

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

IN RE:)
)
BRADLEY STEVEN BLACKBURN,) Bankruptcy Case No. 97-60414
d/b/a BLACKBURN FARMS,)
)
Debtor.)

OPINION

This matter having come before the Court on a Motion to Vacate Order Lifting Automatic Stay and an Objection to Relief from Automatic Stay, both having been filed by the Debtor, on March 9, 1999; the Court, having reviewed written Memoranda of the parties and being otherwise fully advised in the premises, makes the following findings of fact and conclusions of law pursuant to Rule 7052 of the Federal Rules of Bankruptcy Procedure.

The parties have agreed that the material facts in this matter are not in dispute and that the issues presented to the Court can be decided as a matter of law based upon the written arguments filed by the parties.

FINDINGS OF FACT

On May 19, 1997, the Debtor filed for relief under Chapter 12 of the Bankruptcy Code, and his Chapter 12 Plan of Reorganization was duly confirmed by this Court on December 30, 1997. Prior to the filing of the Debtor's Chapter 12 petition, the Debtor and Commodity Credit Corporation (CCC) had entered into two executory contracts.

The first contract was entered into on October 10, 1989. The Debtor and CCC entered into a

Conservation Reserve Program Contract under which the Debtor set aside certain tillable farm acreage for a 10 year period in exchange for a payment at the rate of \$70 per acre per year by CCC. The annual payment on this contract is \$10,808. In order to receive the annual payment from CCC on this contract, the Debtor was obligated not to farm the subject acreage for a 10 year period. Under the contract, the Debtor was obligated to follow the Conservation Reserve Program (CRP) regulations with respect to reduction of soil erosion. Most importantly, the Debtor was obligated to maintain the acreage in question in vegetation cover and was not allowed to farm the ground for the entire 10 year period. In exchange for the Debtor's obligations, CCC was to make the annual payments, with said payments conditioned upon the Debtor's compliance with all regulations of the CRP, including maintaining the vegetation cover. Should the Debtor not fulfill his obligations under the CRP contract, the CCC was not obligated to make the annual rental payment and could further terminate the contract. Should the CCC terminate the contract, the Debtor was to forfeit all rights to future rental payments, and had to refund prior payments received under the CRP to the CCC.

On November 26, 1996, the Debtor and CCC entered into a second executory contract known as a Production Flexibility Contract (PFC). Under the PFC program, the CCC was to make annual payments to the Debtor over a 7 year period. It is under this contract that the dispute herein has arisen. The CCC asserts that it determined that it had overpaid the Debtor the sum of \$4,454.19 in 1997. As such, CCC has sought to offset this amount from amounts that are due the Debtor under the previously mentioned CRP contract. It is this setoff that is the subject of the relief from stay which the Debtor seeks to vacate and object to.

The Debtor's Chapter 12 Plan of Reorganization, which was confirmed on December 30, 1997,

indicates that the Debtor is assuming all government contracts, including the two contracts at issue here. The confirmed Plan did not provide for CCC to setoff post-petition obligations it owes the Debtor under the CRP contract against any pre-petition indebtedness that the Debtor may have owed to CCC. The Government did not object to the Debtor's Chapter 12 Plan of Reorganization, and, furthermore, the Government has never filed a proof of claim asserting its rights to setoff from the post-petition CRP obligations. The Government contends, and it is not disputed, that it did not know of the overpayment on the 1997 PFC contract until after the November 17, 1997, governmental proof of claim deadline. However, CCC withheld the sum of \$4,454, of the Debtor's 1998 CRP payment on October 6, 1998; and, on February 11, 1999, CCC filed the subject Motion for Relief from Stay seeking a setoff of the subject monies, pursuant to 11 U.S.C. § 553.

As noted above, CCC filed its Motion for Relief from Stay on February 11, 1999. There being no response to that Motion, an Order was entered on February 26, 1999, allowing the relief requested in CCC's Motion. On March 9, 1999, Debtor filed the instant Motion to Vacate Order Lifting Automatic Stay in which it was alleged that neither the Debtor's counsel nor Debtor were ever served with the Motion for Relief from Stay which was filed with this Court on February 11, 1999, and that, in fact, the Debtor's attorney only received notice of the Motion from the Chapter 12 Trustee on March 3, 1999. Further, the Debtor noted that there was a valid objection to the Motion for Relief from Stay, and that objection was filed in writing, together with the Motion to Vacate Order Lifting Automatic Stay, on March 9, 1999. At hearing on April 23, 1999, the parties agreed that there were no factual disputes and the matter could be decided on written Memoranda, which have now been supplied to the Court.

CONCLUSIONS OF LAW

It is not disputed by the parties that, in order for there to be right of setoff for CCC, the requirements of 11 U.S.C. § 553 must be established. Those three requirements are as follows: (1) the creditor owes a debt to the debtor which arose prior to the commencement of the bankruptcy case; (2) the creditor has a claim against the debtor which arose prior to the commencement of the bankruptcy case; and (3) the debt and claim are mutual obligations. See: In re Gore, 124 B.R. 75, at 77 (E.D. Ark. 1990); and U.S. thru ASCS v. Gerth, 991 F.2d 1428 (8th Cir. 1993). The Debtor has conceded that there was a claim by the Creditor against the Debtor which arose prior to the commencement of the case; however, the Debtor disputes that CCC has met the requirements that the Creditor owes a debt to the Debtor which arose prior to the commencement of the bankruptcy case and that the debt and claim are mutual obligations. In reviewing the written Memoranda of the parties, the Court finds that the position argued by the Debtor and the cases cited in support of that position present the more well reasoned argument under the facts of this situation, even though there is a clear split of authority on these points.

Under the authority cited by the Debtor, the Court finds that the CRP payments which the Debtor has earned post-petition are not debts that existed pre-petition. Both parties agree that the CRP contract is executory and that the Debtor assumed this contract in his Chapter 12 bankruptcy. Under the clear language of the contract, the Court finds that that the Debtor has no right to receive his annual rental payment on the CRP contract until he performs under the obligations of that contract and the regulations of the CRP. Thus, this payment is not subject to setoff under 11 U.S.C. § 553. The Court has reviewed the cases cited by the Debtor of In re Walat Farms, Inc., 69 B.R. 529 (E.D. Mich. 1987); In re Evatt, 112 B.R. 405 (W.D. Okla. 1989); *aff'd.* at In re Evatt, 112 B.R. 417 (W.D. Okla. 1990); and In re Gore,

supra., and finds that these cases are more well reasoned in finding that the CRP payments the Debtor earns post-petition are not debts that existed pre-petition. In particular, the Court, in Gore, stated:

. . . The payments under the assumed contract will accrue only as the obligation of the debtors-in-possession are performed post-petition. If the debtors-in-possession fail to perform, the government can terminate the contract. Therefore, the government's debt to the Gores was not absolutely owed pre-petition and the post-petition CRP payments cannot be offset against the Gores pre-petition debt to the SBA. In re Gore, 124 B.R. 75, at 78.

In reviewing the Memoranda of the parties, the Court also agrees with the Debtor that the alleged debt and claim of CCC are not mutual obligations. As set out above, the third requirement to allow a setoff, under 11 U.S.C. § 553, is that the debt and claim be mutual obligations. Mutuality requires that the debts must be in the same right and between the same parties standing in the same capacity. In re Gore, supra, at 78. There is no dispute by the Debtor that CCC is a government agency and, thus, stands in the same capacity for purposes of a § 553 setoff. However, the Debtor argues, and the Court agrees, that the pre-petition debtor and the post-petition debtor-in-possession are not the same entities for the purposes of setoff. Once the Chapter 12 bankruptcy petition was filed, the pre-petition debtor became a debtor-in-possession, which is a separate entity created by the filing of the Chapter 12. See: In re Gore, supra, at 78. The post-petition debtor-in-possession does not stand in the same shoes as a pre-petition debtor for setoff purposes. See: In re Evatt, supra, at 414. The change in this capacity upon the filing of the Chapter 12 petition destroys the mutuality of the obligations. The Court notes that there is a split of authority as to whether mutuality exists between a pre-petition debtor and a post-petition debtor-in-possession, and that there are cases that hold that the mutuality requirements exists. See: U.S. thru ASCA v. Gerth, supra; In re Allen, 135 B.R. 856 (Bankr. N.D. Iowa 1992); and In re Buckner, 218 b.R. 137 (10th Cir. 1998).

However, in reviewing the facts of this situation, this Court chooses to follow the reasoning as set forth by the Debtor in his Memorandum and the cases cited therein.

Finally, the Court notes that, pursuant to 11 U.S.C. § 553, setoff is not mandatory. The Bankruptcy Court must exercise its equitable discretion in deciding whether to grant a creditor's motion for relief from the automatic stay to effect an administrative setoff under 11 U.S.C. § 553. See: Matter of Butz, 104 B.R. 128 (S.D. Iowa 1989). As the Court found in the Butz case, this Court finds that, to allow a government agency to pursue administrative setoff in the context of a reorganization case is inconsistent with the rehabilitative purpose of Chapter 12 of the Bankruptcy Code. In the instant case, the Court notes that the Debtor's cash flow projections show that the CRP payments are an important component of the Debtor's ability to cash flow and to make his Chapter 12 Plan payments. In this case, the Debtor has taken the CRP acreage out of production in order to receive the annual rental payment from the CCC. If the Debtor had not entered into the CRP contract, he would be able to farm this land, produce crops, and use the proceeds to finance his reorganization plan. Thus, the equities in this case lean in favor of the Debtor and denial of the right of CCC to setoff the 1998 CRP payment against the 1997 overpayment on the PFC contract. The Court finds that this equity is buttressed by the fact that the CCC did not object to the Debtor's Chapter 12 Plan, and that the Order confirming the Chapter 12 Plan is binding upon all parties to it. See: In re Cooper, 94 B.R. 550 (Bankr. S.D. Ill. 1989).

ENTERED: June 16, 1999

/s/ Gerald D. Fines
United States Bankruptcy Judge