00-10016 Form id: 122 Ntc Date: 02/20/2001 Off: 3 Page : 1
Total notices mailed: 10

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