IN THE UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF ARKANSAS
FAYETTEVILLE DIVISION

IN RE: DAMON S SCOTT, Debtor **No. 5:15-bk-71061**
Ch. 7

DAMON S SCOTT **PLAINTIFF**

v. **5:15-ap-7099**

UNITED STATES DEPARTMENT OF EDUCATION **DEFENDANT**

ORDER GRANTING SUMMARY JUDGMENT

Before the Court are the Cross Motions for Summary Judgments filed in this adversary proceeding. The debtor filed his complaint against the United States Department of Education [DOE] on September 28, 2015. In his complaint, the debtor seeks the return of $7146.00 that the United States Department of the Treasury [USDOT] withheld from the debtor's income tax refund and applied to part of the debt owed by the debtor to DOE. The debtor's theory of recovery is that the offset is a preferential payment to DOE that can be avoided under 11 U.S.C. § 547. Additionally, in the debtor's brief in support of his motion for summary judgment, the debtor argues in the alternative that the transfer was an impermissible setoff under § 553(b). DOE answered the complaint denying the debtor's allegations. The Court initially set the complaint and answer for trial in May 2016; however, at the request of the parties, the Court continued the trial to give the parties an opportunity to file their respective motions for summary judgment. Because the Court finds that USDOT's setoff was permissible under § 553, the Court grants DOE's motion for summary judgment and denies the debtor's motion for summary judgment.

The Court has jurisdiction over this matter under 28 U.S.C. § 1334 and 28 U.S.C. § 157, and it is a core proceeding under 28 U.S.C. § 157(b)(2)(O). The following opinion constitutes findings of fact and conclusions of law in accordance with Federal Rule of

Bankruptcy Procedure 7052.

Federal Rule of Bankruptcy Procedure 7056 provides that Federal Rule of Civil Procedure 56 applies in adversary proceedings. Rule 56 states that summary judgment shall be rendered "if the movant shows that there is no genuine dispute as to any material fact and the movant is entitled to a judgment as a matter of law." Fed. R. Civ. P. 56(a). The burden is on the moving party to establish the absence of a genuine issue of material fact and that it is entitled to judgment as a matter of law. *Canal Ins. Co. v. ML & S Trucking, Inc.*, No. 2:10-CV-02041, 2011 WL 2666824, at *1 (W.D. Ark. July 6, 2011) (citing *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 586-87, (1986); *Nat'l Bank of Commerce of El Dorado, Ark. v. Dow Chem. Co.*, 165 F.3d 602 (8th Cir.1999)); *see also Celotex Corp. v. Catrett*, 477 U.S. 317, 323 (1986) (citing to former Fed. R. Civ. P. 56(c)). When ruling on a summary judgment motion, the Court must view the facts in the light most favorable to the non-moving party and allow that party the benefit of all reasonable inferences to be drawn from the evidence. *Canada v. Union Electric Co.*, 135 F.3d 1211, 1212-13 (8th Cir. 1997); *Ferguson v. Cape Girardeau Cty.*, 88 F.3d 647, 650 (8th Cir. 1996).

The parties filed a Joint Statement of Undisputed Facts on July 12, 2016, which set out the relevant facts for the Court's decision. In August 2011, the debtor became indebted to DOE under an "unsecured student loan scheme" pursuant to the William D. Ford Federal Direct Loan Program. The debtor defaulted on his payment to DOE on September 19, 2013. According to the debtor, 90 days prior to the debtor filing his bankruptcy petition on April 22, 2015, he owed DOE approximately $11,300. On February 11, 2015, 70 days prior to the debtor filing his petition, USDOT, through its Bureau of the Fiscal Service, gave the debtor notice that it had seized the debtor's tax refund in the amount of $7146.00 for the 2014 tax year.[1] USDOT forwarded the money

[1] Prior to the seizure, DOE would have notified the debtor of its intention to reduce the debtor's obligation to DOE by reducing the debtor's future tax refunds, if any, and allowed the debtor at least 60 days to present evidence that the debt was not past-due

to DOE in partial satisfaction of the debtor's prior obligation. As of October 5, 2015, the debtor still has an outstanding obligation to DOE in the amount of $4163.27, which is accruing interest at the rate of $0.62 per day.

Even though the debtor's primary argument focuses on preference under § 547 of the bankruptcy code, the Court must first determine whether the setoff was a permissible setoff under § 553. If it was, § 547 does not apply. *In re Knapp*, 1997 WL 34722843 *3, 95-95124, Bankr. S.D. Iowa, Oct. 15, 1997) ("Since the setoff in issue was valid and the statutory limitations do not apply, there is no need to analyze the facts under section 547.") According to § 553, except for the exceptions provided for within § 553 itself and §§ 362 and 363 of the code, the "right of a creditor to offset a mutual debt owing by such creditor to the debtor that arose before the commencement of the case . . . against a claim of such creditor against the debtor that arose before the commencement of the case" is not affected by the provisions of the bankruptcy code. 11 U.S.C. § 553(a). In other words, "whatever right of setoff otherwise exists is preserved in bankruptcy." *Maryland v. Strumpf*, 516 U.S. 16, 18 (1995); *see also In re Lott*, 79 B.R. 869, 870 (Bankr. W.D. Mo. 1987) (stating that if § 553 is applicable, § 547 cannot be utilized to undo its effect and recognizing congressional intent of allowing setoff as permissible preference under certain circumstances). If DOE was permitted to offset the funds prior to the filing of the bankruptcy petition and none of the exceptions in § 553 apply, the Court must grant summary judgment in favor of DOE as a matter of law.

DOE has the burden of proving its right to setoff. To prevail, DOE must prove each of the following elements:

(1) A debt exists from the creditor to the debtor and that debt arose prior to the commencement of the bankruptcy case.

(2) The creditor has a claim against the debtor which arose prior to the

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or not legally enforceable. *See* 31 U.S.C. § 3720A. Reduction of tax refund by amount of debt.

commencement of the case.

(3) The debt and the claim are mutual obligations.

U.S. Through ASCS v. Gerth, 991 F.2d 1428, 1431 (8th Cir. 1993) (citations omitted). With respect to the first and second requirements, according to the parties' stipulated facts, the tax refund USDOT otherwise owed to the debtor and DOE's claim against the debtor on the defaulted loan payment both arose prior to the debtor filing his bankruptcy petition on April 22, 2015. With respect to the third requirement, "the prevailing view appears to be that different agencies of the USA stand in the same right and capacity for the purpose of section 553 setoffs." *In re Knapp*, 1997 WL 34722843 *3; *see also Turner v. Small Business Admin.* (*In re Turner*), 84 F. 3d 1294, 1298 (10th Cir. 1996) ("the United States is a unitary creditor for setoff purposes in bankruptcy"); *Lopes v. U.S. Dep't of Housing and Urban Dev.* (*In re Lopes*), 211 B.R. 443, 446 (D.R.I. 1997) ("The United States is necessarily comprised of many different departments or entities, each with a specialized structure and purpose. However, these entities are part of the same whole–namely, the United States Government."); *In re Stewart*, 253 B.R. 51 n.2 (Bankr. E.D. Ark. 2000) (citing cases stating same). Because DOE and USDOT represent a unitary creditor and obligor–the United States–the Court finds that the third requirement is also met. Accordingly, each of the elements have been met and DOE has met its burden of proof.

The burden now shifts to the debtor to prove one of the enumerated exceptions contained within § 553. The only relevant exceptions to the setoff under § 553 appear in either subsection (a) or subsection (b).[2] Section 553 states,

> (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, except to the extent that—

[2] Because neither party alleges that §§ 362 or 363 are at issue, the Court will not consider those code sections for the remainder of the opinion.

(1) the claim of such creditor against the debtor is disallowed;
(2) such claim was transferred, by an entity other than the debtor, to such creditor—
(A) after the commencement of the case; or
(B)(i) after 90 days before the date of the filing of the petition; and
(ii) while the debtor was insolvent (except for a setoff of a kind described in section 362(b)(6), 362(b)(7), 362(b)(17), 362(b)(27), 555, 556, 559, 560, or 561); or
(3) the debt owed to the debtor by such creditor was incurred by such creditor—
(A) after 90 days before the date of the filing of the petition;
(B) while the debtor was insolvent; and
(C) for the purpose of obtaining a right of setoff against the debtor (except for a setoff of a kind described in section 362(b)(6), 362(b)(7), 362(b)(17), 362(b)(27), 555, 556, 559, 560, or 561).
(b)(1) Except with respect to a setoff of a kind described in section 362(b)(6), 362(b)(7), 362(b)(17), 362(b)(27), 555, 556, 559, 560, 561, 365(h), 546(h), or 365(i)(2) of this title, if a creditor offsets a mutual debt owing to the debtor against a claim against the debtor on or within 90 days before the date of the filing of the petition, then the trustee may recover from such creditor the amount so offset to the extent that any insufficiency on the date of such setoff is less than the insufficiency on the later of—
(A) 90 days before the date of the filing of the petition; and
(B) the first date during the 90 days immediately preceding the date of the filing of the petition on which there is an insufficiency.
(2) In this subsection, "insufficiency" means amount, if any, by which a claim against the debtor exceeds a mutual debt owing to the debtor by the holder of such claim.

11 U.S.C. § 553.

The Court has reviewed the exceptions under § 553(a) and finds that none of those exceptions are applicable: (1) DOE's claim against the debtor has not been disallowed; (2) based on the Court's finding that DOE and USDOT are, for these purposes, the same creditor, there was no transfer of the claim to the creditor within 90 days of the filing of the debtor's petition; and (3) the debt was incurred before 90 days prior to the filing of the debtor's petition.

The debtor's sole argument for an exception is based in § 553(b) and an alleged "insufficiency" that occurred within the 90 days prior to the filing of the debtor's

petition. However, the debtor's reliance on this provision is misplaced. An insufficiency is defined as the amount "by which a claim against the debtor exceeds a mutual debt owing to the debtor by the holder of such claim." 11 U.S.C. § 553(b)(2). To the extent that the insufficiency as of the date of setoff is less than the insufficiency on the 90th day prior to filing the petition, the trustee (or in this case, the debtor) can recover the difference. This is sometimes called the "improvement in position test." *See, e.g., Smith v. Mark Twain Nat'l Bank*, 805 F.2d 278, 289 (8th Cir. 1986). The debtor errs by suggesting that solely because an insufficiency was present at all times during the 90 day period prior to the filing of the debtor's petition, the debtor should be able to recover the improvement of DOE's position as measured by the decrease of the insufficiency on February 11, 2015, the date of the setoff.

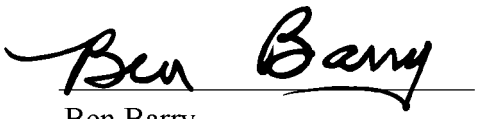
Determining a recoverable insufficiency is a simple mathematical calculation. On January 22, 2015–90 days prior to the filing of the–DOE had a claim against the debtor of approximately $11,300.00. Also on January 22, the debtor was entitled to a refund from USDOT of $7146.00.[3] At that time, the claim against the debtor exceeded the debt owed to the debtor by $4154.00. This is the amount of the insufficiency on the 90th day prior to filing the petition. On February 11, 2015, USDOT seized the debtor's tax refund and submitted it to DOE. After taking into account the setoff, DOE reduced the debtor's obligation from $11,300.00 to $4154.00. Because there was no debt owed to the debtor at that time, the insufficiency remained $4154.00; there was no change in value between January 22–90 days prior to filing–and February 11–the date of the setoff. In other words, DOE did not improve its position pre-petition at the expense of other creditors. *See, e.g.*, H.R. 484, 101st Cong. 2d Sess 5 (1990) ("Section 553(b)(1) is designed for instances in which a financial institution or other creditor has taken advantage of an opportunity to excessively improve its financial position with respect to the debtor in the days immediately prior to the debtor's filing a bankruptcy petition.") The Court finds

[3] The debtor's right to his refund accrued on December 31, 2014. *See, e.g. In re Ferguson*, 83 B.R. 676 (Bankr. E.D. Mo. 1988).

that the exception under § 553(b) is not applicable in this instance and the debtor has failed to meet his burden of proving an exception to a permissible setoff.

Accordingly, for the reasons stated above, the Court grants DOE's motion for summary judgment as a matter of law and denies the debtor's motion for summary judgment. The Court will enter a separate judgment in accord with Federal Rule of Bankruptcy Procedure 7058.

IT IS SO ORDERED.



Ben Barry
United States Bankruptcy Judge
Dated: 07/18/2016

cc: Deborah Groom
Stanley V. Bond