UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

In re	:	CHAPTER 11
	:	(Jointly Administered)
PRINCE SPORTS, INC., *et al.*[1]	:	
	:	Case No. 12-11439 (KJC)
Debtors	:	(Re: D.I. 386)

MEMORANDUM ORDER
DENYING MOTION OF BORDENTOWN INVESTMENTS LLC[2]

BY: KEVIN J. CAREY, UNITED STATES BANKRUPTCY JUDGE

Currently before the Court is the Motion of Bordentown Investments LLC ("Bordentown" or the "Landlord") For an Order (i) Compelling the Debtor to Timely Perform Lease Obligations Under 11 U.S.C. §365(d)(3) and (ii) Allowing and Compelling Payment of Administrative Claim (the "Motion") (D.I. 386). The Reorganized Debtors filed an objection to the Motion (D.I. 410) and a hearing was held on December 4, 2012. For the reasons set forth herein, the Motion will be denied.

Background - Undisputed Facts

The relevant facts are not disputed. The Debtors and their affiliates operate a sporting goods company that develops, sources and markets racquet sports equipment, footwear, apparel

[1]The following chapter 11 bankruptcy cases are being jointly administered pursuant to an order dated May 2, 2012 (D.I. 27): Prince Sports, Inc., Prince Sports Holdings, LLC, Prince Sports Management Holdings, LLC and Prince Sports Acquisition Holdings Corp. (the "Debtors"). Pursuant to the confirmed Debtors' Second Amended Chapter 11 Plan of Reorganization, as amended (D.I. 326-1) (the "Plan"), after the effective date of the Plan, the Debtors (or any successor thereto) became the "Reorganized Debtors."

[2]This Memorandum Order constitutes the findings of fact and conclusions of law required by Fed.R.Bankr.P. 7052. This Court has jurisdiction to decide the matters before it pursuant to 28 U.S.C. §1334 and §157(a). This is a core proceeding pursuant to 28 U.S.C. §157(b)(1) and (b)(2)(A) and (B).

and accessories for tennis and indoor court sports.

On May 12, 2004, Berwind Property, Ltd., as landlord, and debtor Prince Sports, Inc. ("PSI"), as tenant, entered into a Lease, pursuant to which PSI leased certain real property and improvements located at Two Advantage Court, Bordentown, New Jersey. (Ex. 1).[3] The parties entered into three amendments to the Lease dated March 1, 2005, June 19, 2007 and May 2008.[4] (Ex. 2, Ex. 3 and Ex. 4). The Debtors used the Leased Premises for general office purposes, as well as for warehousing and distribution. (Lease, Preamble §J). Bordentown is the successor to the interest of Berwind Properties, Ltd. in the Lease.

Under the terms of the Lease, PSI was obligated to pay rent on the first of each month consisting of (i) a fixed amount in rent based upon the square footage of the Leased Premises, and (ii) an amount set by the Landlord based on the Landlord's estimate of PSI's proportionate share of real estate taxes and operating expenses. (Lease, §6, §7(b), §8(b)). The Lease further provides that if PSI pays more than its share of real estate taxes or operating expenses in a given year, then PSI would be entitled to a credit for the excess amount paid, which PSI could use to offset the next due installment of rent, or, if the Lease term had expired, the Landlord would refund the overpayment to PSI promptly after determining the amount due. (Lease, §7(b)(iv), §8(b)(i)(4)). The parties agreed that PSI and the Landlord applied such credits to rent payments in the years prior to bankruptcy.

On May 1, 2012, the Debtors filed chapter 11 bankruptcy petitions. On July 27, 2012, the

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[3]At the December 4, 2012 hearing, the parties stipulated to the admission of an exhibit binder containing six exhibits.

[4]The Lease and the three amendments are referred to herein, collectively, as the "Lease," and the premises leased to the Debtors pursuant to the Lease is referred to as the "Leased Premises."

Court entered the Findings of Fact, Conclusions of Law and Order Confirming Debtors' Second Amended Plan of Reorganization (D.I. 326). The Debtors rejected the Lease pursuant to the terms of the confirmed Plan, but were required to pay post-petition rent for occupying the Leased Premises during May, June and July 2012.

Prior to the bankruptcy filing, in March 2012, Bordentown prepared a reconciliation of the real estate taxes and operating expenses paid by PSI under the Lease in 2011 and determined that PSI was entitled to a credit for an overpayment of approximately $35,000. (Tr. 28:3 - 28:14). PSI disputed that amount and asked Bordentown to re-calculate it. (*Id.*). Bordentown re-calculated the 2011 reconciliation and, in August 2012, sent the Reorganized Debtors a summary showing that PSI was entitled to a credit of $145,938.01 (the "Summary"). (*Id.*, Ex. 5). PSI had previously applied a credit of $35,957.91 to its rent payment for May 2012.[5] (Response, ¶10). After receiving the Summary, on or about September 12, 2012, the Reorganized Debtors paid the administrative rent claim for July 2012 by deducting the remaining credit due pursuant to the 2011 reconciliation ($109,980.10) (the "Remaining 2011 Credit") from the rent payment due for July 2012, and paying the balance of approximately $25,000 to Bordentown . (*Id.*, Tr. 27:17 - 27:20).

On September 14, 2012, Bordentown filed a proof of claim for lease rejection damages in the amount of $653,226.57, reflecting that part of the claim was secured by a right of setoff based on the "Security Deposit/CAM Reconciliation" in the amount of $342,963.01, leaving an unsecured claim in the amount of $310,263.56. (Ex. 6). Also on September 14, 2012,

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[5]Although it is not clear when PSI paid the rent for May and June 2012, apparently Bordentown had no objection to PSI's set off against the May 2012 administrative rent claim.

Bordentown filed the Motion seeking payment of its administrative rent claim for July 2012 in the amount of $109,980.10. In the Motion, Bordentown argues that the Remaining 2011 Credit should be applied to the lease rejection damage claim, rather than the July 2012 administrative rent claim. The Reorganized Debtors filed an objection to the Motion, asserting that Bordentown's administrative rent claim was paid in full because PSI had appropriately exercised its right to setoff the Remaining 2011 Credit against the rent payment due for July 2012. At oral argument, the Reorganized Debtors also argued that, even if setoff was not available, PSI was entitled to rely on the equitable doctrine of recoupment.

Discussion

The issue before the Court is whether PSI can apply the Remaining 2011 Credit against the amount due for the July 2012 administrative rent claim under the doctrines of either setoff or recoupment. Bordentown argues that neither doctrine is available because the Lease provides that PSI can offset a reconciliation credit against the *next due installment of rent*. The Summary showing the Remaining 2011 Credit was sent to PSI in August 2012 and Bordentown argues that the Lease does not permit PSI to offset rent owed for the *previous* month. Bordentown also argues that PSI could not rely upon the equitable doctrine of recoupment until PSI exercised its contractual remedy under the Lease by setting off the Remaining 2011 Credit against Bordentown's proof of claim for rejection damages.

Bordentown's arguments are not persuasive. "Setoff and recoupment are not dependent on the parties' contract; rather, they are equitable remedies available independent of any contractual remedy." *CDI Trust v. U.S. Electronics, Inc. (In re Commc'n Dynamics, Inc.),* 382 B.R. 219, 226 (Bankr.D.Del. 2008) citing *Univ. Med. Ctr. v. Sullivan (In re Univ. Med. Ctr.)*, 973

F.2d 1065, 1080 (3d Cir. 1992) (noting that "an express contractual right is not necessary to effect a recoupment.").[6] Because both setoff and recoupment are equitable remedies, PSI's right to assert those remedies is not impaired by the Lease provisions.[7]

The Reorganized Debtors argue that they can assert setoff and recoupment against payment of the July 2012 administrative rent claim pursuant to Bankruptcy Code §558, which provides, in pertinent part, that "[t]he estate shall have the benefit of any defense available to the debtor as against any entity other than the estate, including statutes of limitations, statutes of frauds, usury, and other personal defenses." 11 U.S.C. §558. Both common law doctrines of setoff and recoupment have been applied in bankruptcy cases.

The common law doctrine of setoff - - as it is applicable to creditors - - was imported into the Bankruptcy Code through §553(a) (*Lee v. Schweiker,* 739 F.2d 870, 875 (3d Cir. 1984)), but §553(a) restricts a creditor's setoff rights to debts and obligations that arose pre-petition. *Lee,* 739 F.2d at 875; *In re Women First Healthcare, Inc.*, 345 B.R. 131, 134 (Bankr.D.Del. 2006). Section 558 does not include such restrictive language and, consequently, courts have concluded that a debtor may set off pre-petition claims against post-petition obligations it owes. *Women First,* 345 B.R. at 134. Therefore, it does not matter that PSI seeks setoff of a post-petition rent claim, so long as there are valid, mutual debts between the same two parties.

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[6]Other parts of the *University Medical Center* opinion are superceded by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Publ.L. No. 109-8, 105 Stat. 80, as recognized in *In re Mu'min,* 374 B.R. 149 (Bankr.E.D.Pa. 2007). *In re McWilliams,* 384 B.R. 728, 730 (Bankr.D.N.J. 2008).

[7]The Reorganized Debtors prefer to apply the Remaining 2011 Credit against the administrative rent claim, instead of the rejection damages claim, because the Plan provides that general unsecured claims will be paid a pro rata share of a fund to be distributed by the Liquidating Trust and, if the unsecured creditor so elects, a pro rata share of the "Released Parties Contributions," as described in the Plan. (Plan, §4.6, §6.15). The Reorganized Debtors argue that they will not receive any benefit from the Remaining 2011 Credit unless it is applied to decrease the July 2012 administrative rent claim.

Women First, 345 B.R. at 134-35 quoting *Citizens Bank of Md. v. Strumpf*, 516 U.S. 16, 18, 116 S.Ct. 286, 133 L.Ed.2d 258 (1995) (holding that the right of setoff "allows 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'.") (quoting *Studley v. Boylston Nat'l Bank*, 229 U.S. 523, 528, 33 S.Ct. 806, 808, 57 L.Ed. 1313 (1913)). There is no dispute that the parties' debts in this case are mutual.

However, even if the happenstance of when the debts arose would prevent the use of setoff, the Reorganized Debtors still have the right to recoupment in this case.[8] The common law defense of recoupment is incorporated into bankruptcy by decisional law. *Lee,* 739 F.2d at 875 citing *In re Monongahela Rye Liquors,* 141 F.2d 864 (3d Cir. 1944). "Recoupment is the setting up of a demand arising from the same transaction as the plaintiff's claim or cause of action, strictly for the purpose of abatement or reduction of such claim." *Univ. Med. Ctr.*, 973 F.2d at 1079 (internal quotation marks and emphasis omitted) quoting 4 COLLIER ON BANKRUPTCY §553.03 at 553-15-17 (Lawrence P. King, ed., 15th ed. 1992). The *University Medical Center* Court also noted that:

> In the bankruptcy context, recoupment has often been applied where the relevant claims arise out of a single contract "that provide[s] for advance payments based on estimates of what ultimately would be owed, subject to later correction." *In re B&L Oil Co.,* 782 F.2d 155, 157 (10th Cir. 1986).

Univ. Med. Ctr., 973 F.2d at 1080. PSI's rights fit squarely within the doctrine of recoupment. The administrative rent claim and the Remaining 2011 Credit both arise out of the Lease. The Remaining 2011 Credit is essentially a defense to Bordentown's administrative rent claim and,

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[8]Bordentown has not demonstrated, and the Court cannot discern, any basis, for concluding that one remedy takes precedence over the other.

therefore, applying the doctrine of recoupment is justified. *Id.* PSI is entitled to assert recoupment, and the availability of the setoff remedy - - *i.e.,* applying the Remaining 2011 Credit against Bordentown's rejection damages claim - - does not change the analysis.

Accordingly, upon consideration of the Motion and the response thereto, after a hearing, and for the reasons set forth above, it is hereby **ORDERED** that the Motion is **DENIED**.

BY THE COURT:

KEVIN J. CAREY
UNITED STATES BANKRUPTCY JUDGE

Dated: December 11, 2013

cc:: Stuart M. Brown, Esquire[9]

[9]Counsel shall serve a copy of this Memorandum Order upon all interested parties and file a Certificate of Service with the Court.