

**UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE**

_____)	Chapter 11
IN RE:)	
)	
PSA, INC.,)	Case Nos. 00-3570 (JCA)
ETS PAYPHONES, INC.,)	through 00-3572 (JCA) and
ETS VENDING, INC. ET AL,)	00-3718 (JCA) through 00-3725
)	
Debtors.)	(Jointly Administered Under
_____		Case No. 00-3570)

MEMORANDUM OPINION¹

Before the Court is the Motion of Legends Communications, Inc. ("Legends"), to compel payment of administrative expense claim. For the reasons stated below we deny the Motion to compel payment of administrative expense claim.

The issue before the Court is whether a postpetition administrative claim owed to Legends may be offset against a prepetition receivable owed to PSA, Inc. ("Debtors") and if so whether Section 553 or 558 of the Bankruptcy Code applies and allows setoff. The Court finds that this claim may be setoff against the prepetition receivable owed to Debtors under § 558.²

I. FACTS

By way of a Stipulation of Facts, the parties agreed to the

¹ This Opinion constitutes the findings of fact and conclusions of law of the Court pursuant to Federal Rule of Bankruptcy Procedure 7052.

² This Court has jurisdiction over this matter, which is a core proceeding, pursuant to 28 U.S.C. §§ 1334 and 157(b) (1), (b) (2) (A), (B), and (O).

following facts:

(1) For purposes of the Motion hearing only, Debtors and Legends stipulate that the amount of post-petition invoices outstanding and due from ETS to Legends is \$140,297.18.

(2) For purposes of the Motion hearing only, Debtors and Legends stipulate that there is a pre-petition receivable due from Legends to ETS Payphones in excess of \$140,297.18. The determination of the actual amount of the receivable is reserved.³

(3) For purposes of the Motion hearing only, Legends reserves and withdraws its request for payment of the invoiced amount for the DS3 connections the internet which totaled \$323,972.64.⁴

II. POSITIONS OF THE PARTIES

Legends filed the present Administrative Claim for payment under 11 U.S.C. § 503(b)(1)(A)⁵ for postpetition services performed. In response to Legends' Motion to Compel Administrative Expenses, Debtors objected on the grounds that the

³ The Court is unaware of any action commenced by Debtors to recover the prepetition receivable.

⁴ There were issues and allegations of fact raised at argument, but these will not be considered here as they were not supported by evidence.

⁵ All statutory references are to the Bankruptcy Code, 11 U.S.C. § 101 et seq., unless otherwise noted.

claim could be setoff (also commonly referred to as offset) by applicable state law against the prepetition receivable as a defense that is preserved for the debtor under section 558. Legends answered Debtors' objection by asserting that § 553 controls and, although that section has been construed to apply to debtors, the mutuality requirement is not fulfilled where the debts are postpetition and prepetition.

III. DISCUSSION

A. § 553

Section 553 provides, in pertinent part:

"(a) Except as otherwise provided in this section and in sections 362 and 363 of this title, this title does not affect any right of a creditor to offset a mutual debt owing by such creditor to the debtor that arose before the commencement of the case under this title against a claim of such creditor against the debtor that arose before the commencement of the case . . ."

11 U.S.C. § 553 (a) (2001).

The § 553 doctrine of setoff gives "a creditor the right to 'offset a mutual debt owing by such creditor to the debtor,' provided that both debts arose before commencement of the bankruptcy action and are in fact mutual." In re University Medical Center, 973 F.2d 1065, 1079 (3d. Cir. 1992), citing, In re Davidovich, 901 F.2d 1533, 1537 (10th Cir. 1990). Since the

present Motion concerns debts that are prepetition and postpetition and the setoff is being asserted by the debtor, we must look to § 558 of the Bankruptcy Code to determine setoff rights.

B. § 558

Section 558 provides:

“The estate shall have the benefit of any defense available to the debtor as against any entity other than the estate, including statute of limitations, statutes of frauds, usury, and other personal defenses. A waiver of any such defense by the debtor after the commencement of the case does not bind the estate.”

11 U.S.C. § 558 (2001) (formerly 11 U.S.C. § 541 (e)).

In order to defeat unjust or improper claims against the estate, “the trustee [or debtor] must be able to assert all the defenses that the Debtor could have asserted had bankruptcy not intervened.” See Papercraft, 127 B.R. at 350 n. 8, citing, 4 *Collier on Bankruptcy* ¶ 558.02 (15th ed. 1991). Debtors cites In re Papercraft Corp., 127 B.A. 346 (Bankr. W.D. Pa. 1991), for authority that § 558 preserves any prepetition defenses a debtor may have. Courts have held that § 558 preserves any right of offset that debtors may have under state law, including the right to offset debtors’ prepetition claims against administrative expense claims. See Papercraft, 127 B.R. at 350; In re M.W.

Ettinger Transfer Co., 1988 WL 129334 at *4 (Bankr. D.Minn. 1988). Specifically, Judge Fitzgerald stated in Papercraft that "because § 558 preserves to the Debtor the defenses it would have had prepetition, the court must examine the transaction as though the bankruptcy had not been filed." See Papercraft, 127 B.R. 346, 350. Examining the transaction this way "eliminates the prepetition/postpetition distinction and, in essence, obliterates the requirement that the mutual debts must both be prepetition obligations in a § 558 context." See Papercraft, 127 B.R. at 350.⁶

Next, the Court must look to applicable Georgia law, due to the fact that both Legends and Debtors are headquartered in Georgia and the amounts involved accrued pursuant to services supplied in Georgia. Westchester Structures, 181 B.R.730, 740 (Bankr. S.D.N.Y. 1995). The Georgia Code allows a Defendant to setoff a debt owed him by the Plaintiff against the claim of the Plaintiff in an action to collect the debt. O.C.G.A. § 13-7-1.⁷

Since § 558 of the Bankruptcy Code preserves Debtors' setoff

⁶ The Court is aware that mutuality has been defined to include a requirement that there be contemporaneous transactions between the same parties. The Court believes that on the present facts the debts must be between the same parties for purposes of mutuality. Therefore since the corresponding debts are between Legends and Debtors, the debts are mutual.

⁷ Section 13-7-1 states: "[s]etoff does not operate as a denial of the plaintiffs claim; rather it allows the defendant to set off a debt owed him by the plaintiff against the claim of the plaintiff." See O.C.G.A. § 13-7-1.

rights as provided by Georgia law and because under § 558 the prepetition/postpetition distinctions are irrelevant, Debtors' may offset Legends' claim against amounts owed to Debtors by Legends. The use of setoff rights does not operate as a denial of Legends' claim, it reduces or eliminates the amount actually paid on account of the claim.

In addition, neither party will be harmed if the Debtors' postpetition debt and prepetition receivable is setoff. Legends will receive the equivalent of a payment through the cancellation of debt that will occur as a result of the setoff. As to Debtors, by allowing setoff, the bankruptcy estate will not be reduced through payment of the obligation, leaving the money in the estate. Furthermore, the Court does not wish to force Debtors to sue Legends in a separate action on its prepetition receivable claim. See Ettinger, 1988 WL 129334 at *4 (holding that debtor could offset prepetition, unpaid rent against lessor's claim for postpetition rent because it is "wholly unjust, improper and foolish" to force debtor to sue the lessor in a separate action on its prepaid rent claim).

Therefore the Court holds that based on § 553 and Georgia law, the \$140,297.18 owed to Legends by Debtors may be setoff against the prepetition receivable owed to Debtors, valued in excess of \$140,297.18 by the parties. The Court believes this is a fair and just result for both parties, given the facts of this

Motion.

IV. CONCLUSION

For the foregoing reasons, we deny Legends' Motion to compel payment of administrative expense claim.

An appropriate order is attached.

BY THE COURT:

Dated: April 19, 2002

John C. Akard
United States Bankruptcy Judge