

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

IN RE:)	In Proceedings
)	Under Chapter 13
DAVID HUEGEN, d/b/a Huegen)	
Lumber Company,)	BK 88-30529
)	
Debtor.)	
)	
DAVID HUEGEN, d/b/a Huegen)	
Lumber Company,)	
)	
Plaintiff,)	
)	
v.)	ADV. NO. 88-0267
)	
PEOPLES BANK OF ALBERS,)	
)	
Defendant.)	

MEMORANDUM AND ORDER

On July 7, 1988 debtor filed a petition for relief under Chapter 13 of the Bankruptcy Code. At the time of the filing of his petition, debtor owed the Peoples Bank of Albers ("Bank") \$93,948.70 plus interest pursuant to a promissory note dated July 6, 1987. Likewise, at the time his petition was filed, debtor had funds totaling \$1,847.08 on deposit with the Bank. After learning of debtor's bankruptcy, the Bank imposed an administrative freeze on the debtor's deposit account. In addition to freezing debtor's account, the Bank has refused to pay debtor the sum of \$1,482.57, which constitutes the price of certain merchandise ordered by the Bank from debtor on July 6, 1988.

On November 10, 1988, debtor filed a complaint for Turnover of Funds requesting that the Bank be ordered to turn over to debtor the sum of \$3,329.65. which represents the funds on deposit with the Bank and the amount owed for the merchandise supplied by

debtor. In response to debtor's complaint, the Bank filed its answer and further asserted its right of setoff as an affirmative defense. The Bank also requested relief from the automatic stay to exercise its right to offset the funds in the frozen account and the funds owed to debtor for the merchandise ordered on July 6, 1988.

Debtor agrees that the Bank has a right to offset the funds in question. Debtor contends, however, that in order to assert setoff as a valid defense in this action, the Bank must also show that it is entitled to relief from the automatic stay. The sole issue this Court must decide, therefore, is whether a creditor can successfully assert the right of setoff as an affirmative defense in a turnover action without first obtaining relief from the automatic stay. For the reasons set forth below, the Court finds that 1) a creditor must first prove a valid right of setoff under section 553 of the Bankruptcy Code to successfully defend a turnover action; and 2) once that right of setoff has been established, the creditor need not, in order to succeed in the turnover action, further prove entitlement to relief from the stay.

Section 542(b) of the Bankruptcy Code, provides:

(b) Except as provided in subsection (c) or (d) of this section, an entity that owes a debt that is property of the estate and that is matured, payable on demand, or payable on order, shall pay such debt to, or on the order of, the trustee, except to the extent that such debt may be offset under section 553 of this title against a claim against the debtor.

11 U.S.C. §542(b) (emphasis added). In order to defeat a cause of action for turnover, therefore, the creditor need only prove a valid

right of setoff under section 553.

In the present case, debtor has not challenged the existence or mutuality of the prepetition debts, and in fact agrees that the Bank has a valid right to offset the funds in question. In light of this admission, debtor's complaint for turnover must be denied in its entirety. Contrary to debtor's assertion, the Bank must not further prove, at this point, that it is entitled to relief from the stay. See In re Charter Co., 86 B.R. 280 (Bankr. M.D. Fla. 1988) (creditor may assert setoff as defense to turnover action without obtaining relief from the stay). See also In re Williams, 61 B.R. 567, 572 (Bankr. N.D. Tex. 1986); In re Fulghum Construction Corp., 23 B.R. 147, 153 (Bankr. M.D. Tenn. 1982). "[T]he filing of the bankruptcy petition does not cut off a creditor's right to setoff under §553 but instead stays the creditor's exercise of that right." In re Fulghum Construction Corp., 23 B.R. at 153 (emphasis in original) See also Butz v. Champaign Landmark, Inc., 33 B.R. 926, 930 (Bankr. S.D. Ohio 1983). Inasmuch as the Bank's substantive right of setoff has been established by agreement of the parties, debtor's request for a turnover of the funds cannot, under section 542 (b), be granted.

As noted above, however, once a valid right of setoff has been established, the Bank must seek relief from the automatic stay to actually exercise that right. Section 362(a)(7) expressly stays "the setoff of any debt owing to the debtor that arose before the commencement of the case under this title against any claim against the debtor...." 11 U.S.C. §362(a)(7). As stated in Williams, "the Code curiously recognizes the right of the Bank to withhold payment in view

of the Bank's valid offset rights while prohibiting the exercise of such offset rights in §362(a)(7)." In re Williams, 61 B.R. at 572. The Bank recognizes this, and even stated at the hearing on this matter that it won't necessarily be allowed to offset the funds in question (should the Bank, for example, pursue its motion for relief from stay). Whether the Bank is entitled to relief from the stay to pursue its right of setoff or is adequately protected and thus prohibited from doing so, is a separate matter that is not before the Court at this time.

The Court recognizes the "stalemate" created by its decision. However, this stalemate can be alleviated by a number of alternatives, including an application for use of cash collateral filed by debtor, or further pursuit by the Bank of its motion for relief from stay.* "The bankruptcy code does not specify which [alternative] should be used nor whether the creditor or the debtor should initiate action to break what appears to be a statutory logjam." In re Edgins, 36 B.R. 480 (Bankr. App. 1984).

ACCORDINGLY, IT IS ORDERED that Judgment enter in favor of defendant and against plaintiff.

/s/ Kenneth J. Meyers
U.S. BANKRUPTCY JUDGE

ENTERED: May 15, 1989

*It is not clear to the Court whether the Bank wishes to pursue the Motion for Relief from Stay filed with its Answer.