Mary Ann Whipple
United States Bankruptcy Judge

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF OHIO
WESTERN DIVISION

In Re:	)	Case No. 05-70084
	)	
Converse W. Keefer, Jr.	)	Chapter 7
	)	
Debtor.	)	
	)	JUDGE MARY ANN WHIPPLE

MEMORANDUM OF DECISION RE TRUSTEE'S APPLICATION TO COMPROMISE

Chapter 7 Trustee Ericka S. Parker filed an Application to Compromise ("Application") [Doc. # 263], seeking approval of a Settlement and Assignment Agreement and Release ("Agreement") between the Trustee and David Ball, STS Restaurant Management Inc. ("STS") and CAD Properties LLC ("CAD") (collectively "Ball") under which the Trustee sought to sell to Ball certain assets of the bankruptcy estate, namely, a 50% interest in Keefer Construction Services LLC, a 100 % interest in Keefer Building Company LLC, and a 25% interest in Warehouse Partners, Ltd ("Warehouse Partners") ("the Assets") and to assign to Ball the claims alleged by Debtor against David Ball, STS and CAD in adversary case no. 06-3263 ("the Bankruptcy Court Litigation"), claims asserted by Debtor in five state court cases involving both Debtor and Ball ("the State Court Litigation"), and the right to assert a fraudulent conveyance claim against Keefer concerning the prepetition transfer of his residence to his non-filing spouse ("Fraudulent Conveyance Claim"). [Doc. # 278]. As consideration for the sale of the Assets and assignment of claims, the agreement provides that Ball will pay $13,700 and will withdraw proofs of claim # 15 and 16, in the amounts of $189,484.04 and $269,078.03, respectively. [*Id.*].

Debtor objected to the Application, [Doc. # 266], arguing that the Agreement does not serve the best interests of the bankruptcy estate. At a hearing held on June 11, 2008, Debtor stated he did not dispute the reasonableness of the consideration to be paid by Ball. However, he objected to the timing of the sale because, according to Debtor, the claims being sold are also his defenses by way of setoff and/or recoupment in the separate dischargeability action brought by David Ball, STS, CAD and Superior Investment (pending Adv. Pro. No. 07-3112) wherein he will attempt to show the nonexistence of any debt owed by him to Ball.

In response, the Trustee and Ball filed an amended Agreement ("Amended Agreement") that addressed Debtor's objection. [Doc. # 278, Ex. A]. The Amended Agreement provides that "[i]t is expressly understood and agreed that the Trustee is selling and assigning only the Bankruptcy Estate's affirmative claims, not any defenses, setoff, recoupment or similar rights that the Debtor may have with respect to Ball's objection to the Debtor's discharge and/or the dischargeability of a debt." [*Id.* at ¶ 4]. Debtor objects to the Amended Agreement, again arguing that the sale/assignment of claims prior to a determination in the dischargeability proceeding will be prejudicial to him. [Doc. # 279]. He, therefore, asks the court to defer ruling on the Application until after the dischargeability determination is made.

Finding that the above-quoted language of the Amended Agreement, and thus the intent of the parties (i.e. the Trustee and Ball), is ambiguous and that the ambiguity affected the court's ability to decide the Trustee's motion, the court set this matter for further hearing to determine the construction intended by the parties. The court set forth the following two possible constructions of the language quoted above.

Given the fact that the Agreement was amended for the purpose of, among other things, addressing Debtor's objection that the sale of claims would impair his ability to defend the dischargeability action, one construction is that the Trustee is assigning only the estate's "offensive" interest in the claims asserted by Debtor in the Bankruptcy Court Litigation and the State Court Litigation but that she is abandoning the estate's interest in the claims to the extent that they can be used defensively. *Cf. Davis v. Sun Oil Co.*, 148 F.3d 606, 612 (6th Cir. 1998) (stating that claim-splitting is precluded except where "the parties have agreed in terms or in effect that the plaintiff may split his claim, or the defendant has acquiesced therein"). Under this construction, Debtor would then "own" the defensive use of the claims and could assert the claims in Ball's dischargeability proceeding in an effort to negate an element of Ball's claim, the existence of a debt owed by him to Ball, *see Sheehan v. Wiener (In re Wiener)*, 228 B.R. 647 (Bankr. N.D. Ohio 1998) (finding debt dischargeable where the debtor would be able to exercise either a right of setoff or recoupment to totally eliminate the plaintiff's claim), but that he could not assert the claims in an effort to obtain a

judgment against Ball for affirmative relief in the dischargeability proceeding or in any other litigation.

Alternatively, a second construction of the quoted language in the Amended Agreement is simply that the Trustee is not selling anything that Debtor is otherwise entitled to raise in defending against Ball's dischargeability claim. To the extent that setoff and/or recoupment are "rights that the Debtor may have," [*see* Doc. # 278, Amended Agmt, ¶ 4], they are not being sold. However, the Amended Agreement does not enlarge Debtor's rights where none now exist. Recoupment is a defense that allows a party to reduce its liability on a plaintiff's claim and involves matters that arise out of the same transaction forming the basis of the plaintiff's claim. *See Gober v. Terra+Corp. (In re Gover)*, 100 F.3d 1195, 1208 (5th Cir. 1996); *Brown v. General Motors Corp.*, 152 B.R. 935, 938 (Bankr. W.D. Wis. 1993) (citing *Mullen v. United States*, 696 F.2d 470, 472 (6th Cir. 1983); *In re Jones*, 289 B.R. 188, 192 (Bankr. M.D. Fla. 2002). Setoff, on the other hand, is a counterclaim, not a defense; it need not arise out of the same transaction and must rest upon an independent claim that is enforceable in its own right. *See, e.g., In re New Haven Foundry, Inc.*, 285 B.R. 646, 648 (Bankr. E.D. Mich. 2002). Under the second construction, Debtor could raise a recoupment defense, since a defense without an affirmative right to recovery is not an asset of the estate that can be sold, but he could not assert a claim for setoff, which necessarily rests upon a claim owned by the estate that is now sought to be sold.[1] *See Bemas Constr., Inc. v. Dorland (In re Dorland)*, 374 B.R. 765, 775 (Bankr. D. Colo. 2007) (finding the debtor lacked standing to assert a counterclaim of setoff in a dischargeability proceeding where the trustee had not abandoned the claim); *PM Factors, Inc. v. Kreisel (In re Kreisel)*, 2008 Bankr. LEXIS 2164 (Bankr. C.D. Cal., August 14, 2008).

At the hearing held on September 25, 2008, attorneys for Ball and for the Trustee both agreed that the first interpretation set forth above is the construction they intended. They agree that Debtor can assert both a recoupment defense and any counterclaims in an attempt to negate an element of Ball's dischargeability claim (i.e. the existence of a debt owed by him to Ball), but that he cannot use the counterclaims offensively to obtain a money judgment against Ball. Based on this construction of the Amended Agreement, the court considers the Trustee's Application to Compromise.

The Bankruptcy Code provides that "[t]he trustee, after notice and a hearing, may . . . sell . . . , other than in the ordinary course of business, property of the estate." 11 U.S.C. § 363(b)(1). The standard for approval of a proposed sale of estate assets under § 363(b) has been explained as follows:

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[1] It is not clear to the court at this juncture whether the claims asserted by Debtor in the Bankruptcy Court Litigation involve matters that arise out of the same transactions that form the basis for the alleged debt asserted by Ball in the pending nondischargeability action.

> [C]ourts generally apply standards that, although stated in various ways, represent essentially a business judgment test. Some courts have described the standard as one of "good faith" or of whether the transaction is "fair and equitable." Others question whether the sale is "in the best interest of the estate." In the context of sales of substantially all of the assets of the estate, some courts have required that the price to be paid be "fair and reasonable."

In re Frezzo, 217 B.R. 985, 988-89 (Bankr. E.D. Pa. 1998) (quoting 3 Alan N. Resnick, et al., *Collier on Bankruptcy* ¶ 363.02[1][g] (15th ed. Revised)). Similarly, to the extent that the Trustee's assignment of claims to Ball, the party against whom the claims are alleged, can be construed as a settlement or compromise of those claims, approval of the compromise depends on whether the compromise is fair and equitable. *Olson v. Anderson (In re Anderson)*, 377 B.R. 865, 870 (B.A.P. 6th Cir. 2007). "The court must weigh the conflicting interests of all relevant parties, 'considering such factors as the probability of success on the merits, the complexity and expense of litigation and the reasonable views of creditors.'" *Id.* at 870-71 (quoting *Bauer v. Commerce Union Bank*, 859 F.2d 438, 441 (6th Cir. 1988)).

In this case, no creditors have objected to the Application to Compromise or the Amended Agreement. And no interested party has disputed the reasonableness of the consideration to be paid by Ball. The only objection to the Application is that of Debtor based on his argument that the assignment of the State Court Litigation and Bankruptcy Court Litigation claims against Ball will prejudice him in his defense in the dischargeability proceeding as those claims are asserted as affirmative defenses by Debtor in his answer to Ball's dischargeability complaint. However, under the Amended Agreement, as discussed above and as both the Trustee and Ball agree, the Trustee is abandoning the defensive use of the claims asserted by Debtor in his answer. Under the interpretation of the Amended Agreement clarified by the parties, the timing of the compromise will not negatively affect Debtor's defense of the Ball nondischargeability action. Rather the transaction will enhance his defense of that action, as any right of setoff that he would otherwise have been prohibited from asserting because it belonged to the bankruptcy estate under the administration and control of the Trustee can now be defensively pursued by Debtor. Because there is no longer any impediment to his assertion of all relevant defenses and counterclaims, Debtor's objection is overruled.

The Trustee persuasively testified that she has reviewed the State Court Litigation claims, which form the basis of the Bankruptcy Court Litigation claims, and that both Ball and Debtor have "good claims." There is, however, no money in the bankruptcy estate for her to pursue those claims. In light of her abandonment of the defensive use the claims, and given their factual complexity and the fact that there is no clear winner, the court finds the Amended Agreement to be fair and equitable and in the best interests of the estate.

A separate order granting the Amended Application will be entered by the court.