UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF OHIO

In Re	)	
	)	**JUDGE RICHARD L. SPEER**
Ottawa River Steel Co.	)	
	)	Case No. 02-3073
Debtor(s)	)	
	)	(Related Case: 01-31282)
Elizabeth Vaughan, Trustee	)	
	)	
Plaintiff(s)	)	
	)	
v.	)	
	)	
Kerry Steel, Inc.	)	
	)	
Defendant(s)	)	

MEMORANDUM OPINION AND DECISION

This cause comes before the Court upon the Plaintiff/Trustee's Motion for Summary Judgment. In said Motion, the Plaintiff/Trustee seeks to avoid and then recover for the benefit of the Debtor's estate, certain prepetition transfers made by the Debtor to the Defendant. This Court has now had the opportunity to review the arguments of Counsel, the exhibits, as well as the entire record of the case. Based upon that review, and for the following reasons, the Court finds that the Plaintiff's Motion for Summary Judgment should be Denied.

FACTS

On March 13, 2001, an involuntary petition was initiated against the Debtor, Ottowa River Steel Company (hereinafter the "Debtor"), under Chapter 7 of the United States Bankruptcy Code; the order for relief was thereafter entered on June 15, 2001, in accordance with 11 U.S.C. § 303(h).

Upon the order for relief being entered, the Plaintiff, Elizabeth Vaughan, was appointed as bankruptcy trustee (hereinafter "Trustee"). After appointment, the Trustee, on March 21, 2002, initiated the instant adversary proceeding seeking to avoid and thereafter recover for the benefit of the estate, two types of transactions that took place between the Debtor and the Defendant, Kerry Steel: (1) $88,763.25 in preferential payments pursuant to § 547(b); and (2) $196,006.24 as a preferential setoff under § 553(b). Relative to these claims are the below stated facts.

Prior to the time the involuntary petition was filed, the Defendant, Kerry Steel (hereinafter "Kerry"), and the Debtor had business relationship, wherein each party had both mutual accounts receivable and accounts payable against the other. As it concerns this relationship, the facts presented in this case show that on December 13, 2000, exactly ninety days prior to the time the involuntary petition was filed, the Debtor owed Kerry $371,108.86, and Kerry owed the Debtor $164,068.03. (Doc. 20, Ex. B & C).

During the time period between December 13, 2000, and the filing of the involuntary petition, Kerry made two credits against the Debtor's indebtedness totaling $338,547.24: (1) $282,629.10 credited on January 29, 2001; (2) $55,918.14 credited on February 23, 2001. (Doc. 20, Ex. D & F). After applying these credits, the Debtor's outstanding indebtedness to Kerry was reduced to $11,034.59. In addition, during this same time period, the Debtor issued three checks to the Defendant totaling $88,763.25: (1) $12,463.62 issued on December 15, 2000; (2) $32,819.63 issued on December 20, 2000; and (3) $43,480.00 issued on January 16, 2001. (Doc. 6, Ex. A). These checks were issued on various invoices that were between 93 and 123 days old. A review of the Debtor's payment history shows that invoices from Kerry were, on average, paid approximately 70 days after their issuance, but that on some occasions the invoices were not paid until well over 90 and even 100 days after their issuance. (Doc. No. 30, Ex. 1).

LAW

11 U.S.C. § 547. Preferences

(b) Except as provided in subsection (c) of this section, the trustee may avoid any transfer of an interest of the debtor in property–

(1) to or for the benefit of a creditor;

(2) for or on account of an antecedent debt owed by the debtor before such transfer was made;

(3) made while the debtor was insolvent;

(4) made–

(A) on or within 90 days before the date of the filing of the petition; or

(B) between ninety days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider; and

(5) that enables such creditor to receive more than such creditor would receive if–

(A) the case were a case under chapter 7 of this title;

(B) the transfer had not been made; and

(C) such creditor received payment of such debt to the extent provided by the provisions of this title.

(c) The trustee may not avoid under this section a transfer–

(2) to the extent that such transfer was–

(A) in payment of a debt incurred by the debtor in the ordinary course of business or financial affairs of the debtor and the transferee;

(B) made in the ordinary course of business or financial affairs of the debtor and the transferee; and

(C) made according to ordinary business terms;

11 U.S.C. § 553. Setoff

(b)(1)Except with respect to a setoff of a kind described in section 365(h), 546(h), or 365(i)(2) of this title, if a creditor offsets a mutual debt owing to the debtor against a claim against the debtor on or within 90 days before the date of the filing of the petition, then the trustee may recover from such creditor the amount so offset to the extent that any insufficiency on the date of such setoff is less than the insufficiency on the later of–

(A) 90 days before the date of the filing of the petition; and

(B) the first date during the 90 days immediately preceding the date of the filing of the petition on which there is an insufficiency.

(2) In this subsection, "insufficiency" means amount, if any, by which a claim against the debtor exceeds a mutual debt owing to the debtor by the holder of such claim.

DISCUSSION

Determinations concerning administration of the debtor's estate; orders to turn over property of the estate; proceedings to determine, avoid, or recover preferences; and other proceedings affecting the liquidation of the assets of the estate are core proceedings pursuant to 28 U.S.C. § 157. Thus, this case is a core proceeding.

This cause comes before the Court upon the Defendant's Motion for Summary Judgment. The standard for summary judgment is set forth in Fed.R.Civ.P. 56, which is made applicable to this proceeding by Bankruptcy Rule 7056, and provides for in pertinent part: A movant will prevail on a motion for summary judgment if, "the pleadings, depositions, answers to interrogatories, and

admissions on file, together with affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law." *Celotex Corp. v. Catrett*, 477 U.S. 317, 106 S.Ct. 2548, 91 L.Ed.2d 265 (1986). In order to prevail, the movant must demonstrate all the elements of the cause of action. *R.E. Cruise, Inc. v. Bruggeman*, 508 F.2d 415, 416 (6th Cir.1975). Thereafter, upon the movant meeting this burden, the opposing party may not merely rest upon their pleading, but must instead set forth specific facts showing that there is a genuine issue for trial. *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 250, 106 S.Ct. 2505, 2511, 91 L.Ed.2d 202 (1986). Inferences drawn from the underlying facts must be viewed in a light most favorable to the party opposing the motion. *Matsushita v. Zenith Radio Corp.*, 475 U.S. 574, 586-88, 106 S.Ct. 1348, 1356, 89 L.Ed.2d 538 (1986).

One of the primary goals of the Bankruptcy Code is to ensure the equal treatment of similarly situated creditors. *In re Dupuis*, 265 B.R. 878, 880 (Bankr. N.D.Ohio 2001). To this end, the Bankruptcy Code confers upon the trustee certain powers to avoid those types of transfers which, if left in place, would allow one creditor to receive a distribution, of what would otherwise be estate assets, ahead of other similarly situated creditors. As applied to this case, the Trustee seeks to avoid a total of $284,769.49 in prepetition transfers made by the Debtor to Kerry. As authority for this action, the Trustee relies on the avoidance powers set forth in Bankruptcy Code §§ 553(b) and 547(b). The applicability of these sections will now be addressed, beginning with § 553(b).

Section 553(b) allows a trustee to recover a setoff made by a creditor in the period immediately preceding the filing of the debtor's bankruptcy petition. Section 553(b) thus sets forth an exception to the general rule that a creditor's prepetition right to setoff survives bankruptcy. This exception, however, only applies when, in the 90-day period immediately preceding the filing of the debtor's bankruptcy petition, a creditor improves its position with respect to its right of setoff. *In re Summit Fin. Serv., Inc.*, 240 B.R. 105, 121 (Bankr. N.D.Ga 1999). The policy underlying this rule

is to discourage creditors from artificially creating or enlarging their right to setoff during the debtor's slide into bankruptcy. *In re Rehab Project, Inc.*, 238 B.R. 363, 370 (Bankr. N.D.Ohio 1999).

To establish if a creditor has improved their setoff position within the 90-day period immediately preceding the filing of the debtor's bankruptcy petition, a strict mathematical formal is employed. This mathematical formula is done by calculating the "insufficiency" on the date the last setoff occurred with the "insufficiency" on the ninetieth (90th) day prior to the filing of the debtor's bankruptcy petition or if there was no insufficiency on this day, then on the first day in which there was an insufficiency. For purposes of this analysis, an insufficiency is statutorily defined under subsection (b)(2) of § 553 as the "amount, if any, by which a claim against the debtor exceeds a mutual debt owing to the debtor by the holder of such claim." Once these figures are established, a comparison is then made, and to the extent that the "insufficiency" on the ninetieth (90th) day is greater than the "insufficiency" on the date the last setoff occurred, such an amount constitutes an improvement in position, and is therefore avoidable by the bankruptcy trustee under § 553(b). *Id.*

In applying all of the credits given by Kerry to the Debtor, the above formula yields an improvement in position of $196,006.24. Neither Party disputes this figure. Kerry, however, argues that some of those credits it gave against the Debtor's indebtedness should not be utilized in the § 553(b) formula because the credits were not based upon its right to setoff, but rather upon its right of recoupment.

Although similar in many respects, the doctrine of setoff differs from recoupment in that a right to setoff is a mutual obligation which arises out of separate transactions, while the right of recoupment, which is essentially a counterclaim, arises out of the same transaction. *In re Nickerson & Nickerson, Inc.*, 62 B.R. 83, 87 (Bankr. D.Neb.1986). This difference has lead to the well-established rule in bankruptcy that a creditor who holds a right of recoupment is not subject to the rules and restrictions governing a setoff in bankruptcy, including the avoiding powers of a trustee

under § 553(b). *See*, *e.g.*, *Warsco v. Household Bank, F.S.B*, 272 B.R. 246, 252-53 (Bankr. N.D.Ind. 2002); *Matter of McDonald*, 224 B.R. 862, 870 (Bankr.S.D.Ga.1998); *In re Miner Indus., Inc.*, 119 B.R. 6 (Bankr.D.R.I.1990); *In re Yonkers Hamilton Sanitarium Inc.*, 22 B.R. 427, 432 (Bankr. S.D.N.Y.1982), *aff'd*, 34 B.R. 385 (S.D.N.Y.1983).

In arguing for the existence of the recoupment doctrine, Kerry, in its Memorandum in Opposition to the Trustee's Motion for Summary Judgment, stated:

> There were dozens if not hundreds of transactions between [Kerry] and the Debtor which led to the contras (setoffs) of $282,629.10 and $55,918.14 on which the Trustee bases her claim. Most of these transactions are simply sales and purchases back and forth between [Kerry] and the Debtor and the netting of one against the other does constitute a setoff as described in § 553. Some of those transactions, however, did not arise from mutual sales, but arose because of defective steel sold by the Debtor to the Defendant and/or due to a myriad of other types of claims that the Defendant had against the Debtor from other types of breaches. These are recoupments, not setoffs and no consequences should attach to them since they are in the nature of recovery of damages.

(Doc. No. 25, at pg. 4). This statement was supported by the affidavit of Kerry's Vice-President of Finance. (Doc. No. 25).

Undoubtably, a claim for damages arising because of a faulty product creates a right of recoupment with respect to any claim of remuneration sought by the seller for the faulty product. *In re Asset Recovery Grp, Inc.*, 261 B.R. 825, 829 (Bankr. W.D.Pa. 2001). Notwithstanding, the Trustee argues that the Court should not accept Kerry's position on recoupment because, contrary to its promise to do otherwise, it failed to submit any factual data to support this position. (Doc. No. 30, at pg. 3). The Court, however, must reject this argument.

To being with, while the Court agrees that specific factual data should have been submitted as promised, the lack thereof is not necessarily fatal with a motion for summary judgment. This is because to defeat a motion for summary judgment, the nonmovant must merely show that there exists a genuine factual issue to be resolved; specific factual data, although helpful in this regard, is not absolutely necessary when, as is the situation here, an affiant with first hand knowledge of the issue attests to its existence. In addition, and lending credibility to Kerry's supporting affidavit, is the fact that rights of recoupment typically exist in manufacturing companies, such as the Kerry and the Debtor, which do a significant amount of business together. Therefore, for these reasons, the Trustee's Motion for Summary Judgment on its cause of action under § 553(b) will be Denied.

The next issue raised in this matter concerns the Trustee's action to recover, as a preferential transfer under § 547(b), the $88,763.25 in payments issued by the Debtor to Kerry during the time period between December 13, 2000, and the filing of the involuntary petition. Kerry, although not disputing that these payments meet the technical definition of a preferential transfer under § 547(b), defends against the Trustee's action on two different grounds: (1) a double recovery theory; and (2) the ordinary course of business defense set forth in § 547(c)(2).

The double recovery theory espoused by Kerry is based upon the premise that the § 547(b) preference which the Trustee seeks to recover was already included in the "insufficiency" calculations under § 553(b), and therefore should not be again recoverable as a preference under § 547. From strictly a legal standpoint, this position is correct for a couple of reasons. First, § 550(d) specifically limits a trustee to "a single satisfaction" when a transfer is avoided under either § 547 or § 553.[1] Second, the purpose of the trustee's avoiding powers does not include providing a windfall

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This section provides that, "[t]he trustee is entitled to only a single satisfaction under subsection (a) of this section." In turn, subsection (a) states, in pertinent part, that ". . . to the extent that a transfer is avoided under section . . . 547 . . . 553(b), the trustee may recover, for the benefit of

to the estate, but as already discussed, is designed to prevent one creditor from receiving an advantage over another similarly situated creditor. *In re Dupuis*, 265 B.R. at 880.

At the present time, however, there exists insufficient evidence to establish, one way or the other, the veracity of the Kerry's position. This is because while Kerry credited the Debtor's account a total of $338,547.24 during 90 days prior to the filing of the instant bankruptcy, the "insufficiency" at the 90-day mark preceding the bankruptcy filing stood at just $207,040.83, a difference of $131,506.41. Thus, a determination must be made what part, if any, of the $88,763.25 in alleged § 547 preferential payments made by Kerry during the 90-day preference period are attributable to the additional $131,506.41 credited against the Debtor's account, and therefore outside the scope of a double recovery.

In addition to raising the defense of a double recovery, Kerry also raises what is known as the "ordinary course of business" defense to the existence of a preferential transfer. This defense, which is set forth in § 547(c)(2), provides that a transfer, despite being preferential under § 547(b), may not be avoided by the trustee if three conditions are met: (1) the transfer was made in payment of a debt incurred by the debtor in the ordinary course of business or financial affairs of the debtor and the transferee; (2) the transfer was made in the ordinary course of business or financial affairs of the debtor and the transferee; and (3) the transfer was made according to ordinary business terms. As this is an affirmative defense, it is the transferor's burden to establish these elements by a preponderance of the evidence. *Miller v. Florida Mining and Materials (In re A.W. & Assoc., Inc.)*, 136 F.3d 1439, 1441 (11th Cir.1998). In support of its compliance with these elements, Kerry submitted an affidavit from its Vice President of Finance, wherein it was stated that it is common and ordinary in the steel industry for payments to be made approximately 90 days from the invoice

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the estate, the property transferred . . ."

date and that it was the arrangement between Kerry and the Debtor to make payments at around the 90-day mark.

As it applies to the latter statement, the evidence in this case shows that, on average, the Debtor paid Kerry's invoices not 90 days after receipt, but instead approximately 70 days after receipt. According to the Trustee this deviation in payment history demonstrates that those transfers made during the 90-day preference period were not in the ordinary course pursuant to § 547(c)(2)(B). The Court, however, while it agrees that this change in payment history does raise some suspicion, does not believe that looking at averages is the sole factor which controls whether a transfer is made during the ordinary course of business for purpose of § 547(c)(2). This is because averages alone fail to take into account extraneous factors such as seasonal influences on performance in certain industries or the fact that the unusual weight of individual figures can lead to erroneous averages. *Speco Corporation v. Canton Drop Forge, Inc. (In re Speco Corporation)*, 218 B.R. 390, 398 (Bankr.S.D.Ohio 1998). Instead, given such considerations, it is also helpful to look at the range of the payments dates. *Youthland, Inc. v. Sunshine Girls of Florida, Inc. (In re Youthland, Inc.)*, 160 B.R. 311, 315 (Bankr.S.D.Ohio 1993).

In this regard, the facts of this case show that on an intermittent basis, the Debtor did pay many of Kerry's invoices after 90 days, with many also being paid well over 100 days after the invoice was issued. As such, the Court feels that, in complying with the summary judgment mandate of giving the nonmoving party the benefit of all reasonable doubts and inferences, a genuine issue exists regarding whether Kerry should be afforded the ordinary course of business defense as set forth in § 547(c)(2). Therefore, based upon this finding, together with the fact that there exists a triable issue concerning Kerry's double recovery defense, the Trustee's Motion for Summary Judgment will be denied with respect to her preference claim under § 547(b).

In reaching the conclusions found herein, the Court has considered all of the evidence, exhibits and arguments of counsel, regardless of whether or not they are specifically referred to in this Opinion.

Accordingly, it is

ORDERED that the Motion for Summary Judgment submitted by the Plaintiff/Trustee, Elizabeth Vaughan, be, and hereby, DENIED.

It is ***FURTHER ORDERED*** that this matter be, and is hereby, set for a Further PreTrial on Friday, June 13, 2003, at 1:30 P.M., in Courtroom No. 1, Room 119, United States Courthouse, 1716 Spielbusch Avenue, Toledo.

Dated:

Richard L. Speer
United States
Bankruptcy Judge