UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

Not For Publication

----------X

In re:

BOUSA INC. f/k/a
BULK OIL (USA) INC.,

Chapter 11
Case No. 89-B-13380 (JMP)

Debtor.

----------X

MEMORANDUM DECISION AND ORDER MODIFYING THE AUTOMATIC STAY TO EFFECT A SETOFF

APPEARANCES:

UNITED STATES ATTORNEY FOR THE
SOUTHERN DISTRICT OF NEW YORK
Attorney for the United States
86 Chambers Street, 4th Floor
New York, NY 10007

Michael J. Garcia, Esq.
Joseph A. Pantoja, Esq.

BECKER, GLYNN, MELAMED & MUFFLY LLP
Attorneys for Bousa, Inc.
299 Park Avenue
New York, NY 10171

Michael Zeb Landsman, Esq.
Jesse T. Conan, Esq.
Of Counsel

JAMES M. PECK
UNITED STATES BANKRUPTCY JUDGE

Before the court is a controversy regarding the right of three agencies of the federal government, the Internal Revenue Service ("IRS"), the Environmental Protection Agency ("EPA"), and the former United States Custom Service, now Department of Homeland Security,

U.S. Customs and Border Protection ("Customs" and together with the IRS and EPA, the "Government"), to assert a setoff against BOUSA, Inc. f/k/a Bulk Oil USA, Inc. ("BOUSA" or the "Debtor") of mutual prepetition obligations under the particular facts of this remarkably old bankruptcy case. The question presented is whether the Government has a right to setoff, and if so, whether it waived that right as a consequence of not expressly preserving it (1) in proof of claim forms filed against the Debtor many years ago, (2) by not objecting to confirmation of the Debtor's plan and (3) by not pleading a right to setoff as an affirmative defense or counterclaim in post-confirmation litigation brought by the Debtor against Customs in the Court of International Trade ("CIT").

The litigation in the CIT produced a settlement that called for Customs to pay over $4 million to the Debtor, but the Government has withheld payment of the full amount due pending a determination of its asserted right to setoff amounts claimed by the Government against the Debtor. The impact of permitting setoff is significant and will adversely affect other creditors of the Debtor's estate. If a setoff is authorized, the Government will be entitled to a credit of almost $2 million against amounts otherwise payable to the Debtor, thereby sharply cutting distributions to other unsecured creditors under the Debtor's confirmed liquidating plan.

Procedural Background

Bankruptcy Judge Cornelius Blackshear entered an order dated November 18, 2004 denying the Government's motion for relief from the automatic stay for authorization to effect a setoff. The Government appealed from that order. In a memorandum opinion and order dated June 13, 2005, District Judge Peter K. Leisure vacated Judge Blackshear's order and remanded this matter for further findings of fact and conclusions of law in accordance with 28 U.S.C. § 157(c)(1). The District Court opinion did not address the merits of the legal dispute regarding

the right to setoff and found that the record on appeal was insufficient to permit effective appellate review of the Bankruptcy Court's November 18, 2004 order.

Following Judge Blackshear's retirement in March, 2005, the case was assigned to Judge Lifland and was reassigned to me when I was appointed in January, 2006. Two status conferences were held (one before Judge Lifland and a second after reassignment of the case) to consider procedures applicable to the remand and a briefing schedule. The parties opted to rely upon their briefs previously filed in connection with the District Court appeal of Judge Blackshear's order denying the motion to authorize a setoff. The Debtor and the Government presented oral argument on July 26, 2006 and, at the Court's request, submitted supplemental briefs on August 23, 2006.[1] The underlying facts are undisputed, and whether the Government has a right to setoff at this stage of the bankruptcy case is purely a legal question.

After consideration of the papers submitted by the parties and oral argument, the Court concludes, despite the passage of an unusually long period of time before first formally articulating a right to setoff, that the Government did not waive its right to setoff mutual debts within the meaning of § 553 of title 11 of the United States Code, as amended (the "Bankruptcy Code"), and grants the Government's Motion for Authorization to Effect a Setoff for the reasons set forth in this Memorandum Decision and Order.

Factual Background

BOUSA is a New York corporation that imported petroleum products into the United States. On December 29, 1989, BOUSA filed for protection under chapter 11 of the Bankruptcy

[1] By letter sent to the parties on the date of oral argument (Docket No. 184), the Court asked for limited additional briefing on: (1) whether the rules of procedure applicable to cases in the CIT permit the assertion of state law based claims and defenses (such as setoff); (2) whether the Government's failure to plead a right to setoff in the CIT litigation constitutes a waiver in light of the filing years earlier of proofs of claim by the Government in the BOUSA bankruptcy case; and (3) if a waiver has occurred, whether the Government could rescind such waiver and reinstate its right to a setoff.

Code. Prior to filing for bankruptcy relief, BOUSA had annual sales of over $500,000,000, but incurred $400,000,000 of debt due to falling oil prices in conjunction with the financial difficulties of its European affiliates. On its schedule of assets, filed contemporaneously with its chapter 11 petition, BOUSA noted an anticipated lawsuit against Customs for recovery of excessive duties.

On October 5, 1990, the EPA filed a proof of claim in the chapter 11 case for an unsecured non-priority claim of $536,250 to satisfy BOUSA's outstanding balance under a settlement agreement. On August 16, 1993, the IRS filed a proof of claim for a priority claim of $148,420.24 and a general claim of $4,261.53 to satisfy liability for failure to file tax returns covering dates in 1988 and 1989.

On January 28, 1992, Customs filed an amended proof of claim for an unsecured non-priority claim of $882,494.86.[2] This claim arose from due and owing Customs duties, plus interest, imposed on eight shipments of petroleum products that BOUSA imported in 1985 and 1986.

On December 12, 1990, BOUSA commenced two separate actions in the CIT concerning the classification of tariffs assessed on BOUSA imports in 1985 and 1986. The CIT (Judge R. Kenton Musgrave) determined that it lacked jurisdiction over 10 of the 21 disputed importations on June 9, 1993.[3] The Bankruptcy Court confirmed BOUSA's Liquidating Plan for Reorganization (the "Plan") on July 31, 1995. The IRS objected to the Plan, but withdrew that objection upon the stipulation that the proceeds of recovery in a separate litigation would be applied to the IRS debt.

[2] Customs' original proof of claim was filed on April 26, 1990 for an unsecured and unidentified amount.
[3] Accordingly, Judge Musgrave transferred those actions to the District Court, which in turn referred the actions to the Bankruptcy Court. These actions are currently pending.

The claims remaining in the CIT were eventually settled pursuant to a stipulated judgment, dated July 11, 2003.[4] Under the terms of the settlement, Customs was required to pay $4,361,473.18 to the Debtor. Customs paid BOUSA $2,384,298.66 on August 25, 2003, but held back $1,977,174.52 "in abeyance" pending disposition of its motion to lift the stay and effect a setoff.

On February 13, 2004 the IRS and EPA filed motions with the Bankruptcy Court for relief from the automatic stay to effect setoff. On June 7, 2004 Customs filed the same motion. The Bankruptcy Court consolidated the motions and heard oral arguments on October 27, 2004. At the hearing, BOUSA argued that (1) the Government waived setoff rights by failing to assert them earlier in the BOUSA bankruptcy, and (2) the Government had violated the automatic stay by withholding the balance of BOUSA's refund in the CIT action "in abeyance." The Government argued (1) it was entitled to relief from the stay pursuant to § 362(d)(1) of the Bankruptcy Code, and (2) it had not violated the automatic stay because it did not intend to effect a setoff, nor did any records or actions reflect such an intention at the time it withheld a portion of the CIT refund.

On November 18, 2004, Judge Blackshear issued an order stating that, upon consideration of the parties' briefs, pleadings, exhibits, and oral argument, "pursuant to the Court's rulings stated on the record in open court with respect to the Government's Motions," those motions were denied.[5]

The Government filed a timely appeal on November 29, 2004. On June 13, 2005, the District Court detailed the facts of the appeal, expressed concern as to whether the Bankruptcy

[4] *Bousa, Inc. v. United States*, No. 90-12-00658 (Ct. Int'l Trade Apr. 21, 2003).

[5] Following the October 27, 2004 oral arguments, Judge Blackshear denied the government's motion and reserved the right to issue a written opinion if necessary for appeal; however, no opinion was written prior to the appeal, and the only writing setting forth the Bankruptcy Court's ruling was the November 18, 2004 order.

Court considered the relevant factors before denying the requested relief[6] and remanded the contested matter to this Court for findings of fact and conclusions of law.

The Government's motion requests that the court lift the automatic stay to permit the netting of amounts owed the Government by BOUSA against amounts still owed to BOUSA by virtue of the stipulated judgment in the CIT. BOUSA challenges the right to setoff at this point in the case, contending that whatever right to setoff that at one time may have existed was waived by the Government during the prolonged procedural history of this case.

Discussion

The Government's motion for stay relief requires the Court to determine whether a right to setoff exists as a matter of law, and if so, whether it has been lost by reason of knowing and intentional acts and omissions of the Government in this bankruptcy case and in the CIT litigation. That is the threshold issue here. If there exists a right to a setoff that has not been waived by conduct, the Government is entitled to relief from the automatic stay to apply the funds now held in abeyance to satisfy its claims against BOUSA. The motion should be granted only upon a finding that the Government has a right to setoff and has not waived that right.

I. Right to Setoff

Although the Bankruptcy Code does not establish a right of setoff, §553 is widely recognized as preserving any right to setoff under applicable non-bankruptcy law. 11 U.S.C. §553(a); *Citizens Bank of Maryland v. Strumpf*, 116 U.S. 286, 289 (1995). Initially, the Court must consider whether, regardless of waiver questions, the Government has a right of setoff

[6] Specifically, the District Court cited to the Bankruptcy Court's lack of discussion of the factors laid out in *Sonnax v. Tricomponent Prod. Corp (In re Sonnax Indus., Inc.)*, 907 F.2d 1280, 1286 (2d Cir. 1995), that shape the analysis of whether to grant relief from the automatic stay pursuant to § 362(d)(1) of the Bankruptcy Code in the Second Circuit.

under applicable nonbankruptcy law. The requirements for a setoff are generally recognized to include the following: (1) the amount owed by the debtor must be a prepetition debt; (2) the debtor's claim against the creditor must also be prepetition; and (3) the debtor's claim against the creditor and the debt owed the creditor must be mutual. *See, e.g., In re Ionosphere Clubs, Inc.*, 164 B.R. 839, 841 (Bankr. S.D.N.Y. 1994).

The Government has met the first and second requirements. BOUSA's debt to the Government arose prepetition and the Government's claim against BOUSA also arose prepetition. For purposes of setoff, a debt arises when all transactions necessary for liability have occurred, regardless of whether the claim was contingent when the petition was filed. *United States v. Gerth*, 991 F.2d 1428, 1433 (8th Cir. 1993). BOUSA argues that the Government's debt arose postpetition and the Government is estopped from asserting otherwise because it admitted the debt arose postpetition in a letter-brief to Judge Blackshear on October 25, 2004. Upon review of that letter-brief, the Court finds no such admission. The Government's debt to BOUSA is properly considered a prepetition obligation, despite the fact that it did not become fixed until entry of a postpetition judgment, because it arose when the Government imposed excessive customs duties on oil shipped prepetition in 1986 and 1987. By the time BOUSA filed the petition, the Government had performed all acts required for its liability to occur regardless of BOUSA's postpetition CIT litigation. *Id.* at 1433-34 ("dependency on a postpetition event does not prevent a debt from arising prepetition…A debt can be absolutely owing prepetition even though that debt would never have come into existence except for postpetition events."). Customs' debt to BOUSA was contingent at the commencement of the case and became fixed postpetition, but it is properly characterized as prepetition debt. Indisputably, BOUSA's debts to the Government all arose prepetition from

taxes, tariffs or duties assessed against BOUSA or stipulations relating to transactions occurring before the petition date.

The Government has also met the third requirement of mutuality even though the IRS and EPA are seeking to setoff debt owed to BOUSA by Customs, because federal agencies are deemed to be a single party for purposes of setoff. *Cherry Cotton Mills v. United States*, 327 U.S. 536, 537 (1946); *Aetna Cas. & Surety Co. v. LTV Steel Co. (In re Chateaugay)*, 94 F.3d 772, 779 ("[T]he [Department of Labor] possesses a common law right to setoff its nontax debts against tax refunds."). Therefore, unless waived, the Government has a right to setoff.

II. Waiver of Right to Setoff

BOUSA contends that the Government waived its right to setoff (1) by virtue of its failure to assert a right to setoff in its proofs of claim, (2) by failing to object to the plan filed by BOUSA and (3) by failing to assert the right to setoff in the Government's pleadings in the CIT litigation. In examining each of these contentions to determine if the Government waived its right to setoff, the Court must assess whether the Government acted or failed to act in a manner reflecting a knowing, voluntary and intentional relinquishment of that legal right. *See, e.g., United States v. Johnson*, 391 F.3d 67, 75 (2d Cir. 2004), *citing Johnson v. Zerbst*, 304 U.S. 458, 464 (1938) (defining waiver as an "intentional relinquishment or abandonment of a known right or privilege"); *In re Frank Santora Equipment Corp.*, 256 B.R. 354, 370-71 (Bankr. E.D.N.Y. 2000) ("[a] waiver is the voluntary and intentional relinquishment or abandonment of a *known existing* legal right.") (emphasis added); *City of New York v. State*, 40 N.Y.2d 659, 669, 389 N.Y.S.2d 332 (1976) (under New York law, a waiver is "the intentional relinquishment of a known right with both knowledge of its existence and an intention to relinquish it").

A. The Proofs of Claim

BOUSA's first contention is that the Government waived its right of setoff because the EPA, Customs and the IRS filed proofs of claim that made no mention of any setoff rights and classified the amounts due from BOUSA as unsecured. Moreover, in the case of the IRS, the form stated, "[t]his claim is not subject to any setoff or counterclaim, except NONE." The IRS's prior statement that the claim is not subject to setoff does not defeat the Government's current assertion of a right to setoff against amounts due from the Government to the Debtor because the stipulated judgment in the CIT was not docketed until approximately ten years after the filing of the IRS claim (and so did not become fixed and noncontingent until that date). Additionally, the setoff in question is not one that reduces the IRS claim against BOUSA but one that, if allowed, reduces the net amount payable by Customs to the Debtor's estate.

The Government had no judgment in the CIT when the various proofs of claim were filed against BOUSA, and so had no right to setoff at that time. *See In re Westchester Structures, Inc.*, 181 B.R. 730, 740 (Bankr. S.D.N.Y. 1995); *In re Prudential Lines*, 148 B.R. 730, 751-52 (Bankr. S.D.N.Y. 1992), *aff'd in part and reversed in part on other grounds*, 170 B.R. 222 (S.D.N.Y. 1994), *appeal dismissed*, 59 F.3d 327 (2d Cir.1995); *Trojan Hardware Co. v. Bonacquisti Const. Corp.*, 534 N.Y.S.2d 789 (3d Dep't 1988) (holding that creditor had no right to offset contingent debt, as that debt was dependent upon the outcome of litigation between the parties). Because no right to setoff of mutual debts arose until a decade later upon entry of the stipulated judgment, no waiver occurred when the Government filed proofs of claim for unsecured amounts that did not identify a then contingent and unmatured potential debt from the Government to BOUSA that might never materialize. Also, BOUSA knew that it had a contingent claim against Customs and knew that the Government had filed proofs of claim in its bankruptcy case. Consequently, this is

not a situation in which BOUSA or its creditors were unaware of the possibility that setoff might be claimed by the Government in the future.

Whether or not formally stated by the Government in proof of claim forms, BOUSA knew the circumstances that might lead the Government to request authority to offset the mutual debt and claims involving BOUSA. The Debtor's Disclosure Statement dated March 3, 1995 at page 12 disclosed the pending litigation against Customs relating to misclassification of gasoline shipments and mentioned the relationship between the mutual debts and claims in the following sentence: "BOUSA seeks to recover $2,000,000 and the cancellation of more than $628,000 of claims of U.S. Customs against BOUSA."[7] Thus, BOUSA itself recognized and highlighted for creditors the existence of claims by and against Customs.

Beyond Disclosure Statement language, case law in this Circuit and elsewhere supports the view that the failure to include language in a proof of claim reserving the right to assert a future setoff against the Debtor does not require finding a waiver of the setoff. In a case decided under the former Bankruptcy Act, the Second Circuit held that amendment of a proof of claim after the bar date that changed a claim from unsecured to secured status for purposes of effecting a setoff was proper when no party had detrimentally relied on the previous failure to properly classify the claim. *Chassen v. United States*, 207 F.2d 83, 83 (2d Cir. 1953). Although BOUSA argues that *Chassen* no longer applies because of the changes to the meaning of "claim" under the Bankruptcy Code, courts have continued to cite *Chassen* following enactment of the Bankruptcy Code. *See, e.g., Canzano v. Ragosa (In re Colarusso)*, 280 B.R. 548, 560 (Bankr. D. Mass. 2002); *In re Britton*, 83 B.R. 914, 920 (Bankr. E.D.N.C. 1988).

[7] *See* Exhibit J attached to the affidavit of Kevin Olson, Docket No. 144.

In *AETNA Casualty & Surety Co. v. LTV Steel Company (In re Chateaugay Corp.)*, 94 F.3d 772, 777 (2d Cir. 1996), the Court of Appeals acknowledged that some courts have held a failure to assert the right to setoff in a proof of claim is a waiver, but noted that other courts have found the right to setoff may be preserved even if it has not been asserted in the proof of claim. In *United States v. Fleet Bank of Massachusetts (In re Calore)*, 288 F.3d 22, 40-41 (1st Cir. 2002), for example, the First Circuit noted, "as a general matter, a creditor's silence in the early stages of bankruptcy proceedings, such as the filing of a proof of claim, does not waive the right of setoff." On the basis of this case authority and in light of the contingent nature of the debt owed by Customs to the Debtor that required many years of litigation to finally resolve, the Court finds that the Government did not knowingly and intentionally give up its right to a setoff by failing to reserve rights in proofs of claim filed in BOUSA's bankruptcy case.

B. Failure to Object to Confirmation and Plan Issues

BOUSA's second contention is that the Government waived its right to setoff by failing to object to or vote against BOUSA's plan of reorganization. The Second Circuit typically affords confirmation of a plan res judicata effect, preventing the assertion of claims not preserved in the plan. *See Silverman v. Tracar, S.A. (In re American Preferred Prescription)*, 255 F.3d 87, 92 (2d Cir. 2001); *Katz v. I.A. Alliance Corp. (In re I. Appel Corp.)*, 300 B.R. 564, 567 (S.D.N.Y. 2003).

BOUSA relies on the holding in *Continental Airlines*, 134 F.3d 536, 542 (3d Cir. 1998), in which the Third Circuit held that confirmation of the debtor's Chapter 11 plan extinguished the government's right of setoff. The *Continental Airlines* court reaffirmed its earlier holding in *United States v. Norton*, 717 F.2d 767 (3d Cir. 1983) (setoff is not permitted after confirmation), ruling: "We recognize that a right of set-off is preserved under § 553 in a bankruptcy proceeding

but we believe that the right must be exercised by the creditor in timely fashion and appropriately asserted in accordance with other provisions of the Bankruptcy Code." *Continental Airlines*, 134 F.3d at 541.[8]

In *Daewoo International (America) Corp. Creditor Trust v. SSTS America Corp.*, 2003 WL 21355214, at *5 (S.D.N.Y. June 11, 2003), this district followed the reasoning of *Continental* but also held that the right to setoff did not survive plan confirmation because setoff was specifically prohibited in the plan confirmed by the bankruptcy court. Similarly, in *In re Lykes Brothers Steamship Company, Incorporated*, 217 B.R. 304, 307 (Bankr. M.D. Fla. 1997), the plan stated,

> "Entities that have held, currently hold or may hold a Claim or other Debt, Liability or Equity Interest that is discharged pursuant to the terms of the Plan are and shall be permanently enjoined and forever banned to the fullest extent permitted by law from taking any of the following actions on account of any such discharged Claims, Debts, Liabilities or Equity Interests . . . (d) asserting a setoff . . . ."

BOUSA argues that the liquidating plan confirmed in this case on July 31, 1995 should also be interpreted as a bar to setoff because of the classification and treatment of claims under that plan and the fact that the Government's claims are not listed as being subject to setoff. For this

[8] There is a split among the circuits on this issue. In *In re De Laurentiis Entertainment Group Inc.*, 963 F.2d 1269, 1276-77 (9th Cir. 1992), *cert. denied*, 506 U.S. 918, 121 L. Ed. 2d 249, 113 S. Ct. 330 (1992), the Ninth Circuit ruled that a right of setoff survives even if the claimant fails to file an objection prior to plan confirmation. The *De Laurentiis* court ascribed supremacy to the language and structure of § 553, as well as the precedence given the setoff provision under the Bankruptcy Act, and found that "[the language of § 553] seems intended to control notwithstanding any other provision of the Bankruptcy Code. To give § 1141 precedence would be to ignore this language." *Id*. It noted that if the other provisions were interpreted to take precedence over § 553, setoffs would be allowed in bankruptcy only if they were included in a plan of reorganization, and such a result would render § 553 superfluous since a setoff could be added to a reorganization plan even without § 553. *Id*. at 1277. The *De Laurentiis* court also reviewed equitable considerations, noting that if not for the right of setoff, some creditors would find themselves in the unenviable position of having to pay their debts to the debtor in full, but only receiving a small fraction of the money owed to them by the debtor. *Id*. Similarly, in *In re Davidovich*, 901 F.2d 1533,1539 (10th Cir. 1990), the Tenth Circuit reasoned that a creditor's right to setoff is a universally recognized right grounded in principles of fairness. On this basis it declined to adopt a posture that would unfairly "deny a creditor the right to recover an established obligation while requiring the creditor to fully satisfy a debt to a debtor." *Id*.

reason, BOUSA urges that the plan in this case has the same preclusive effect with respect to setoff as the plans in *Daewoo* and *Lykes*.

But the relevant section of BOUSA's confirmed plan simply provides, "The classification and treatment of Claims and Interests, and all distributions made on account of Allowed Claims or Stock Interests, shall be in full and complete satisfaction, release, and discharge of all such Claims and Interests."[9] This release language relating to classification and treatment of claims and distributions to holders of such claims is not equivalent to an express prohibition of the right to setoff. The language used in the liquidating plan simply does not speak directly to the right of setoff, does not include provisions similar to that in *Daewoo* or *Lykes* and is insufficient to extinguish setoff rights, or to put any creditor on adequate notice that it was required to object to the Plan in order to preserve those rights. The absence of specific language in the plan defeats BOUSA's argument.

"[C]onfirmation of a debtor's plan of reorganization does not extinguish prepetition setoff rights, especially of secured creditors *where the plan does not specifically treat those setoff rights*, irrespective of whether any given holder of the right fails to assert it prior to confirmation." *In re Bare*, 284 B.R. 870, 874 (Bankr. N.D. Ill. 2002) (emphasis added) (holding that IRS was not barred from effecting a setoff after plan confirmation, notwithstanding that it had asserted an unsecured, priority tax claim and had not objected to confirmation of the plan). Thus, because BOUSA's plan does not treat setoff rights explicitly and does not prohibit a setoff by any creditor after confirmation, the Government's failure to object to the plan does not constitute a waiver of the right to setoff.

[9] Article 6, section 6.1. *See* Exhibit K attached to the affidavit of Kevin Olson, Docket No. 144.

C. Failure to Plead Setoff in the CIT

BOUSA's third contention is that the Government waived the right to setoff by not raising setoff as a defense or counterclaim in the CIT action. During oral argument, BOUSA's counsel focused attention on this omission and suggested that the Court could simply rely on the CIT pleadings to find a waiver and decide in favor of the Debtor. In support of this position, BOUSA cited to the Second Circuit's decision in *Valley Disposal, Inc. v. Central Vermont Solid Waste Management Distribution*, 113 F.3d 357, 365-66 (2d Cir. 1997), which held that a defendant may not refuse to pay a money judgment against it without having asserted a counterclaim during the litigation. This case, when read in conjunction with authorities cited by the Government in its supplemental brief, leads the Court to conclude, despite some superficial similarities between this case and the situation in *Valley Disposal*, that the failure to plead setoff did not constitute a waiver of setoff by the Government. As explained below, no waiver has occurred because the pleading rules with respect to counterclaims in the CIT differ somewhat from those in the District Court, and it is the bankruptcy forum, not the CIT, that must determine whether setoff still remains available under the circumstances.

In *Valley Disposal*, Judge Kearse found that the defendant waived the right to bring a setoff claim for an award of attorneys' fees by failing to bring this claim to the attention of the District Court prior to the fee award more than a year after it concededly could have done so. The Court of Appeals reviewed the pleading requirements under Rule 13 of the Federal Rules of Civil Procedure providing that a setoff, if one is to be asserted, must be raised in a pleading during the lawsuit by means of a counterclaim in the answer to the complaint. Rule 13 deals with both compulsory counterclaims arising out of the same occurrence or transaction as the claim of the plaintiff and permissive counterclaims that do not arise out of the same occurrence

or transaction. In the case of a permissive counterclaim, the failure to assert the counterclaim has no estoppel effect that would prevent assertion of the claim in a later suit. *Valley Disposal*, 113 F.3d at 364. The defendant there was not required to assert its setoff claim in order to preserve its rights in some other action, although the failure to plead did bar setoff in the District Court litigation.

Valley Disposal does not limit the Government's ability to setoff the claims against BOUSA from amounts now payable to the Debtor. The Government's setoff claims are permissive counterclaims that arise from transactions unrelated to those underlying the CIT litigation. *See Valley Disposal*, 113 F.3d at 364; *see also, Fin. One Pub. Co. v. Lehman Bros. Special Fin., Inc.*, 414 F.3d 325, 336 (2d Cir. 2005) *citing Cipa Mfg. Corp. v. Allied Golf Corp.*, 1995 WL 337022, at *2 (N.D. Ill. June 1, 1995); *United States v. Bonneau Co.*, 12 C.I.T. 246, 248-249 (Ct. Int'l Trade 1988). Notably, the pleading rules applicable to litigation in the CIT, the Rules of the United States Court of International Trade ("CIT Rules"), are more restrictive than those in the District Court. The version of Rule 13 of the Federal Rules of Civil Procedure applicable to CIT proceedings does not make counterclaims compulsory and does not grant exclusive jurisdiction over counterclaims unless such claims arise out of the same transactions as those presented in the plaintiff's complaint.

Rule 13 of the CIT Rules requires that:

> A pleading shall state as a counterclaim any claim which at the time of serving the pleading the pleader has against any opposing party, **if (1) the claim involves the imported merchandise that is the subject matter of the civil action**, or (2) the claim is to recover upon a bond or customs duties relating to such merchandise.

Fed. Ct. Int'l Trade R. 13-1(a) (2006) (emphasis added).

Only claims involving the same imported merchandize shall be made by counterclaim. Here, the claims that give rise to the right to setoff against sums payable under the stipulated judgment are

unrelated to the subject matter of the CIT litigation. The claims of the IRS and EPA are obviously different from the subject matter of the CIT action, and even the claim filed by Customs in this bankruptcy case relates to separately identified shipments that are not the subject of the CIT litigation.

The CIT has exclusive jurisdiction with respect to a counterclaim that involves imported merchandise that is the subject matter of the action then pending before it. 28 U.S.C. § 1583; *U.S. v. Lun May*, 652 F. Supp 721, 723 (Ct. Int'l Trade 1987). Given the nature of the Government's claims for setoff, the CIT is not the only forum with jurisdiction to hear such claims. The IRS, EPA and Customs had already filed those claims with the Clerk of the Bankruptcy Court, and BOUSA understood that these claims were on file in its bankruptcy case while it was prosecuting litigation against Customs in the CIT to recover amounts for the benefit of its creditors.

Unlike *Valley Disposal*, where claims, at the election of the pleader, could be asserted or not against the plaintiff in the District Court, holders of prepetition claims against BOUSA were required to file them only in the Bankruptcy Court. Moreover, until the BOUSA bankruptcy case is closed or dismissed, the Bankruptcy Court under the language of the confirmed liquidating plan has continuing jurisdiction to allow and reconcile all claims against the estate.[10] The CIT litigation was a separate and specialized proceeding that dealt with particular claims by BOUSA against Customs and was not the exclusive or even the proper forum to address unrelated claims of the Government against BOUSA that were already on file in BOUSA's bankruptcy case.

[10] Article 12 of the plan provides that the Bankruptcy Court retains jurisdiction to determine claims and to fix or liquidate claims. *See* Exhibit K at page 21 attached to the affidavit of Kevin Olson, Docket No. 144.

In sum, given the nature of litigation in the CIT, the limited exclusive grant of the CIT's jurisdiction over counterclaims and the scope of relevant issues that can be raised in that court in response to a complaint against Customs, the failure of Customs to assert a counterclaim for setoff for itself, the IRS or the EPA does not amount to a waiver of the right to setoff amounts owed by BOUSA to the Government from amounts owed by Customs to BOUSA.

III. Automatic Stay

A. Administrative Freeze is not a Violation of Automatic Stay

Independent of its arguments regarding waiver, BOUSA contends that the Government's motion to lift the automatic stay also should be denied because the Government violated the stay when it withheld almost $2 million owed to BOUSA under the stipulated CIT judgment pending resolution of the setoff issue. BOUSA claims that the Government, without court approval, has already effected a setoff by holding back the disputed funds. This contention is without merit under applicable law.

The United States Supreme Court held in *Citizens Bank of Maryland v. Strumpf*, that a creditor did not violate the automatic stay when it refused to pay its debt not "permanently and absolutely, but only while it sought relief under § 362(d) from the automatic stay." 516 U.S. at 19. Section 362(a)(7) of the Bankruptcy Code, staying setoff of prepetition debts, does not require immediate payment of a debt subject to setoff, "for forcing the creditor to pay *its* debt immediately" would "divest the creditor of the very thing that supports the right of setoff," thereby rendering meaningless § 553(a)'s general rule that the Bankruptcy Code does not affect the right of setoff. *Id.* at 20. Because the Government has not actually effected a setoff, but rather has held the disputed funds in a suspense account in BOUSA's name without distribution to the IRS or EPA pending the resolution of this motion, it has not violated the automatic stay.

B. Cause for Relief From the Automatic Stay

In deciding whether to modify the automatic stay, one of the factors the court must consider is the impact of the stay on the parties and the balance of harms. *Sonnax v. Tricomponent Prod. Corp. (In re Sonnax Indus., Inc.)*, 907 F.2d at 1286. Equity favors setoff and thus a creditor's valid setoff right should not be disallowed "unless compelling circumstances require it…The statutory remedy of setoff should be enforced unless the court finds after due reflection that allowance would not be consistent with the provisions and purposes of the Bankruptcy Act as a whole." *Bohack Corp. v. Borden, Inc.*, 599 F.2d 1160, 1164 (2d Cir. 1979). As stated in *Citizens Bank v. Strumpf,* the very purpose of allowing setoff is to permit "entities that owe each other money to apply their mutual debts against each other, thereby avoiding the absurdity of making A pay B when B owes A." 516 U.S. at 18. Granting relief from the stay to permit the Government to exercise its right of setoff will avoid this absurdity described by the Supreme Court, is consistent with the provisions of the Bankruptcy Code and does not impose undue harm on the Debtor's estate.

Although the Government's proposed setoff of amounts payable to the estate pursuant to the CIT stipulated judgment will diminish distributions to other creditors, the setoff has no effect on BOUSA's plan of liquidation, which was confirmed over eleven years ago and made no promises to any unsecured creditor regarding the amount that might be realized from future litigation recoveries. This case is an antique, and it is difficult to conceive of an ongoing justification for the automatic stay to remain in effect other than to maintain the status quo pending resolution of this contested matter. Having found that the Government's right to setoff has not been lost, the Court grants relief from the stay to permit the exercise of that right by the Government. In accordance with Rule 4001(a)(3) of the Federal Rules of Bankruptcy Procedure,

this grant of relief is stayed until the expiration of ten days after the date of entry of this Memorandum Decision and Order.

IV. Conclusion

The Court has determined that the Government has a right to setoff that was not waived by any acts or failures to act of the Government and that is not prohibited by any provision of BOUSA's plan. For the reasons set forth in this Memorandum Decision and Order, the Motion for Authorization to Effect a Setoff is hereby granted.

Dated: New York, New York
September 29, 2006

s/ James M. Peck
Honorable James M. Peck
United States Bankruptcy Judge