

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

IN RE:

MARY E. SMILEY
JAMES P. SMILEY

Debtor(s).

In Proceedings
Under Chapter 13

Case No. 97-41750

OPINION

Creditor, Central Illinois Public Service ("CIPS"), objects to confirmation of the debtors' amended Chapter 13 plan ("Chapter 13 plan"), asserting that the plan improperly excludes CIPS from receiving its pro-rata share of payments to unsecured creditors. After the debtors' Chapter 13 bankruptcy filing, CIPS obtained relief from stay and applied a security deposit, made in a previous Chapter 7 case, to the debtors' prepetition indebtedness. The debtors contend that by reason of CIPS' application of this security deposit, CIPS has already collected the amount it would have received as an unsecured creditor under the debtors' Chapter 13 plan. They argue, therefore, that their plan properly excludes CIPS from receiving further payments to prevent unfair discrimination against other creditors.

Debtor Mary Smiley initially filed an individual Chapter 7 case on September 25, 1997. At that time, she owed \$2,236.68 on her account with CIPS. This account, 08-150-041-2280-5, was for service from May 5, 1997, through September 25, 1997. CIPS subsequently requested and obtained a security deposit in the amount of \$340 to assure payment for service during the

bankruptcy proceeding. Thereafter, on October 29, 1997, debtors Mary and James Smiley filed a joint Chapter 13 bankruptcy case.¹ At that time, Mary Smiley owed \$190.67 on account 08-150-041-2280-6 for service from September 25, 1997, through October 29, 1997.

Following the debtors' joint Chapter 13 filing, CIPS requested a second security deposit of \$340 for service during the Chapter 13 case. CIPS further filed a motion for relief from stay to apply the first security deposit toward prepetition indebtedness. The debtors failed to respond, and CIPS' motion was granted. CIPS then applied the \$340 security deposit from the Chapter 7 proceeding, together with interest of \$1.53, to account 08-150-041-2280-5, reducing the debtors' total indebtedness to CIPS to \$2,085.82. In objecting to the debtors' plan, CIPS asserts that it was entitled to apply Mary Smiley's security deposit in the Chapter 7 case towards her prepetition indebtedness either as a recoupment arising from the parties' reciprocal obligations or because the deposit constituted collateral securing her obligation to CIPS. CIPS maintains that its application of the security deposit served merely to reduce, not eliminate, CIPS' claim against the debtors in their subsequent Chapter 13 proceeding. Consequently, CIPS argues, it should receive further payment on the remaining indebtedness -- the deficiency remaining after

¹ Mary Smiley's motion to dismiss her Chapter 7 case was granted by this Court on November 25, 1997.

recovery of its collateral -- under the debtors' Chapter 13 plan.

The Court is unaware of any case that considers the issue of a utility's application of a security deposit in the context of determining objections to confirmation of a Chapter 13 plan. For the most part, decisions concerning the application of security deposits have dealt with the necessity for obtaining relief from stay before a utility can apply such a deposit against the debtor's past due bills. Courts in these cases have employed one or both of the theories advanced by CIPS here, reasoning either that relief from stay is not necessary because application of the security deposit constitutes recoupment, not prohibited by the automatic stay, rather than setoff, see In re McMahon, 129 F.3d 93, 95-98 (2d Cir. 1997); In re Norsal Industries, Inc., 147 B.R. 85, 89 (Bankr. E.D.N.Y. 1992), or, alternatively, that under applicable regulatory provisions, payment of the security deposit evidences an intent to guarantee the debtor's obligation, entitling the utility to relief from stay to realize on its collateral. See Brooks Shoe Mfg. Co. v. United Telephone Co., 39 B.R. 980, 982 (E.D. Pa. 1984); see also In re Thomas, Nos. 91-1677, 91-8086, 1991 WL 643146, at *4-6 (Bankr. D.S.C. 1991). Another court, also considering the violation from stay issue, rejected a utility's claim that it was entitled, as a secured creditor, to retain monies deposited, finding that in order for a security deposit to constitute collateral, it was necessary to hold such monies in a segregated

account. See In re Voight, 24 B.R. 983, 985 (Bankr. N.D. Tex. 1982).

The debtors, citing Voight, maintain that due to CIPS' failure to segregate Mary Smiley's security deposit in a separate account, CIPS holds no secured position regarding this deposit and is not entitled to retain the \$340 as collateral securing payment of their debt to CIPS. They assert that CIPS' claim as an unsecured creditor in this Chapter 13 proceeding has been satisfied by its receipt of the \$340 security deposit. Thus, they contend, allowing CIPS further payments under the plan would result in unfair discrimination toward other unsecured creditors.

The Court finds it unnecessary to characterize the security deposit here as either collateral securing the debtors' obligation or as a means of collecting on unsecured debt because, under the facts of this case, CIPS' right to retain the deposit depends on its character as a security deposit under § 366(b) of the Bankruptcy Code. See 11 U.S.C. § 366(b). Unlike the present case, the decisions relied upon by the parties, Brooks Shoe and Voight, were concerned exclusively with prepetition security deposits required by utilities under applicable state regulations. Here, by contrast, CIPS obtained the deposit at issue only when, after Mary Smiley's bankruptcy filing, CIPS invoked § 366(b) requiring the debtors to provide "adequate assurance" of payment for service after the petition date.

Section 366 gives debtors protection from a cutoff of service after filing bankruptcy, providing in subsection (a) that a utility may not "alter, refuse or discontinue service" solely because of the bankruptcy filing or because of nonpayment of a bill that would be discharged in the case. See 11 U.S.C. § 366(a). Subsection (b), in turn, protects the utility by requiring the debtor to provide assurance of payment for service supplied after the bankruptcy filing. Thus, § 366(b) states that a utility may refuse service if the debtor fails to furnish "adequate assurance of payment, in the form of a deposit or other security, for service after [the] date [of the order of relief]." 11 U.S.C. § 366(b) (emphasis added).

Because § 366(b) explicitly limits a debtor's guarantee of payment to amounts incurred for service after the bankruptcy filing, a clear delineation exists between indebtedness existing at the time of filing and that arising after commencement of the case. Thus, a utility may properly apply a prepetition security deposit to a debt incurred prior to bankruptcy, see In re Miner Industries, Inc., 119 B.R. 6, 8 (Bankr. D.R.I. 1990), or, conversely, may apply a § 366(b) security deposit made after filing to a debt for service following bankruptcy. See In re Begley, 41 B.R. 402, 409 (E.D. Pa. 1984), aff'd 760 F.2d 46 (3d Cir. 1985). In Begley, the court found that the utility had used the § 366(b) "adequate assurance" deposit "for precisely the purpose for which the deposit was intended -- to pay for postpetition electricity service in the event of [the debtors']

delinquency." Id. While the Begley court had no need to employ the doctrine of recoupment to support the utility's right to the § 366(b) deposit at issue, use of this doctrine by other courts in approving a utility's application of a prepetition deposit to prepetition debt emphasizes that bankruptcy creates a cleavage between prepetition and postpetition indebtedness. Recoupment is allowed in such cases because the parties' claims -- the debtor's claim to return of the security deposit and the utility's claim to payment for service -- arise from the "same transaction." See McMahon, 129 F.3d at 97; Norsal Industries, 147 B.R. at 88-89. There is, however, no similar justification for a utility to apply a prepetition security deposit to postpetition indebtedness or, contrarily, to apply a § 366(b) security deposit made postpetition to prepetition indebtedness. Cf. In re Coleman, 52 B.R. 1, 3 (Bankr. S.D. Ohio 1985) (prepetition security deposit and postpetition deposit made under § 366(b) are "entirely independent matters").

In this case, the \$340 security deposit in Mary Smiley's initial Chapter 7 case was made pursuant to § 366(b) and provided assurance to CIPS that it would receive payment for service furnished during that proceeding. The security deposit had no relation to prepetition debt that had accrued on Mary Smiley's account prior to the Chapter 7 filing. Mary Smiley's bankruptcy filing thus effected a division between prepetition debt existing at the time of filing and postpetition debt accruing subsequently -- a distinction recognized by CIPS in

setting up a new account, 08-150-041-2280-6, for service after the date of filing. Although, at the time of the debtors' subsequent Chapter 13 case, there was an arrearage of \$190.67 on this account, CIPS applied the \$340 security deposit, made to assure payment in the Chapter 7 case, to account 08-150-041-2280-5, which represented indebtedness that had accrued prior to the Chapter 7 filing. This was an impermissible use of the § 366(b) security deposit from the Chapter 7 case, as this deposit could only be applied to indebtedness accruing "for service after [the] date [of the order of relief]" in the Chapter 7 case. For this reason, CIPS' application of the \$340 security deposit to account 08-150-041-2280-5, representing prepetition debt incurred before the Chapter 7 filing, would result in its receiving greater than its proportional share of payments if it were paid the amount of its asserted claim under the debtors' Chapter 13 plan.

The same conclusion follows if the Court analyzes this case under the theory advanced by CIPS that the \$340 security deposit constituted collateral securing the debtors' obligation to pay past due utility bills. Although CIPS cites state regulatory provisions governing a utility's right to request security deposits from customers,² the security deposit here was made

² CIPS has adopted "terms and conditions" for service which incorporate rules and regulations of the Illinois Commerce Commission concerning security deposits required by utilities. See 83 Ill. Adm. Code, 280.70 (1997). These "terms and conditions" provide that CIPS may require a reasonable deposit "to secure the prompt payment of bills[.]"

pursuant to § 366(b), which specifically limits any guarantee of payment to debts for service provided after the filing of a bankruptcy case. As such, the security deposit did not serve to secure payment of any bills that accrued prior to the Chapter 7 filing, and the regulatory provisions cited by CIPS have no bearing on its rights as a creditor in this proceeding.³

The Court's finding that CIPS improperly applied the \$340 security deposit at issue to prepetition indebtedness does not, however, entirely settle the question of the amount of payments CIPS should receive under the debtors' Chapter 13 plan. Since CIPS would be entitled to apply the § 366(b) deposit in the Chapter 7 case to indebtedness accruing during that proceeding, determination of CIPS' remaining unsecured debt in this Chapter 13 case must take into account its right to apply the Chapter 7 deposit to the \$190.67 owing on account 08-150-041-2280-6. The balance wrongfully applied to account 08-150-041-2280-5, which the Court calculates as \$150.86, shall go toward reducing the amount of any remaining payments due CIPS as an unsecured creditor in the debtors' Chapter 13 case. Accordingly, CIPS' objection to confirmation of the debtors' plan is sustained in part and overruled in part. The debtors are granted leave to file, within 20 days, any amended plan

³ CIPS could, of course, have invoked these regulatory provisions to require a security deposit from the debtors prior to bankruptcy, but evidently chose not to do so.

found to be necessary to comply with this Court's opinion.

SEE WRITTEN ORDER.

ENTERED: March 31, 1998

/s/ KENNETH J. MEYERS
UNITED STATES BANKRUPTCY JUDGE