SO ORDERED.

SIGNED this 07 day of October, 2005.

Dale L. Somers
Dale L. Somers
UNITED STATES BANKRUPTCY JUDGE

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF KANSAS

In re:	
VERNON G. KLAASSEN and **GRACE S. KLAASSEN**	**CASE NO. 01-14724** **CHAPTER 12**
DEBTORS.	

MEMORANDUM AND ORDER DENYING MOTION OF THE ANDALE FARMERS COOPERATIVE COMPANY FOR RELIEF FROM AUTOMATIC STAY

The matter before the Court is the motion of claimant, the Andale Farmers Cooperative Company, for relief from automatic stay for the purpose of allowing an offset pursuant to 11 U.S.C.A.

§ 553.[1] The parties seek a ruling on the motion based upon a stipulation of facts and briefs. The Andale Farmers Cooperative Company (Co-op or Claimant) is represented by Terry D. Bertholf. The debtors, Vernon G. Klaassen and Grace S. Klaassen (Debtors), are represented by Dan W. Forker, Jr., Forker, Suter & Rose. This is a core proceeding over which the Court has jurisdiction.[2]

The Debtors are members[3] of the Co-op and before filing purchased goods and services from it. As members, the Debtors became entitled to patronage allocations of certain net savings of the Co-op, termed patronage or ledger credits.[4] The Co-op seeks to set off pursuant to section 553 its prepetition claim of $22,328.15, for goods sold, against the Debtors' patronage credits.[5] Reliance is placed upon the articles of the Co-op which provide that the association shall have a lien on all non-stock capital accounts or credits and the bylaws which provide in part that "the Association, at its

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[1] Future references in the text to the Bankruptcy Code shall be to the section only.

[2] 28 U.S.C.A. § 1334 (a); and 28 U.S.C.A. §§ 157(a) and (b)(2)(G).

[3] The record does not establish whether one or both Debtors are members or participating nonmembers of the Co-op. Because members and participating nonmembers appear to have identical rights relative to the issues before the Court, this opinion will refer to the relationship as membership. The record also makes no distinction between Debtors Vernon Klaassen and Grace Klaassen. The Court will regard them both as members with identical rights.

[4] The nature of these patronage credits is discussed below at notes 15 though 17.

[5] The Co-op's proof of claim gives notice of a claim for $22,328.15 for goods sold and services performed. None of the boxes in section 5, secured claim, are checked but the line "value of collateral" is completed "$22,328.15 Stock and Equity in Co-op." On the other hand, the Co-op and the Debtors have briefed the offset issue as if the Debtors' interest were limited to patronage credits and do not include stock rights. The Court will therefore analyze the issues presented assuming that only patronage rights are involved. If this is erroneous, the Court requests that the parties so inform the Court by motion to alter or amend, stating the true situation and addressing what impact the erroneous assumption of the nature of the Debtors' interest has upon the Court's ruling.

option, shall be entitled to set off, against any claims which it may have against any member or participating patron, any amounts which the Association may owe the patron" and may set off such credits to foreclose its lien. The Debtors oppose set off, asserting that the patronage credits do not constitute a debt of the Co-op to the Debtors such that off set is not available and, in any event, urging that if the Co-op has a right of set off, it was waived by delaying the assertion of its alleged right until after confirmation of the Debtors' Chapter 12 plan, to which the Co-op did not object. For the reasons stated below, the Court denies the Co-op's motion.

I. FACTS.

The following allegations in the Co-op's motion were not denied by the Debtors:

1. On the third day of December, 2001 Claimant filed Proof of Claim in the total amount of $22,328.15 all of which is claimed as secured by Claimant's right to set off against Debtors' stock and equity in Claimant.

2. Claimant is a Kansas farmers' cooperative organized and existing under the Kansas Cooperative Marketing Act, K.S.A. 17-1601 et seq. Debtors' stock and equity in Claimant were earned through deferred patronage allocations, 26 U.S.C. 1381-1388, and in accordance with the pre-existing obligation in Claimant's Articles of Incorporation and

Bylaws, ... , and such stock and equity remains subject to Claimant's lien and right of set off. Bylaws Article II § 9.

The referenced Bylaw provision, Article II § 9, provides:

> Section 9. **SETOFF.** The association, at its option, shall be entitled to set off, against any claims which it may have against any member or participating patron, any amounts which the association may owe the

> patron. The association may exercise its lien upon the patron's capital investments in the association, as provided in the Articles of Incorporation, and it may set off against any claims which it may have against any member or participating nonmember any amounts which the patron has invested in the capital of the association including, but not limited to, common stock, preferred stock, participation certificates, ledger credits, per unit retains, and that nonqualified allocation credits.

The parties stipulated to the following facts:

1. That Klaassen filed for Chapter 12 Relief on the 1st day of October, 2001.

2. That on the 3rd day of December, 2001, Claimant filed Proof of Claim in said Bankruptcy in the total amount of $22,328.15 all of which was claimed as secured by Claimant's right to setoff against Klaassen's stock and equity in Claimant at the par or stated value thereof without discount or reduction.[6]

3. That on the 28th day of June, 2002 Debtors filed their Chapter 12 Plan of Reorganization Dated June 27, 2002.

4. That on the 3rd day of February, 2003 the Court ordered Confirmation of Debtors Plan of Reorganization under Chapter 12 Dated June 27, 2002.

5. That Claimant was not reflected as a secured creditor in the Debtors' confirmed Chapter 12 Plan described at paragraph 3 and 4 above.

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[6] The stipulation does not include the value of the Debtors' equity credits, but appears to assume that the value equals or exceeds the amount of the Co-op's claim against the Debtors, which is alleged by the Co-op in its proof of claim to be $22,328.15.

6. That Claimant was not named as either a secured creditor or as an unsecured creditor in Debtors' Confirmed Chapter 12 Plan described in paragraphs 3, 4 and 5 above.[7]

7. Claimant filed no objection to Debtors' Chapter 12 Plan of Reorganization.

8. Debtors' (sic) have made no payment or distribution to Claimant as an unsecured creditor, as described at paragraph 4(e) of Debtors' Confirmed Chapter12 Plan.

The Court's review of the record reveals the following additional facts:

1. Neither the "secured" nor "unsecured" box on the Co-op's proof of claim was checked. The proof of claim, on the value of collateral line, states "Value of Collateral: $22,328.15 Stock and Equity in Co-op."

2. The Debtors' Schedule B includes stock in Andale Farmers Co-op having a current value of $4,825.00.

3. The Debtors' list of creditors filed with their petition includes the Andale Farmers Co-op as having an unsecured nonpriority claim of $18,178.60.

4. Debtors' confirmed Chapter 12 plan in the summary of creditors lists the Andale Farmers Co-op as having an unsecured claim of $11,048.60. .

II. ANALYSIS.

A. DOES THE CO-OP HAVE A RIGHT TO SET OFF ?

The Co-op seeks relief from stay for the purpose of exercising set off. "The right of set off (also called 'offset') allows entities that owe each other money to apply their mutual debts against each

[7] The summary of creditors attached to the Debtors' confirmed plan includes the Andale Farmers Co-op as an unsecured creditor with a claim in the amount of $11,048.60.

other, thereby avoiding 'the absurdity of making A pay B when B owes A."[8] The bankruptcy code does not create a federal right of set off but section § 553[9] preserves rights of set off which otherwise exist under state or federal law.[10] The portion of section 553 relevant to this proceeding is the following:

> (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 commencement of the case . . ..

In general, section 553 preserves the right of set off when four conditions exist: (1) The creditor holds a claim against the debtor that arose prepetition; (2) the creditor owes a debt to the debtor that arose prepetition; (3) the claim and the debt are mutual; and (4) the claim and the debt are valid and enforceable.[11] Because the section merely recognizes and preserves the rights to set off that exist under other applicable law, the threshold determination in every case is the source of the alleged set off right.[12]

The Coop assets it has a right to set off under Kansas law. The Kansas Supreme Court has summarized Kansas law of offset as follows:

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[8] *Citizens Bank of Maryland v. Strumpf*, 516 U.S. 16, 18, 116 S.Ct. 286, 133 L.Ed.2d 258 (1995), *quoting Studley v. Boylston Nat. Bank*, 229 U.S. 523, 528, 33 S.Ct. 806, 57 L.Ed. 1313 (1913).

[9] 5 *Collier on Bankruptcy* ¶ 553.01[2] (Alan N. Resnick & Henry J. Sommer eds.-in-chief, 15th ed. rev. 2005)(hereinafter cited by volume and paragraph number).

[10] *Citizens Bank of Maryland v. Strumpf*, 516 U.S. at 18.

[11] 5 *Collier* at ¶553.01[1].

[12] *Id.* at ¶553.01[2].

> First, setoff requires mutuality, meaning that the same parties owe a sum of money to each other. There must be at least two distinct debts or judgments that have matured at the time of the motion for setoff . . .. In addition, the parties and judgments or debts must coexist, *i.e.*, both must be determined, presently due, and await at the time of setoff.[13]

In *Turnbull*,[14] the Kansas Supreme Court reversed a district court which had allowed a cooperative member to set off his equity credits against an open account due the cooperative because the debts were not coexistent (presently due). The court characterized the equity credits as constituting "an interest of a stockholder of a cooperative association which is contingent and not immediately payable."[15] Therefore, the second Kansas requirement for offset identified above, that there be at least two mature debts, was not present. The court thoroughly examined the nature of equity credits as follows:

> Nonprofit cooperative associations organized under the provisions of the Kansas Cooperative Marketing Act, K.S.A. 17-1601 *et seq* to make profit for their members as producers . . .. The bylaws may state the amount of the annual dividends which may be paid on stock and the manner in which the remainder of the association's profits shall be prorated in the form of patronage dividends to its stockholders. K.S.A 17-1609.
>
> * * *
>
> The bylaws of the Co-op provide for the retention of up to 80 per cent of the operating profits that are allocated to Co-op members in order to furnish capital for the Co-op. Each member of the Co-op is credited with its proportionate share of furnished capital on the books of the Co-op. This deferred patronage allocation is termed "equity credits"

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[13] *Mynatt v. Collis*, 274 Kan. 850, 881, 57 P.3d 513, 534 (2002).

[14] *Atchison County Farmers Union Co-op Association v. Turnbull (Turnbull)*, 241 Kan. 357, 736 P.2d 917 (1987).

[15] *Id.*, 241 Kan. at 360-61, 736 P.2d at 921.

> and may be paid out or redeemed only at the discretion of the board of directors.
>
> Equity credits are not an indebtedness of a cooperative association which is presently due and payable to the members, but represent an interest which may be paid to them at some unspecified later date to be determined by the board of directors. Such equity credits represent patronage dividends which the board of directors of the cooperative, acting under statutory authority, has elected to allocate to its patrons, not in cash or other medium of payment, which would immediately take such funds out of the working capital of the cooperative, but in such manner as to provide or retain capital for the cooperative and at the same time reflect the ownership interests of the patron in such retained capital. 18 Am.Jur.2d, Cooperative Associations § 23.
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> * * *
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> . . . A member or a stockholder of a cooperative association is bound by the bylaws and cannot contend that when equity credits are allocated upon the books of the association that an indebtedness is created which can be used as a setoff against a debt the member or stockholder owns the association.[16]

The Debtors contend that *Turnbull* is controlling and preclude set off in this case. The Co-op does not contend that *Turnbull* was wrongly decided or identify any of its bylaws concerning equity credits which would render the Kansas Supreme Court's analysis in *Turnbull* inapplicable. Rather, Claimant contends that a different result should occur in this case because of the bylaw of the Claimant addressing offset, which is quoted above.

A creditor and a debtor may by contract determine the scope of their set off rights.[17] Bylaws of a co-op constitute a contract between the cooperative and its members and govern transactions

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[16] *Id.*, 241 Kan. at 359-361, 736 P.2d at 920-921.

[17] 5 *Collier* at ¶ 553.04[1].

between them.[18] It is clear that the first sentence of article II, section 9 of the bylaws does not trump the holding of *Turnbull*. The first sentence merely authorizes common law set off. It states, "The association, at its option, shall be entitled to set off, against any claims which it may have against any member or participating patron, any amounts which the association may owe the patron." As established by the Kansas Supreme Court in *Turnbull*, under the Kansas Cooperative Marketing Act, patronage credits do not constitute an amount which the association owes the patron.

The second sentence of section 9 of the bylaws addresses the association's "exercise of its lien upon the patron's capital investments in the association," providing that the Co-op "may set off against any claims which it may have against any member or participating nonmember any amounts which the patron has invested in the capital of the association . . ." including stock, participation certificates, and ledger credits. The Co-op's articles of incorporation provide for a lien in the interests enumerated in article II, section 9 of the bylaws. For example, article VII, section 6 provides in part:

> The Bylaws of this association may provide for and establish such non-stock capital accounts or credits as shall be necessary or proper for the purpose of furthering the cooperative character of this association and for the purpose of providing such additional capital as may be required for the continued effective operation of this association. Such non-stock capital accounts may include, but shall not be limited to, stock credits, ledger credits, revolving fund credits, per-unit retains, nonqualified allocation credits, and such other book credits for which provision is made in the Bylaws; and such credits may be redeemed, retired, or repurchased only in accordance with the said Bylaws of this association. This association shall have a lien upon all such non-stock capital accounts or credits, which lien may be exercised only at the discretion and direction of the Board of Directors.

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[18] *Turnbull*, 241 Kan. at 360, 736 P.2d at 921.

For purposes of article 9 of the Uniform Commercial Code, cooperative equity credits are general intangibles,[19] which can be perfected only by filing.[20] The Co-op does not assert that it filed a UCC–1, and its lien in the equity credits created by the articles[21] is therefore unperfected.

The Court finds this second sentence of section 9 of the bylaws ambiguous. It could be intended to address foreclosure of security interests granted by the articles. If this is the case, it does not address the matter before the Court. Offset is an exercisable right, not a lien which attaches to property.[22] Further, the Co-op is seeking relief from stay to offset its claim, not to foreclose a security interest. Of course, the fact that the lien is unperfected raises additional concerns because of the Code's lien avoidance provisions, which apparently were not exercised in the case. On the other hand, the second sentence of bylaw article II, section 9, addressing offset, could have been intended to alter the Kansas Supreme Court's ruling in *Turnbull* and to provide that equity credits and other financial interests enumerated in the bylaws are debts owed to the patron or the stockholder so that offset is available. The current state of the record does not permit the Court to make a choice between these possible interpretations. The Court is unable to rule whether the Co-op has a right of offset under

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[19] K.S.A. 2001 Supp. 84-9-102(42); *see In re Barr*, 180 B.R. 156 (Bankr. N.D. Tex. 1995) (holding capital credits held by electric cooperative are general intangibles); and *Leake v. First Nat'l Bank of Broadway (In re Shiflett),* 40 B.R. 493 (Bankr. W.D. Va. 1984) (holding that debtors' interest in capital reserve account in milk producers' cooperative is a general intangibles).

[20] K.S.A. 2001 Supp. 84-9-310.

[21] The parties have not raised as an issue to be decided whether the articles were effective to grant a security interest in the equity credits. For purposes of this opinion, the Court will assume that the Co-op has such a lien.

[22] *In re Stephenson*, 84 B.R. 74, 77 (Bankr. N.D. Tex. 1988).

Kansas law.[23] The existence of such a right is required for relief from stay. The Co-op has failed to satisfy its burden to prove entitlement to offset.[24]

B. IF THE CO-OP HAS A RIGHT OF SET OFF UNDER SECTION 553, WAS THE RIGHT TO EXERCISE THAT RIGHT WAIVED?

The Court next examines the issue of waiver raised by the Debtors, who argue that even if the Co-op has a right of offset, it waived that right by failing to pursue it in a timely manner. The facts before the Court relevant to waiver are the following. The Debtors listed the Co-op as an unsecured creditor when filing for relief on January 27, 2001. Although the Co-op filed a proof of claim on December 3, 2001, referring to offset, that document failed to mark the box stating that it was a secured claim.[25] The Debtors' Chapter 12 Plan, filed on June 28, 2002, listed the Co-op as an unsecured creditor. The Co-op failed to object to the plan, and it was confirmed on February 3, 2005. About two months later, on April 5, 2005, the Co-op filed the present motion for relief from stay to exercise offset.

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[23] If the Co-op has a right under Kansas law, the Court would then have to consider whether the bankruptcy code elements of section 553, identified above, are satisfied. Other bankruptcy courts have held that a co-op is not entitled to offset a debtor's obligation to it against the debtor's patronage account. *E.g., Taylor v. Assumption Cooperative Grain Co. (In re Beck)*, 96 B.R. 161 (Bankr. C. D. Ill. 1988); *Nelson v. Cavalier Rural Electric Co-operative of Langdon, N D (In re Axvig)*, 68 B.R. 910 (Bankr. D.N. D. 1987); and *Sherman v. Eugene Farmers Cooperative (In re Cosner)*, 3 B.R. 445 (Bankr. D. Or. 1980). The bankruptcy case relied upon by the Claimant, *Universal Cooperatives, Inc. v. FCX, Inc. (In re FCX, Inc.)*, 853 F.2d 1149 (4th Cir. 1988) concerned modification of a chapter 11 plan, not relief from stay to allow offset.

[24] *Federal National Mortgage Ass'n v. County of Orange (In re County of Orange)*, 183 B.R. 609 (Bankr. C.D. Cal. 1995) (holding that burden of proving enforceable right of set off rests with the party asserting it).

[25] 11 U.S.C.A. § 506(a) provides that an allowed claim of a creditor that it subject to set off under 11 U.S.C.A. § 533 is a secured claim to the extent of the amount of subject to set off.

There is no question that the right to offset may be waived. However, "[t]he precise circumstances under which the right may be lost, . . . are difficult to isolate."[26] The principles are summarized as follows:

> Waiver is typically defined as the knowing relinquishment of a known right, and a party may certainly agree to forego a right of set off by written contract. However, waiver may also be inferred from the particular circumstances of the case. In general, the issue of an implicit waiver is resolved by reference to a variety of factors, with the general caveat that waiver of a right of setoff is not to be lightly inferred. The relevant factors may include the length of any delay in the assertion of the right (although this by itself, will not usually suffice to support a waiver), unjust creditor enrichment, the diligence of the creditor, detrimental reliance and prejudice, and creditor behavior that is inconsistent with any intent to maintain the right.[27]

A waiver may be express, for example by a creditors' written statement that it will not assert set off, or may be implied from the creditor's conduct.[28] In this case, the argument of the Debtors is that the Co-op waived its right to offset by failing to pursue the right until after confirmation, even though it filed a proof of claim giving notice of its position. This raises the legal question of whether, assuming the Co-op has a right of offset, its exercise is barred as a matter of law when first sought to be exercised after

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[26] 5 *Collier* at ¶ 553.07; see e.g., *United States v. Fleet Bank of Mass.* (*In re Calore Express Company, Inc.*), 288 F.3d 22 (1st Cir. 2002).

[27] 5 *Collier* at ¶ 553.07.

[28] *In re Calore Express Company, Inc.*, 288 F.3d at 38.

confirmation because of the conflict between section 553,[29] allowing offset not withstanding other provisions of title 11, and section 1227,[30] addressing the binding effect of plan confirmation.

One group of cases answers "no" to the question "whether confirmation of a plan, or the discharge of a creditor's claim, prevents a creditor from offsetting the claim against a prepetition debt that the debtor seeks to collect in a subsequent action."[31] Although in this case, the Co-op is asserting offset offensively as a means of payment of an unsecured claim, not in defense to a claim asserted against it by the Debtors, the reasoning of the courts answering "no" to the above question and allowing defensive use of offset is helpful in understanding the issue presented here.

A Tenth Circuit case, *In re Davidovich*,[32] is a leading case on the question of waiver of the right of offset. It is a chapter 7 case in which a creditor was allowed to assert offset in defense of the

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[29] 11 U.S.C.A. § 553(a) provides in 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 commencement of the case . . ..

[30] 11 U.S.C.A. § 1227 provides in part:

> (a) Except as provided in section 1228(a) of this title, the provisions of the confirmed plan bind the debtor, each creditor, each equity security holder, and each general partner in the debtor, whether or not the claim of such creditor, such equity security holder, or such general partner in the debtor is provided for by the plan, and whether or not such creditor, such equity security holder, or such general partner in the debtor has objected to, has accepted, or has rejected the plan.

[31] 5 *Collier* at ¶ 553.08.

[32] *Davidovich v. Welton (In re Davidovich)*, 901 F.2d 1533 (10th Cir. 1990).

debtor's attempt to enforce an arbitration award in the debtor's favor against the creditor after discharge. The court, based upon the language of section 553 that the right of offset is not affected by the bankruptcy code, held that the filing of a proof of claim is not a prerequisite to the assertion of defensive offset and further that a discharged debt could be offset upon compliance with section 553. The court reasoned that it would be unfair to deny a creditor the right to recover an established obligation against the debtor while requiring the same creditor to fully satisfy a debt to the debtor.

The Ninth Circuit in *Carolco*[33] held that a creditor was entitled to defensive offset after confirmation of a chapter 11 plan. The debtor's successor sued the creditor on a pre-petition debt, and the creditor asserted a counterclaim in quantum meruit and a right to offset that debt against the successor's claim. The court rejected the successor's position that the right to offset was lost when the plan of reorganization was confirmed. Although finding a direct conflict between sections 553 and 1141,[34] the court held that section 553 should take precedence. It reasoned that to hold otherwise would mean that setoff would be allowed only when written into a plan of reorganization, making section 553 superfluous. More importantly, it found that setoff was essential to equitable treatment of creditors:

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[33] *Carloco Television Inc. v. National Broadcasting Co. (In re DeLaurentiis Entertainment Group, Inc.)*, 963 F.2d 1269 (9th Cir. 1992).

[34] 11 U.S.C.A. § 1141(a) provides in part:

> (a) Except as provided in subsections (d)(2) and (d)(3) of this section, the provisions of a confirmed plan bind the debtor, any entity issuing securities under the plan, any entity acquiring property under the plan, and any creditor, equity security holder, or general partner in the debtor, whether or not the claim or interest of such creditor, equity security holder, or general partner is impaired under the plan and whether or not such creditor, equity security holder, or general partner has accepted the plan.

> A set off is allowed as a defense to a claim *brought by the debtor* against a creditor. The creditor can claim only an amount large enough to offset its debt; it cannot collect anything from the debtor. Absent a set off, a creditor . . . is in the worst of both worlds: it must pay its debt to the debtor in full, but is only entitled to receive a tiny fraction of the money the debtor owes it. It was to avoid this unfairness to creditors that set offs were allowed in bankruptcy in the first place.[35]

These cases stand for the rule that "confirmation and discharge do not prohibit the defensive use of setoff in a subsequent action by the debtor."[36]

On the other hand, the Third Circuit has held that confirmation of a chapter 13 or chapter 11 plan precludes a creditor from making offensive use of offset to satisfy a claim addressed by a confirmed plan. In the chapter 13 case, *Norton*,[37] the IRS had been given notice and an opportunity to object to the proposed Chapter 13 plan providing for payment of the tax liability but failed to take such opportunity. Upon confirmation, the court held the IRS became bound by the plan and the payment schedule that would satisfy its claim in full and was not allowed to retain via offset an overpayment due the debtors as security on the debt. The court noted, "To allow the IRS to retain their overpayment as extra security on the debt would seriously compromise the powers of the Bankruptcy Court, the capacity of debtors to rehabilitate, and the equitable distribution that the Bankruptcy Code is designed to foster."[38]

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[35] *In re DeLaurentiis Entertainment Group, Inc.*, 963 F.2d at 1277.

[36] 5 *Collier* at ¶ 553.08[1] (characterizing this view as the majority position).

[37] *United States v. Norton*, 717 F.2d 767 (3rd Cir. 1983).

[38] *Id.*, 717 F.2d at 774.

Norton was followed by the Third Circuit in a chapter 11 case, *In re Continental Airlines.*[39] Following confirmation of the chapter 11 plan of the airline, the government moved to set off its claim against funds owed the debtor which had been deposited post confirmation in the bankruptcy court's registry pursuant to unrelated litigation. The court held that the government was not entitled to set off because of its failure to assert its set off right until after confirmation. The creditor's reliance upon *Caroloco*, discussed above, was rejected because in that case, unlike the case before the court, the creditor timely filed its proof of claim and asserted its right of set off against its debt to the debtor, filing a motion for a relief from the automatic stay prior to confirmation of the plan.[40] It also rejected reliance upon *Davidovich,* the Tenth Circuit case discussed above, finding that the court only discussed the right of set off under section 553 but made no analysis of the impact of section 1141. These cases, and others cited by the government, did not persuade the court that section 1141 could be disregarded when a set off is asserted. Rather, the court held that the effect of confirmation trumped the right of set off. It stated:

> Furthermore, allowing the Government under the facts of this case to come forward after the plan of reorganization has been confirmed and *sua sponte* decide that it has a valid set-off without timely filing a proof of claim and asserting the set-off in the reorganization proceedings, has a probability of disrupting the plan of reorganization. It may also unnecessarily protract the bankruptcy proceedings and consume judicial resources. Furthermore, it is unfair to other creditors and

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[39] *United States v. Continental Airlines (In re Continental Airlines),* 134 F.3d 536 (3rd Cir. 1998).

[40] *Id.*, 134 F.3d at 541.

> Debtors, and can conceivably undermine the plan of reorganization and the objectives and structures of the Bankruptcy Code.[41]

A leading commentator finds that "*Norton* and *Continental* are distinguishable from *Davidovich* and *Carolco*, and the different principles on which these very different decisions rely are not necessarily opposed."[42] This Court agrees. Post confirmation defensive use of offset by a creditor against a claim asserted against it by the debtor is materially different from a creditor's affirmative assertion of a right of offset to satisfy a claim addressed by a confirmed plan. The offensive use, which the Co-op asserts in this case, presents a direct conflict between section 553 and the effect of confirmation under section 1227. This is illustrated in a chapter 12 case by *In re Stephenson*,[43] where the United States sought to set off disaster payments owed to the debtors against the debtors' obligation to the government after confirmation of the debtors' Chapter 12 plan. The court first denied set off on the merits, finding that the disaster payments were authorized post petition and therefore did not qualify under section 553. It further held that any right set off to which the government might have been entitled had been waived by the government's failure to exercise the right prior to confirmation. The government had taken a very active part in the confirmation process and reached agreement with the debtor regarding the terms of the plan without raising the issue of set off. The court found that pursuant to section 1227, "both the debtor and the FmHA are bound by the provisions of the confirmed Plan . . .. The FmHA's failure to assert its setoff rights prior to confirmation

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[41] *Id.*, 134 F.3d at 541-542.

[42] 5 *Collier* at ¶ 553.08.

[43] *In re Stephenson*, 84 B.R. at 74.

constituted a waiver of those rights because the confirmation of the plan vested the property in the Debtor's 'free and clear of any claim or interest of any creditor provided for by the plan.'"[44] As to the apparent conflict between sections 553 and 1227, the court reasoned:

> While § 553 provides that title 11 shall not affect a creditor's right of setoff, the section nowhere prohibits a creditor from waiving that right. The FmHA waived its right to setoff by its failure to exercise that right prior to confirmation. Should there be any conflict between the provisions of § 1227 and § 553, the more specific provisions of § 1227 concerning a Chapter 12 plan must be given effect over the general provisions of § 553 in order to carry out the Congressionally express purpose of rehabilitation of family farmers in Chapter 12. A specific statute is not controlled or nullified by a general statute, regardless of priority of enactment, absent clear intent on the part of the legislators that it do otherwise.[45]

In this case, by offset, the Co-op is attempting to effectively amend the confirmed plan to provide that its claim, which is treated as unsecured by the plan, is paid in full from property which the Debtors listed on their Schedule B. The Court therefore finds *Davidovich* is not controlling because it permitted defensive offset, not offensive offset. The Court finds the reasoning of *Continental Airlines* and *Stephenson* persuasive and holds that offensive offset is not available to satisfy an unsecured claim the payment of which is provided for by the confirmed plan when the creditor did not object to confirmation based upon the right to offset and where relief from stay to pursue offset was not filed until

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[44] *Id.*, 84 B.R. at 78.

[45] *Id.*, 84 B.R. at 78-79.

after confirmation. Although the Co-op stated its intent to utilize offset when it filed its proof of claim, its subsequent conduct waived that right.[46]

III. CONCLUSION.

For the foregoing reasons, the Court denies the Co-op's motion for relief from stay to exercise set off. The Co-op has failed to sustain its burden of proof to show that it is entitled to offset under Kansas law, as required by section 553(a). Further, if the Co-op were otherwise entitled to offset under section 553(a), that right was waived when the Co-op did not object to the Debtors' Chapter 12 plan, which treats the Co-op's claim as unsecured, and delayed moving for stay relief to exercise offset until after confirmation of the plan.

IT IS SO ORDERED.

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[46] *See In re Calore Express Company, Inc.*, 288 F.3d at 38 (holding that waiver of set off rights, whether express or implied, is not necessarily irrevocable).