

IN THE UNITED STATES BANKRUPTCY COURT

FOR THE

SOUTHERN DISTRICT OF GEORGIA
Statesboro Division

IN RE:)	Chapter 12 Case
)	Number <u>91-60141</u>
STANLEY CLAYTON)	
HAZEL N. CLAYTON)	
)	
Debtors)	
_____))	
NEWTON AGRI-SYSTEMS, INC.)	FILED
)	at 10 O'clock & 49 min P.M.
Movant)	Date: 2-14-92
)	
vs.)	
)	
STANLEY CLAYTON)	
HAZEL N. CLAYTON)	
)	
Respondents)	

ORDER

Newton Agri-Systems, Inc. ("Newton") moves the court for relief from stay pursuant to 11 U.S.C. §362(d) to assert setoff and recoupment as defenses in a civil action brought against Newton by Stanley Clayton, a Chapter 12 debtor, and William Clayton in the United States District Court for the Southern District of Georgia (CV-690-108). Based on the evidence presented at hearing and relevant legal authorities, I make the following findings.

FINDINGS OF FACT

Debtors, Stanley Clayton and Hazel Clayton, and their son William Clayton, a nondebtor, jointly operate a dairy farm in Jenkins County, Georgia. Newton is a feed and grain dealer located in Millen, Georgia. Debtors contend feed corn

purchased from Newton was contaminated, and that the alleged contaminated corn proximately caused the death of a sizeable portion of their dairy herd. Newton's insurance carrier is Essex Insurance Company ("Essex"). On October 4, 1990 Essex filed a declaratory judgment action in the United States District Court for the Southern District of Georgia, seeking a declaratory judgment that under the terms of its insurance agreement with Newton, it had no duty to defend Newton in any action brought against Newton for the sale of contaminated corn and that it was not obligated to pay any judgment against Newton realized in such an action.¹ Essex named Stanley Clayton as co-defendant in the declaratory judgment action.¹ Stanley Clayton filed a cross-claim in the declaratory judgment action against Newton for damages allegedly resulting from feeding the corn to his dairy herd.²

On March 8, 1991 debtors filed for protection under Chapter 12, title 11, United States Code. On March 12, 1991,

Stanley Clayton's cross-claim was severed from the declaratory judgment action. William Clayton was added as a party plaintiff in the action against Newton and he and Stanley Clayton filed a new complaint in the severed action.³ In its answer to the complaint, Newton asserted setoff and recoupment defenses, as well as a "counterclaim," based on open accounts arising from Newton's sale of feed and fertilizer to the plaintiffs. Newton contends there is a balance owed for feed delivered to plaintiffs of Forty-One Thousand Four Hundred Thirty-Eight and 73/100 (\$41,438.73) Dollars and a balance owed for fertilizer delivered to plaintiffs of Forty-Five Thousand Nine Hundred Ninety-Eight and 73/100 (\$45,998.73) Dollars.

¹Hazel Clayton was subsequently added as a co-defendant.

²Newton counter-claimed in the declaratory judgment action against Essex seeking to hold Essex liable under the insurance agreement and also alleging damages for fraud and bad faith on the part of Essex in refusing to honor Newton's claim.

³Central Soya Company, Inc. was added as a party defendant in the severed action.

Newton filed a proof of unsecured claim in this Chapter 12 case for Eighty Seven Thousand Four Hundred Thirty-Seven and 46/100 (\$87,437.46) Dollars. Newton asserts in its answer that its counterclaim is compulsory. On the same date Newton filed its answer, it filed a motion for relief in this Chapter 12 proceeding seeking relief from stay to raise and prosecute its defenses of setoff and recoupment in the district court action.

CONCLUSIONS OF LAW

Upon the filing of a bankruptcy petition the Bankruptcy

Code imposes an automatic stay against

the commencement or continuation, including the

issuance or employment of process, of a judicial, administrative, or other action or proceeding against the debtor that was or could have been commenced before the commencement of the case under this title [11], or to recover a claim against the debtor that arose before the commencement of the case under this title. . .

11 U.S.C. §362(a)(1).

As the automatic stay is broadly designed to protect debtors from all actions taken by creditors to enforce a prepetition claim, the automatic stay applies to Newton's defenses of setoff and recoupment, and its "counterclaim," asserted in the district court action against debtor Stanley Clayton, co-plaintiff in the district court action. However,

[o]n request of a party in interest and after notice and a hearing, the court shall grant relief from the stay provided under subsection (a) of this section [362], such as by terminating, annulling, modifying, or conditioning such stay-

(1) for cause, including the lack of adequate protection of an interest in property of such party in interest....

11 U.S.C. §362(d)(1).

"Cause" under §362(d)(1) "has no clear definition and is determined on a case-by-case basis." In re: Tuscon Estates. Inc., 912 F.2d 1162, 1166 (9th Cir. 1990). Where a party in interest alleges "for cause" grounds for relief from stay,

the debtor bears the burden of proof by a preponderance of the evidence that cause does not exist, 11 U.S.C. §362(g)(2), once the movant has established prima facie

there is cause for relief from stay. In re: Pioneer Commercial Funding Corp., 114 B.R. 45, 47 (Bankr. S.D. N.Y. 1990). Newton has made a prima facie showing of "cause" under §362(d)(1) for modifying the stay by establishing that an action against it is pending in the district court and that it has potential defenses of setoff and recoupment which may reduce any recovery of the plaintiffs. Therefore, debtors bear the burden to prove cause to modify the stay does not exist.

In its motion Newton contends it should be allowed to prosecute defenses of recoupment and setoff in the district court action because otherwise the defenses, which Newton argues are affirmative defenses, will be waived under the Federal Rules of Civil Procedure. In its brief submitted following hearing, Newton also alleges that 11 U.S.C. 553(a) authorizes setoff of debtors' obligation on the open accounts against Newton's liability, if any, for the loss of the dairy herd. Newton further argues that its claim on the open accounts is inadequately protected in debtors' Chapter 12 case because if setoff is not allowed, the claim will be paid over the length of debtors' Chapter 12 plan, possibly on a pro rata basis, rather than immediately as debtors' claim will be paid if they prevail in the district court action.

In response debtors argue that Newton failed to raise its counterclaim when Stanley Clayton filed his initial cross-claim in the declaratory judgment action in October 1990 and that therefore,

under the Federal Rules of Civil Procedure, the counterclaim is now time-barred to the extent it constitutes a compulsory counterclaim. To the extent the counterclaim is permissive, debtors argue, there is no time-bar limitation and thus no cause under 362(d)(1) to modify the stay. Debtors also argue that Newton has no right of setoff under 11 U.S.C. 553(a) because the plaintiffs' claim in the district court

action against Newton is presently undetermined and only after liquidation of the plaintiffs' claim can Newton's setoff rights, if any, be determined. Finally, debtors contend that granting Newton relief from stay will not further judicial economy because Newton's claim on the open accounts will be adjudicated in the bankruptcy court in any event since debtors will object to the claim.

In resolving Newton's motion for relief, I need not sort out the distinctions of the state law remedies of recoupment and setoff, see generally 4 Collier on Bankruptcy, ~553.03, 553.13 (L. King 15th ed. 1991), and address the merits of the parties' arguments concerning the existence or availability of each defense in the district court case. The issue before me is whether the automatic stay of 362(a) should be modified to allow Newton, having been sued in the district court, to prosecute whatever available defenses it possesses in that action, including those defenses which, if successful, will reduce the amount of any judgment plaintiffs may obtain. It is for the district court, the court presiding over the litigation in question, applicability and availability of Newton's alleged defenses. However, it is important to note in determining whether to modify the stay to permit Newton's prosecution of these defenses that notwithstanding Newton's characterization in its pleadings of its claim against the plaintiffs on the open accounts as a "counterclaim," what Newton seeks is a reduction of any recovery obtained by the plaintiffs, not affirmative relief. See 4 Collier on Bankruptcy, ~553.13 (L. King 15th ed. 1991).

In considering whether to modify the automatic stay to permit continuance of an action pending in another forum against a debtor who has filed bankruptcy, courts employ a three-part test:

[whether] (a) [a]ny 'great prejudice' to either the bankrupt estate or the debtor will result from continuation of a civil suit,

(b) the hardship to the [non-bankrupt party] by maintenance of the stay considerably outweighs the hardship of the debtor, and

(c) the creditor has a probability of prevailing

on the merits of his case.

In re: Pro Football Weekly, Inc., 60 B.R. 824, 826 (N.D. Ill. 1986) See. e.g.,
Matter of Fernstrom Storage and Van Co., 938 F.2d 731 (7th Cir. 1991); In re: Bock
Laundry Mach. Co., 37 B.R. 564 (Bankr. N.D. Ohio 1984); Matter of McGraw, 18 B.R.
140 (Bankr. W.D. Wis. 1982). In this case, no great prejudice to debtors
or the bankruptcy estate will result if Newton is allowed to fully defend itself in
the district court action. As debtor Stanley Clayton,
along with William Clayton, voluntarily initiated the district court action, he is
already involved in the litigation and if the stay is modified will not be compelled
to enter an action in which he otherwise would not participate. The hardship
to Newton in maintenance of the stay considerably outweighs any hardship to
debtors in granting Newton's motion because Newton will not be able to fully defend
itself if the stay is not modified. The third factor is not considered because
there is insufficient evidence before me to allow me to determine the likelihood of
Newton's success on these defenses.

In addition to the above factors, equitable considerations weigh in favor
of Newton's motion for relief. The purpose of the automatic stay is to afford
protection to a debtor in bankruptcy, "but when the debtor is in the position of
assailant rather than victim, the potential for abuse of that purpose is manifest."
Bohack Corp. v. Borden, Inc., 599 F.2d 1160, 1168 (2nd Cir. 1979). Although 362(a)
stays all actions against the debtor, the debtor is not prevented from filing suit
in another court. See Bankruptcy Rule 6009. Thus,

[w]here a debtor seeks affirmative relief as a plaintiff
in a lawsuit and then invokes the protection of the
automatic stay on a counterclaim, the situation
warrants very careful scrutiny. In such instance, a
court must be cautious to avoid a decision which would
convert Code 362 from a shield into a weapon. A debtor
should not be permitted to reap the benefits of a
litigation in one court, but circumvent the burdens in
another forum.

In re: Overmyer, 32 B.R. 597 (Bankr. S.D. N.Y. 1983).

Because Stanley Clayton and William Clayton initiated the action against Newton in

the district court, fairness dictates that Newton be allowed to fully defend itself, in spite of Stanley Clayton's Chapter 12 proceeding. Bohack, Overmyer, supra. Accord Bernstein v. IDT Corp., 76 B.R. 275 (S.D. N.Y. 1987); In re: Berry P. Parkers Inc., 33 B.R. 115 (D. M.D. Tenn. 1983); In re: Wedtech Corp., 87 B.R. 279 (Bankr. S.D. N.Y. 1988); In re: Saxon Industries Inc., 43 B.R. 64 (Bankr. S.D. N.Y. 1984); Ideal Roofing and Sheet Metal Works Inc., 9 B.R. 2 (Bankr. S.D. Fla. 1980). Contra, In re: Video Cassette Games, Inc., 108 B.R. 347 (Bankr. N.D. Ga. 1989). The purpose of the stay, protection of the debtor while the debtor attempts to reorganize, is not compromised by allowing a party sued by the debtor in a nonbankruptcy forum to raise defenses, which, if successful, reduce the debtor's recovery.

Debtors are incorrect in arguing that judicial economy militates against modifying the automatic stay. Allowing Newton to assert its recoupment and setoff defenses in the district court action promotes judicial economy by permitting all issues concerning Newton's recoupment and setoff defenses to be resolved in a single forum thereby avoiding the necessity of any further litigation in this court concerning those issues and the possibility of inconsistent judgments. The district court's determination as to the extent of Newton's recoupment and setoff rights will be res judicata as to those issues. Thus there will be no need for further litigation of those issues in debtors' Chapter 12 proceeding. "[I]t will often be more appropriate to permit proceedings to continue in their place of origin, when no great prejudice to the bankruptcy estate would result, in order to leave the parties to their chosen forum and to relieve the bankruptcy court from any duties that may be handled elsewhere." H.R. Rep. 95-595, 95th Cong. 2d Sess. 50 (1978), U.S. Code Cong. & Admin. News 1978, pp. 5787, 5836, 6297.

For the foregoing reasons I find debtors have failed to meet their burden to prove that "cause" to modify the stay does not exist. It is therefore ORDERED that the stay is modified to the extent necessary to permit Newton to prosecute all available defenses, including those applicable against Stanley

Clayton, as determined by the district court, in civil action CV-690-108, pending in the United States District Court for the Southern District of Georgia.

JOHN S. DALIS
UNITED STATES BANKRUPTCY JUDGE

Dated at Augusta, Georgia

this 14th day of February, 1992.