United States Bankruptcy Court
District of New Mexico

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UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF NEW MEXICO

In re:

DANIEL KRUPIAK,

Alleged Debtor. No. 7-99-10304 SA

AMENDED MEMORANDUM OPINION ON SETOFF[1]

This matter is before the Court on the issue of the availability of offset for any costs, fees, or damages awarded under section 303(i)[2]. The former alleged debtor appeared through his counsel Brad Hays. Creditors Grossjean and Pacific Mutual Door appeared through their counsel Thomas Dawe. Creditor Apodaca Earth Moving appeared through its attorney Donald Becker.

There is currently pending the Debtor's First Amended Motion for Award of Attorney Fees and Costs, for compensation

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[1] On October 16, 2000, the Court filed its Memorandum Opinion on Setoff (Doc. 265). The court is filing this Amended Memorandum Opinion on Setoff to correct a typographical error in the first memorandum opinion. The language on page 5 of the first memorandum stated in part "...subsection (i)(1) would seem, in proper cases, to seek to return the alleged debtor's economic situation to a prefiling state." The reference should have been to subsection (i)(2), as the context makes clear. The opinion also contains additional policy discussion concerning In re Better Care, Ltd., 97 B.R. 405 (Bankr. N.D. Il. 1989). The correction and added language result in no difference in the Court's ruling.

[2]This Court is not deciding, in this Memorandum Opinion whether there should be an award of attorneys fees and costs at all, but only if such an award is made, may it be offset against what all the parties concede is a much larger debt owed by the alleged debtor to the creditors.

of $58,993.74 and expenses of $7,388.59 for representation of the alleged debtor in the involuntary proceeding. There is also currently pending the Debtor's First Amended Motion For Sanctions Against Petitioners for Filing the Petition in Bad Faith and for Award of Punitive Damages Against Petitioners and Their Counsel. Petitioners raised the issue of offsetting any potential award on these motions against their claims. The Court held a preliminary hearing on the offset motion, requested briefs, and heard final argument. Counsel for Grossjean and Pacific argued that the Court should not rule on the offset motions pending a final hearing on damages. Debtor urged the Court to decide the offset issues now. The Court now issues this memorandum opinion as its findings of fact and conclusions of law. This is a core proceeding. 28 U.S.C. § 157(b)(2)(O).

The Bankruptcy Code does not address the issue present in this case. Furthermore, there is scant case law in the area of a creditor's ability to offset an award under section 303(i)[3] against the creditor's claim. The cases are not in

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[3]Section 303(i) provides:

> If the court dismisses a petition under this section other than on consent of all petitioners and the debtor, and if the debtor does not waive the right to judgment under this subsection, the court may grant judgment -
>
> (1) against the petitioners and in favor of the

agreement. Compare In re K.P. Enterprise, 135 B.R. 174, 185 (Bankr. D. Me. 1992) and In re Schiliro, 72 B.R. 147, 149 (Bankr. E.D. Pa. 1987)(both disallowing setoff) with In re Apache Trading Group, Inc., 229 B.R. 887, 890 (Bankr. S.D. Fl. 1999) and In re Better Care, Ltd., 97 B.R. 405, 415 (Bankr. N.D. Il. 1989)(both allowing setoff).

In Schiliro the Court set forth a policy reason against setoff:

> We believe that there are very strong public policy reasons why an award pursuant to § 303(i) should not and cannot be permitted to be set off against the unsuccessful petitioning creditor's claims against the Debtor. It can be assumed that most, if not all petitioning creditors in involuntary cases are owed sums by Debtors. If the petitioning creditor could suffer no other recourse except a reduction in his probably-uncollectible judgment as a penalty for requiring a debtor to defend an unjustified case, and Congress has specifically stated should result in such a penalty, the dis-incentive built into the system to discourage such actions would evaporate. The rule sought by [creditor] would surely be a boon to creditors who seek to wear down to submission small debtors such as the Debtor here.

Schiliro, 72 B.R. at 149. The Court went on, however, to find

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> debtor for -
> (A) costs; or
> (B) a reasonable attorney's fee; or
> (2) against any petitioner that filed the petition in bad faith, for -
> (A) any damages proximately caused by such filing;
> or
> (B) punitive damages.

that “the necessary element of mutuality” for setoff was lacking because the award of attorney fees was actually for the benefit of the attorney, id. at 151, and denied setoff. K.P. Enterprises, quoting from Schiliro, identified the same policy reasons for not allowing setoff. 135 B.R. at 185. The Court disagreed with Schiliro, however, on whether the fee inured to the benefit of the debtor’s attorney. Id. Like Schiliro, however, the K.P. Enterprises Court found that mutuality was lacking, but that was because the creditor’s claims were subordinated to another creditor’s claims which remained unsatisfied. Id.

In In re Better Care, Ltd., the Court found no reason that setoff should not be allowed. 97 B.R. at 415. The Court discussed the two arguments set forth in Schiliro, i.e., the policy grounds and the lack of mutuality, and disagreed with both. It reasoned that section 303(i) should be construed to discourage litigation; setoff should be available for attorneys fees and for other items of 303(i) damages. Id. The Court also noted that 303(i) awards the attorney fees to the debtor and does not require that the debtor pay these fees to the attorney; it therefore disagreed with the lack of mutuality theory. Id. The other case allowing setoff, In re Apache Trading Group, Inc., discusses Schiliro, Better Care,

Ltd., and K.P. Enterprises, but in the end ruled:

> Based on the facts in this case, the Court finds that setoff is appropriate. An important factor in reaching this decision is the fact that the Court has found that [creditor] did not act in bad faith when he filed the involuntary petitions. The public policy argument loses much of its force where the petitioning creditors have not acted in bad faith.

229 B.R. at 890.

The Court has searched for analogous bankruptcy cases with little success. For example, section 362(h) awards attorney costs and attorneys fees to an individual injured by a willful violation of the automatic stay. The Court found one case dealing with section 362(h) and setoff: Banderas v. Doman (In re Banderas), 236 B.R. 841, 848 (Bankr. M.D. Fl. 1999). In that case the Court refused to allow setoff, finding 1) the claim to be prepetition and the sanction award postpetition, and therefore not subject to setoff, and 2) a policy that allowing a creditor to escape sanctions by claiming setoff would render section 362(h) worthless, leaving debtors without a real remedy. Id.

Section 523(d) is another section that awards costs and fees to a debtor. There appears to be no reported decision in which a creditor attempted to setoff a section 523(d) award against its claims against the debtor.

The Court finds that the reasoning of K.P. Enterprise seems to further the policy of 303(i) the best, at least with respect to any attorney fees or costs that may be awarded under § 303(i)(1). Subsection (i)(1) would seem to ensure that alleged debtors be able to find competent representation in a contested involuntary proceeding regardless of the good faith or bad faith of the petitioning creditor(s). Assuring that parties have adequate incentive and resources to represent themselves and to present the issues fully to the Court is a policy that overrides the otherwise legitimate concern of the Better Care court to discourage litigation.[4] Therefore, the Court will order that any award of costs or fees under § 303(i)(1) cannot be offset by a creditor's claim.

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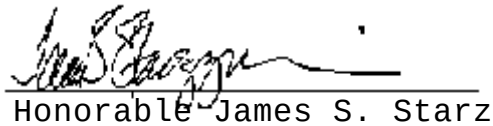
[4] Actually, the Better Care court's argument is more sophisticated than the citation would suggest. There the court distinguished the policy behind §303(i)(1) from the policy behind the fee shifting statute of the Truth in Lending Act, 15 U.S.C. § 1640(a)(3). The court stated that the TILA policy was intended to encourage litigation (by private attorneys general) and was not intended to be primarily compensatory, whereas attorney fees awarded under §303(i)(1) were purely compensatory and were designed to discourage litigation. Given the premise that the award of fees is compensatory, it follows that set-off should be available to the extent that other compensatory damages can be set off. However, it seems to this Court that the policy of discouraging litigation (by awarding attorney fees to alleged debtors who successfully defend involuntary petitions) is better served by ensuring that the fees will always be awarded. In re Schiliro, 72 B.R. at 149.

On the other hand, it seems that any award under § 303(i)(2) is qualitatively different from an award under § 303(i)(1); subsection (i)(2) would seem, in proper cases, to seek to return the alleged debtor's economic situation to a prefiling state. The Court will therefore determine the availability of setoff for § 303(i)(2) following the trial on the merits of the damage case, partly in the hope that the factual examinations will further elucidate the legal issues. Thus the Court will reserve a legal or factual ruling on the availability of setoff of § 303(i)(2) damages pending the outcome of the hearing on damages.



Honorable James S. Starzynski
United States Bankruptcy Judge

I hereby certify that, on the date stamped above, a true and correct copy of the foregoing was either electronically transmitted, faxed, delivered or mailed to the listed counsel and parties.

Ms. Karla K. Poe
PO Box 1276
Albuquerque, NM 87103-1276

Mr. Brad L. Hays
PO Box 15520
Rio Rancho, NM 87174-520

R. Thomas Dawe
PO Box 1276
Albuquerque, NM 87103-1276

Robert Munn
PO Box 91492
Albuquerque, NM 87199

Dennis E. Jontz
PO Box 1276
Albuquerque, NM 87103

C. Calvin Carstens
505 Roma NW
Albuquerque, NM 87102

Robert H. Jacobvitz
500 Marquette NW #650
Albuquerque, NM 87102

Chris W. Pierce
PO Box 6
Albuquerque, NM 87103

Allan L. Wainwright
920 Lomas NW
Albuquerque, NM 87102

Stephen P. Curtis
2701 San Pedro NE
Albuquerque, NM 87110

P. Diane Webb
PO Box 1156
Albuquerque, NM 87103-1156

Office of the UST
PO Box 608
Albuquerque, NM 87103-0608

Donald D. Becker
PO Box 422
Albuquerque, NM 87103-422