

**UNITED STATES BANKRUPTCY COURT  
DISTRICT OF DELAWARE**

In re: ) Chapter 7  
)  
AMERICAN REMANUFACTURERS, INC., ) Case No. 05-20022 (PJW)  
et al., )  
) (Jointly Administered)  
Debtors. )  
\_\_\_\_\_)  
)  
MONTAGUE S. CLAYBROOK, )  
Chapter 7 Trustee for the )  
estates of AMERICAN )  
REMANUFACTURERS, INC., et al., )  
)  
)  
Plaintiff, )  
)  
v. ) Adv. Proc. No. 07-51750 (PJW)  
)  
METRO AUTO XPRESS, LLC. trading )  
as TRI-CITY AUTOMOTIVE )  
WAREHOUSE, )  
)  
Defendant. )

**MEMORANDUM OPINION**

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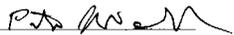
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Dated: July 25, 2008

**WALSH, J.** 

This opinion is with respect to defendant Metro Auto Xpress trading as Tri-City Automotive Warehouse's ("Tri-City" or "Defendant") motion (Doc. # 7) to dismiss Counts Five, Six, Seven, and Eight (the "Alternative Counts") of the complaint brought by the chapter 7 trustee (the "Trustee"). For the reasons discussed below I will grant the motion.

#### **BACKGROUND**

Tri-City is a Colorado limited liability company with its principal place of business in Scottsdale, Arizona. Its main business is wholesale distribution of automotive parts and accessories. The debtor is American Remanufacturers, Inc. and its affiliates (collectively "ARI"). ARI's business involved remanufacturing various automobile parts and selling them to vendors nationwide, and purchasing used parts from its customers for remanufacture and resale. For the purchased used parts, ARI issued a credit to the customer's account. Prior to and after ARI's bankruptcy filing, Tri-City had an ongoing business relationship with ARI; it purchased automotive parts produced by ARI and received credits for used parts sold to ARI. On November 7, 2005, ARI filed petition for relief under chapter 11 of title 11 of the United States Code, § 101, et seq. (the "Bankruptcy Code"). Ten days later, the case was converted to chapter 7. According to the complaint, as of January 12, 2006, Tri-City had an outstanding

obligation of \$218,328.96 for the purchases from ARI of various remanufactured automotive and related parts.

The complaint alleges a total of eight counts, including breach of contract, unjust enrichment, quantum meruit, and turnover of estate property. The counts at issue here are the Alternative Counts, which are Count Five: avoidance of preferential transfers (§ 547); Count Six: avoidance of constructive fraudulent transfers (§ 548); Count Seven: avoidance of impermissible postpetition transfers (§ 549); and Count Eight: recovery of avoided transfers (§550).

The complaint asserts that "[u]pon information and belief, Tri-City alleges that it is entitled to some sort of setoff on the Balance Due in the form of the transfer of credits for the return of goods from the Defendant to the Debtors (the "Setoff"). (Complaint, ¶ 61.) The complaint then asserts that "[t]o the extend the Court finds Tri-City is entitled to the alleged Setoff, then on or within ninety (90) days before the date of the filing of the Petitions (the "Preference Period") and/or following the filing of the Petitions, one or more of the Debtors transferred and/or caused to be transferred, to or for the benefit of Tri-City, at least, the amount of the Setoff (the "Transfers"). (Complaint, ¶ 62.) Thus, according to the complaint, the Setoff constitutes Transfers which are avoidable pursuant to § 547 or § 548 or § 549.

### STANDARD OF REVIEW

The Defendant moves to dismiss certain counts of the complaint pursuant to Rule 12(b)(6) of the Federal Rule of Civil Procedure, which is made applicable to this case by Rule 7012 of the Federal Rules of Bankruptcy Procedure. To survive a motion to dismiss under Fed. R. Civ. P. 12(b)(6), "a plaintiff's obligation to provide the 'grounds' of his 'entitle[ment] to relief' requires more than labels and conclusions, and a formulaic recitation of a cause of action's elements will not do." Bell Atlantic v. Twombly, 550 U.S. \_\_\_, 127 S. Ct. 1955, 1964-65 (2007). The Third Circuit in Phillips v. County of Allegheny, found that the new Twombly standard was not limited to anti-trust claims as in Twombly, but was "intended to apply to the Rule 12(b)(6) standard in general." 515 F.3d 224, 232-33 (3d Cir. 2008). It also held that it "remains an acceptable statement of the standard" that courts in considering a motion to dismiss under Rule 12(b)(6) must: "accept all factual allegations as true, construe the complaint in the light most favorable to the plaintiff, and determine whether, under any reasonable reading of the complaint, the plaintiff may be entitled to relief." Id. at 234 (quoting Pinker v. Roche Holdings, Ltd., 292 F.3d 361, 374 n.7).

### DISCUSSION

As noted above, the complaint expressly conditions the Alternative Counts "[t]o the extent the Court finds Tri-City is

entitled to the alleged Setoff.” (Complaint, ¶ 62.) Thus, the Alternative Counts are premised on the Court finding that Defendant has setoff rights pursuant to § 553.

The Trustee argues that if the Court grants the setoffs, the result would violate the general purpose of the Bankruptcy Code because the Defendant would be elevated to secured creditor status, thus diminishing the estate at the detriment of other creditors. (Doc. # 10, pp. 13-14.) However, as Collier makes clear that is precisely the purpose of a setoff.

As noted by one court, setoff in bankruptcy is the equivalent of a lawful preference. Certainly recognizing the right in bankruptcy often means that the creditor holding the right will be able to recover a greater percentage of his or her claim as compared to other creditors who have no similar entitlement. Given bankruptcy’s bedrock policy of equality of distribution, the Code’s favorable treatment of setoff rights might seem somewhat anomalous. On the other hand, there is little to distinguish between a creditor’s preferred status arising from a right of setoff and the preferred status arising from some other type of security. Section 506(a) recognizes the similarity and treats rights arising through setoff in the same manner as rights arising from a security agreement or other relevant security device. Indeed, a right of setoff has been described as “security of the most perfect kind.”

5 COLLIER ON BANKRUPTCY ¶ 553.02 (Alan N. Resnick & Henry J. Sommers eds. 15th ed. rev. 2008) (footnotes omitted).

For Count Five and Six, the Trustee seeks to avoid the Defendant’s setoffs either as preference transfers pursuant to § 547(b) or a fraudulent transfers pursuant to § 548. However, it is clear that valid setoffs are not avoidable as preferential or

fraudulent transfers for the simple reason that setoffs are not transfers of property of the estate. Again, I refer to Collier on Bankruptcy.

At a minimum, a preference under section 547(b) requires a prepetition "transfer" of an interest of the debtor in property. Similarly, the fraudulent transfer provisions of section 548(a) and the "strong arm" provisions of section 544(b) likewise require a "transfer" that occurred before the commencement of the debtor's case. The term "transfer" is defined in Code section 101, and the definition intentionally omits "setoffs." The legislative history to section 101 explains the omission in clear terms: "Inclusion of 'setoff' is deleted. The effect is that a 'setoff' is not subject to being set aside as a preferential 'transfer' but will be subject to special rules." Similarly, section 553 provides that "this title," i.e., title 11, does not affect setoff rights. Thus, setoff cannot be a preference or a fraudulent transfer.

Id. at ¶ 553.09[1][a] (footnotes omitted) (emphasis added).

With regard to Count Seven, the avoidance of impermissible postpetition transfers, § 549(a) itself provides the answer:

Except as provided in subsection (b) or (c) of this section, the trustee may avoid a transfer of property of the estate -

- (1) that occurs after the commencement of the case; and
- (2) (A) that is authorized only under section 303(f) or 542(c) of this title; or
- (B) that is not authorized under this title or by the court.

If I agree that the Defendant is entitled to setoff, I will have to make a finding that the Defendant is entitled to a setoff right as preserved by § 553. Such a finding would constitute an authorization as contemplated by § 549(a) (1) (2) (B).

Consequently, the Trustee is not entitled to any relief under § 549 either. Finally, because lawful setoffs cannot be avoided, § 550 invoked in Count Eight is not applicable here.

#### **CONCLUSION**

For the reasons stated above, the Defendant's motion to dismiss is granted. Counts Five, Six, Seven, and Eight of the complaint are hereby dismissed.

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ORDER

For the reasons set forth in the Court's memorandum opinion of this date, Defendant's motion (Doc. # 7) to dismiss Counts Five, Six, Seven, and Eight of the complaint is **GRANTED**.



Peter J. Walsh  
United States Bankruptcy Judge

Dated: July 25, 2008