I, the undersigned Clerk of the United States District Court for the Northern District of Iowa, do certify that the foregoing is a true copy of an original document remaining on file and record in my office.
WITNESS my hand and seal of said Court this 30 day of Sept, 2004
Pridgen J. Watkins, Clerk
By: Deputy

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF IOWA
CEDAR RAPIDS DIVISION

IN RE IOWA OIL COMPANY, DEBTOR,	No. C04-1002-LRR **ORDER**
IOWA OIL COMPANY, Plaintiff, vs. CITGO PETROLEUM CORPORATION, Defendant.	FILED US BANKRUPTCY COURT NORTHERN DISTRICT OF IOWA OCT 0 1 2004 SEAN F. McAVOY, CLERK

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I. INTRODUCTION

This matter is before the court pursuant to Citgo Petroleum Company's ("Citgo") appeal to this court from the United States Bankruptcy Court for the Northern District of Iowa's December 12, 2003 Order Regarding Motions for Summary Judgment.[1] Appellee/Intervenor American Trust and Savings Bank (the "Bank") has responded to Citgo's brief in support of its appeal. The matter therefore is fully submitted and ready for decision.

II. STANDARD OF REVIEW

When an order of the bankruptcy court is before the district court for appellate review, the district court may reverse a bankruptcy court's findings of fact only if it determines such findings are clearly erroneous. *In re Dakota Rail, Inc.*, 946 F.2d 82, 84 (8th Cir. 1991). The district court reviews the bankruptcy court's conclusions of law *de novo*. *In re Cochrane*, 124 F.3d 978, 981 (8th Cir. 1997); *In re Kjellsen*, 53 F.3d 944, 946 (8th Cir. 1995).

III. FACTUAL BACKGROUND

The parties do not challenge the bankruptcy court's findings of fact and the court therefore adopts the findings of fact set forth in the bankruptcy court's Order and recited herein. Iowa Oil Company ("Iowa Oil") owns and operates several convenience stores in Iowa, Wisconsin and Illinois. Iowa Oil is a franchisee of Citgo. The two companies have been conducting business with one another since 1977. Iowa Oil and Citgo entered into a Distributor Franchise Agreement (the "Agreement") on August 31, 1992. Under the terms of the Agreement, Iowa Oil is allowed to market Citgo merchandise using the Citgo trademark. Citgo provided merchandise to Iowa Oil on credit. Iowa Oil's credit line with

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[1] The Honorable Paul J. Kilburg, Judge, presiding. This court has jurisdiction for this appeal pursuant to 28 U.S.C. § 158(a)(1).

Citgo has been $1,450,000 since 1997. Iowa Oil's credit line is allocated in the following way: $1,100,000 is merchandise credit and $350,000 is the amount Citgo pays in state excise taxes on Iowa Oil's behalf and which Iowa Oil pays back to Citgo upon collection of such taxes from consumers.

An important component of the relationship between Iowa Oil and Citgo is the methodology by which Citgo handled credit card receipts. Under the terms of the Agreement, Citgo collected all credit card receipts from the sale of merchandise at Iowa Oil's convenience stores. Paragraph 10 of the Agreement provides in pertinent part:

> [Iowa Oil] expressly agrees that CITGO shall have the right but not the obligation to apply the proceeds of credit card invoices or any other credits which may be owing to [Iowa Oil] toward the payment of any indebtedness owed by [Iowa Oil] to CITGO. [Iowa Oil] grants to CITGO a security interest in all credit card invoices and proceeds from such credit card invoices to secure the payment of product purchases from CITGO, and agrees to execute documents reasonably necessary to perfect such security interest.

Citgo's security interest in the credit card invoices and proceeds has not been perfected. The Bank has a perfected security interest in a large portion of Iowa Oil's assets, including inventory, equipment and accounts.

The terms of payment provided that Iowa Oil would pay for all merchandise from Citgo within 12 days of delivery and Iowa Oil would receive a one percent discount for making timely payments. The amount of credit Citgo would extend to Iowa Oil was calculated based on Iowa Oil's ability to pay within the 12-day cycle. Citgo considered Iowa Oil's average purchases from Citgo over the 12-day period and the average amount of credit card receivables held by Citgo in determining Iowa Oil's ability to pay.

Citgo computes the amount owed by Iowa Oil on a daily basis. After computing this amount, Citgo subtracts the amount of credit card invoices and proceeds it currently

holds to arrive at a total balance owed by Iowa Oil. Through an electronic funds transfer system, Citgo is able to withdraw or deposit funds directly into Iowa Oil's bank account. Citgo provides to Iowa Oil 3 days' notice of any drafts it makes on Iowa Oil's bank account.

During 2002, several electronic transfers drawn upon Iowa Oil's bank account were returned for insufficient funds. On several occasions, Iowa Oil cured the default by making a wire transfer of funds to Citgo. Iowa Oil's credit account increased dramatically in September and October of 2002, but Iowa Oil's Secretary and Treasurer, John Noel, assured Citgo that Iowa Oil was planning to liquidate some property and those funds would be used to pay Citgo. In November, Citgo concluded Iowa Oil was not going to be able to pay the outstanding debt. On November 7, 2002, Citgo informed Iowa Oil that it no longer could obtain gasoline from Citgo terminals and that all credit card proceeds collected by Citgo would be applied to Iowa Oil's outstanding trade balance instead of being paid over to Iowa Oil.

Citgo asserts it "inadvertently" overextended $1,255,673.62 in credit to Iowa Oil beyond that allowed according to Citgo's ability-to-pay formula. Citgo asserts it allowed Iowa Oil to overextend its credit because of Iowa Oil's promises to keep the credit account in balance.

Iowa Oil filed its Chapter 11 bankruptcy petition on February 13, 2003. Iowa Oil owed Citgo $1,255,673.62 on that date. As of October 23, 2003, Citgo has withheld $1,236,270.23 in credit card receipts from Iowa Oil. Of that amount, $526,308.80 represents the funds withheld prepetition and $719,961.43 is the amount Citgo has withheld postpetition. Citgo has not sought or been granted relief from the automatic stay in this case. Iowa Oil seeks to have all credit card receipts held by Citgo paid over to Iowa Oil pursuant to 11 U.S.C. § 543(b).

Citgo has not filed a financing statement perfecting a security interest in Iowa Oil's assets. The Bank does possess a perfected security interest in Iowa Oil's accounts. The Bank stipulated that it wished to have the credit card receipts paid over to Iowa Oil so that Iowa Oil can use the credit card receipts in its reorganization. The Bank further stated it would continue to accept interest-only payments on Iowa Oil's outstanding debt.

After Citgo refused to supply gasoline to Iowa Oil, Iowa Oil began to sell and continues to sell non-Citgo brand gasoline at Iowa Oil's convenience stores. Citgo asserts that Iowa Oil's continued use of Citgo's name and trademark is a willful violation of the Lanham Act. Due to the alleged violation, Citgo claims that it is entitled to injunctive relief, Iowa Oil's profits from wrongfully using the trademark, and the costs associated with maintaining this action. Iowa Oil maintains it did not violate the Lanham Act because it was authorized to use the Citgo name and trademark.

The bankruptcy court granted summary judgment in favor of Iowa Oil on Iowa Oil's Claim for Turnover and ordered that Citgo pay over all credit card receipts collected by Citgo for sales at Iowa Oil's store locations in the amount of $1,236,270.23 plus any receipts collected after October 23, 2003.

The bankruptcy court also granted summary judgment in favor of Citgo on its counterclaim for violation of the Lanham Act. The bankruptcy court ruled Citgo was entitled to immediate injunctive relief preventing Iowa Oil from selling non-Citgo gasoline under Citgo's registered name and trademark. The bankruptcy court further ruled that Citgo could file an application for damages after which an evidentiary hearing would be set to determine the award of exact damages, if any.

IV. ISSUES ON APPEAL

Citgo argues on appeal the bankruptcy court erred when it held that the Bank's perfected security interest in Iowa Oil's accounts receivable prevails over Citgo's right to

setoff with respect to the credit card receipts Citgo collected prior to November 15, 2002. Citgo contends the bankruptcy court's ruling is directly contrary to the universally accepted principle of commercial law that a party cannot assign greater rights than such party possesses. Citgo contends the Bank's perfected security interest is subordinate to Citgo's right to setoff under Iowa Code § 554.9404 (formerly §554.9318), which represents § 9-404 of Article Nine of the Uniform Commercial Code as adopted by the Iowa legislature.

Citgo further contends the bankruptcy court erred in ruling that the amount of Citgo's setoff was limited by the 90-day rule set forth in 11 U.S.C. § 553(a)(3). Citgo maintains the bankruptcy court erred in holding that Iowa Oil, the party seeking to avoid the setoff, met its burden of proof with respect to whether Citgo's right of setoff was available under § 553(a)(3).

Next, Citgo posits the bankruptcy court erred when it held Citgo must turn over credit card receipts collected postpetition because Citgo has the right to offset the value of its Lanham Act claim against the credit card receipts Citgo collected postpetition. Citgo therefore urges the bankruptcy court's ruling regarding Citgo's obligation to turn over such credit card receipts should be held in abeyance pending a final determination of the value of Citgo's postpetition administrative claim for trademark infringement.

Finally, Citgo asserts the bankruptcy court erred when it ruled Citgo was not entitled to recoup the $525,438 of excise taxes that Citgo paid to the States of Iowa and Wisconsin on Iowa Oil's behalf. Citgo contends it gave up its right to recover these funds from the States because of Iowa Oil's express assurances that Citgo would be reimbursed for the amounts expended and the time period in which Citgo could have recovered those amounts has passed. Citgo maintains Iowa Oil should be estopped under Iowa law from benefitting from its own false assurances. Citgo further asserts the bankruptcy court ignored a Wisconsin statute which addresses the situation in which a bankrupt motor fuel

distributor fails to reimburse its supplier for taxes paid on its behalf. Citgo urges its right to recoup the Wisconsin motor fuel taxes paid on Iowa Oil's behalf should have priority over the Bank's right to the credit card receipts under the Wisconsin statute.

V. ANALYSIS

A. Citgo's Right to Setoff versus the Bank's Perfected Security Interest

Iowa Oil filed the instant Turnover Complaint seeking to force Citgo to surrender to the bankruptcy estate the credit card receipts for sales made by Iowa Oil convenience stores Citgo has been retaining since November 7, 2002. November 7, 2002 is the date on which Citgo gave Iowa Oil notice it would be applying all credit card receipts collected to Iowa Oil's outstanding debt to Citgo. Citgo asserted its right to setoff under Paragraph 10 of the Agreement as a defense to Iowa Oil's Turnover Complaint. Citgo maintains Citgo is allowed under the terms of the Agreement to offset the credit card receipts at issue against the debt owed to Citgo by Iowa Oil for petroleum purchases made by Iowa Oil from Citgo.

The bankruptcy court concluded the following regarding Citgo's right to setoff the credit card receipts it collected on Iowa Oil's behalf against the debt owed to Citgo by Iowa Oil:

> While determining a creditor's right of setoff versus the rights of a secured party, the Eighth Circuit stated that "Article 9 governs the priority between [the] right to setoff and a perfected security interest." *In re Apex Oil Co.*, 975 F.2d 1365, 1368 (8th Cir. 1992). The *Apex Oil* court continued, "Indeed, we can imagine few situations which fit more snugly within Article 9's domain than a priority dispute between an account debtor and a secured party." *Id.* A perfected security agreement has priority over an unrecorded security agreement. Iowa Code § 554.9322.
>
> Citgo has no right to the credit card proceeds at issue through

its rights of setoff. All proceeds collected post-petition by Citgo are nonmutual. *[In re] American Central Airlines*, 60 B.R. [587], 590 [(Bankr. N.D. Iowa 1986)]. There is no right to setoff debts that lack mutuality. While all the credit card receipts collected pre-petition represent a mutual debt between [Iowa Oil] and Citgo, § 553(a) specifically prohibits a creditor from retaining the funds collected through setoff on and after 90 days prior to the filing of the bankruptcy petition. The purpose of this section is to discourage creditors from withholding payments to a financially distressed company resulting in an increased probability that the debtor must seek protection in bankruptcy. *In re Elcona Homes Corp.*, 863 F.2d 483, 484 (7th Cir. 1988) ("An important purpose of bankruptcy law is to prevent individual creditors from starting a 'run' on the debtor by assuring that they will be treated equally if the debtor is precipitated into bankruptcy, rather than being given either preferential treatment for having jumped the gun or disadvantageous treatment for having hung back."). Under § 553(a), Citgo is only entitled to retain the credit card receipts collected prior to November 15, 2002, the 90 day prepetition date.

Citgo's setoff rights to the credit card receipts collected prior to November 15, 2002 are in direct conflict with the Bank's perfected security interest in [Iowa Oil's] account receivables. "In essence, the right of setoff 'elevates an unsecured claim to secured status, to the extent that the debtor has a mutual, pre-petition claim against the creditor.'" *In re Communication Dynamics, Inc.*, 2003 WL 22345713, at *2 (Bankr. D. Del. 2003) (quoting *In re Univ. Med. Ctr.*, 973 F.2d 1065, 1079 (3d Cir. 1992)). The [c]ourt must resolve this conflict according to Iowa law.

Iowa Code § 554.9201 allows the security interest created in favor of Citgo to be effective between Citgo and the Debtor. However, since the Bank has a competing security interest in [Iowa Oil's] accounts, this [c]ourt must look to Iowa Code §

> 554.9322 to resolve this conflict. That section provides that the security interest which is first perfected by the filing of a financing statement shall have priority over later filed security interests and unperfected security interests. The only exception contained within Article 9 to give a secured party a priority of setoff is found in § 554.9340. However, that section applies to financial institutions and is therefore not available to benefit Citgo.
>
> Citgo must turn over all credit card receipts withheld from [Iowa Oil] as the Bank's security Interest in those accounts is superior to Citgo's and the Bank demands that the credit card receipts be paid over to [Iowa Oil]. Had Citgo filed a financing statement when this security interest was first created, a different priority scheme would be created but a goal of Article 9 is to discourage the creation of secret liens. Under well-established legal principles, the Bank's perfected security interest prevails over Citgo's unperfected security interest.

Order Re: Motion for Summary Judgment, December 12, 2003 at 6-7.

Citgo argues on appeal the bankruptcy court erred in failing to apply Iowa Code § 554.9404 (formerly § 9-318), which codifies the principle that a party cannot assign to another greater rights than the party possesses. Citgo urges the Bank's perfected security interest is subject to Citgo's right to setoff under § 554.9404. The Bank argues in response that Citgo waived its right to setoff in this case. Alternatively, the Bank maintains Citgo has no right to offset or recoupment in this case. Finally, the Bank contends the Iowa Court of Appeals' decision in *West Des Moines State Bank v. Brunswick Corp.*, 483 N.W.2d 338 (Iowa App. 1992), governs this case. The Bank asserts under the ruling in *West Des Moines State Bank* that its perfected security interest in Iowa Oil's accounts has priority over Citgo's right to setoff the credit card receipts in question because Citgo had notice of the Bank's interest prior to the date on which Citgo's right of

offset accrued.

It appears, based on the portion of the bankruptcy court's opinion recited above, the bankruptcy court held Citgo has a contractual right to setoff the credit card receipts collected by Citgo prior to November 15, 2002 against the amounts owed to Citgo by Iowa Oil for petroleum purchases under the Agreement. The bankruptcy court then analyzed Citgo's right to the credit card receipts collected prior to November 15, 2002 as an issue of a conflict in priority between an unperfected security interest and a perfected security interest under Iowa Code § 554.9322. The court's review of the record and the applicable law leads it to conclude the bankruptcy court applied the incorrect standard to Citgo's interest in the credit card receipts. The court finds the issue is correctly framed as that of a conflict in priority between Citgo's right of setoff and the Bank's perfected security interest under Iowa Code § 554.9404.

The Eighth Circuit Court of Appeals has recognized Article 9 of the Uniform Commercial Code, specifically § 9-318 (now § 9-404), governs the priority between the right to setoff and a perfected security interest. *In re Apex Oil Co.*, 975 F.2d at 1368. *See also In re Calore Express Co.*, 288 F.3d 22, 45 (1st Cir. 2002) (noting that a "right of setoff fits within subsection 9-318(1)(b)'s description of 'a defense or claim of the account debtor against the assignor'" and holding "to the extent we could properly view the dispute between [the secured creditor] and the [account debtor] as either a contest 'of priority between conflicting security interests' or a question of the validity of a 'defense or claim of the account debtor against the assignor,' we should adopt the latter perspective") (citations omitted); *Commerce Bank, N.A. v. Chrysler Realty Corp.*, 244 F.3d 777 (10th Cir. 2001) (holding under Kansas Stat. Ann. § 84-9-318 a manufacturer's contractual right of setoff is superior to a bank's perfected security interest); *In re Alliance Health of Fort Worth, Inc.*, 240 B.R. 699, 704 (N.D. Texas 1999) ("Although the right to set-off is not

an Article 9 security interest, § 9-318 determines the priority between a right of set-off and a security interest. . . . It provides that the right to set-off (a defense to payment) prevails over a perfected security interest unless the account debtor . . . had actual notice of the security interest before the set-off right accrued. . . . And, mere filing of a UCC financing statement is not notice for purposes of §9-318." (citing *In re Otha C. Jean & Assocs., Inc.*, 152 B.R. 219, 222 (Bankr. E.D. Tenn. 1993); *Zion's First Nat'l Bank, N.S. v. Christiansen Bros., Inc.* (*In re Davidson Lumber Sales, Inc.*), 66 F.3d 1560, 1565-66 (10th Cir. 1995)).

The Iowa legislature has adopted the Article 9 of the Uniform Commercial Code and Iowa courts have acknowledged that Iowa Code § 554.9318 prevents an assignee from obtaining greater rights than an assignor, even when the assignment takes the form of a perfected security interest. *See First Federal State Bank v. Town of Malvern*, 270 N.W.2d 818, 820 (Iowa 1978) (holding that § 554.9318 codified the common law concept that claims of an assignee are no higher or greater than those of the assignor, even where the assignment is a perfected security interest); *West Des Moines State Bank*, 483 N.W.2d at 343 (noting under § 554.9318 that "[a]n assignee takes its interest subject to defenses or claims of the account debtor against the assignor which accrue before the account debtor receives notification of the assignment" (citing Iowa Code § 554.9318(1)(b) (1991)). Iowa has adopted the revised version of the Uniform Commercial Code. Iowa Code § 554.9404 (formerly § 554.9318) now governs the priority between a creditor's rights to recoupment and setoff and a security interest. This provision states, in pertinent part:

> 1. Assignee's rights subject to terms, claims and defenses – exceptions. Unless an account debtor has made an enforceable agreement not to assert defenses or claims, and subject to subsections 2 through 5, the rights of an assignee are subject to:
> a. all terms of the agreement between the account debtor and

> assignor and any defense or claim in recoupment arising from the transaction that gave rise to the contract; and
> b. any other defense or claim of the account debtor against the assignor which accrues before the account debtor receives a notification of the assignment authenticated by the assignor or the assignee.
> 2. Account debtor's claim reduces amount owed to assignee. Subject to subsection 3 and except as otherwise provided by subsection 4, the claim of an account debtor against an assignor may be asserted against an assignee under subsection 1 only to reduce the amount the account debtor owes.

Iowa Code § 554.9404(1), (2). Because the bankruptcy court correctly ruled Citgo had no right to recoup the credit card receipts at issue, § 554.9404(1)(a) does not apply in this case. Thus, under § 554.9404(1)(b), the Bank's rights to the credit card receipts as Iowa Oil's assignee are subject to Citgo's right to setoff provided Citgo's claim to the credit card receipts at issue arose before Citgo received notice of Iowa Oil's assignment of its rights to the Bank from either the Bank or Iowa Oil. Iowa Code § 554.1201(26) provides:

> A person "notifies" or "gives" notice or notification to another by taking such steps as may be reasonably required to inform the other in the ordinary course whether or not such other actually comes to know of it. A person "receives a notice or notification when (a) it comes to that person's attention; or (b) it is duly delivered at the place of business through which the contract was made or at any other place held out by that person as a place for receipt of such communications.

The Iowa Supreme Court has interpreted this provision to require actual notice of an assignment for purposes of "notification" under § 554.9318. *See Judah AMC & Jeep, Inc. v. Old Rep. Ins. Co.*, 293 N.W.2d 212, 214 (Iowa 1980).[2] The court finds this analysis

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[2] The court disagrees with the Bank's assertion that the filing of a financing statement provided sufficient notice for purposes of former § 554.9318. While the Iowa (continued...)

of the notification issue also applies to notification under § 554.9404.

As the court previously noted, the bankruptcy court held Citgo had the right under the Agreement to setoff the credit card receipts Citgo collected prior to November 15, 2002. There is no evidence Citgo received actual notice of Iowa Oil's assignment to the Bank of its rights to the credit card receipts Citgo collected during this period. Accordingly, the court finds the Bank's right to the credit card receipts collected by Citgo prior to November 15, 2002 is subordinate to Citgo's right to setoff under § 554.9404(1)(b). Accordingly, Citgo is entitled to retain the amount of the credit card receipts collected prior to November 15, 2002.

B. Citgo's Right to Setoff Credit Card Receipts Collected during 90-Day Prepetition Period

Citgo asserts while the bankruptcy court correctly found Citgo is entitled to setoff, the court erroneously held that "[u]nder § 553(a)(3) Citgo is only entitled to retain the credit card receipts collected prior to November 15, 2002, the 90 day prepetition date." Citgo argues § 553(a)(3) precludes setoff only where the debt was incurred by the creditor "(a) after 90 days before the date of the filing of the petition; (b) while the debtor was

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[2](...continued)
Court of Appeals ruled in *West Des Moines State Bank* that the party seeking setoff had notice of the bank's security interest because the bank had filed a financing statement, the court cited § 554.1201(26) in support of this proposition. The court reads § 554.1201(26) to require more than the constructive or public notice provided by the filing of a financing statement. Accordingly, the court elects to follow the Iowa Supreme Court's interpretation of the requisite notification of an assignment under § 554.9318 to the extent it is inconsistent with that of the Iowa Court of Appeals. Moreover, the court finds the revised version of the Article 9 of the Uniform Commercial Code as adopted by the Iowa legislature governs the issue of priority in this case. The revised version of Article 9 became effective in 2001 and Citgo's right to setoff under the Agreement accrued in 2002.

insolvent; and (c) for the purpose of obtaining a right of setoff against the debtor." Citgo contends Iowa Oil failed to carry its burden of proof with respect to the final element of the conjunctive test for avoiding setoff under § 553(a)(3). Citgo asserts there is no evidence from which the bankruptcy court could have concluded Citgo engaged in a "deliberate manipulation . . . to incur a prepetition debt to the debtor for the sole purpose of triggering setoff." Citgo contends Iowa Oil must make such a showing before the court can conclude the exception to the right of setoff embodied in § 553(a)(3) applies.

The Bank argues in response there is evidence in the record Citgo engaged in deliberate manipulation during a time that Citgo was not engaged in any business purpose with Iowa Oil as it had stopped supplying product to Iowa Oil. In particular, the Bank points out that Citgo, a sophisticated trade creditor, used self-help to seize the credit card receipts from Iowa Oil even after Citgo had stopped supplying petroleum products to Iowa Oil. Despite the fact that Citgo no longer was supplying product to Iowa Oil, Citgo retained the credit card proceeds it collected and unilaterally decided to continue to collect and hold credit card proceeds for 8 1/2 months after Iowa Oil filed bankruptcy. The Bank asserts the only purpose Citgo could have for retaining Iowa Oil's credit card receipts is to retain sufficient funds to cover the prepetition debt owed to Citgo by Iowa Oil.

"The right of setoff (also called "offset") allows entities that owe each other money to apply their mutual debts against each other, thereby avoiding 'the absurdity of making A pay B when B owes A.'" *Citizens Bank of Maryland v. Strumpf*, 516 U.S. 16, 18 (1995) (quoting *Studley v. Boylston Nat'l Bank*, 229 U.S. 523, 528 (1913)). The Bankruptcy Code does not create a federal right of setoff. *Id.* at 19. Rather, 11 U.S.C. § 553(a) "provides that, with certain exceptions, whatever right of setoff otherwise exists is preserved in bankruptcy." *Id.*

A creditor's right of setoff against a debtor in bankruptcy is allowed only to the

extent provided by § 553 which 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, except to the extent that –
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> * * *
>
> (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.

11 U.S.C. § 553(a). A debtor is "presumed to have been insolvent on and during the 90 days immediately preceding the filing of the petition." 11 U.S.C. § 553(c). It is the burden of the creditor to establish the debtor is solvent. 4 *Collier on Bankruptcy* § 553.03[5][a][ii] (15th ed. revised 2004).

Thus, to establish a right to a setoff under § 553, the creditor must show:

> 1. A debt owed by the creditor to the debtor which arose prior to the commencement of the bankruptcy case;
> 2. A claim of the creditor against the debtor which arose prior to the commencement of the bankruptcy case; and
> 3. The debt and claim are mutual obligations.

In re Brooks Farms, 70 B.R. 368, 371 (Bankr. E.D. Wis. 1987) (citing *In re Fred Sanders Co.*, 33 B.R. 310 (Bankr. E.D. Mich. 1983); *In re Morristown Lincoln-Mercury*, 42 B.R. 413 (Bankr. E.D. Tenn. 1984); *In re Taylor Motors*, 60 B.R. 760 (Bankr. D. Nev. 1986)). The mutuality requirement of § 553 requires that something be "owed" by both sides. *In re Donnay*, 184 B.R. 767, 787 (Bankr. D. Minn. 1995). To establish mutuality, the court

must find that "(1) the debts are in the same right; (2) the debts are between the same parties; and (3) the parties stand in the same capacity." *Id.* (citing *In re Bay State York Co.*, 140 B.R. 608, 614 (Bankr. D. Mass 1992)). Mutuality does not require that the debts have the same character or have arisen from the same transaction. *Id.* (citing 4 *Collier on Bankruptcy* § 553.04[1] (15th ed. 1994)).

The Bankruptcy Code imposes certain restrictions on the right of setoff recognized in § 553(a). One such restriction, set forth in "[§] 553(a)(3)[,] bars setoff if the creditor became indebted to the debtor for the purpose of obtaining a right of setoff and the debt was incurred within 90 days before the commencement of the debtor's case while the debtor was insolvent." 4 *Collier on Bankruptcy* § 553.03[5][b] (15th ed. revised 2004). As one court has recognized, § 553(a)(3) "is intended to eliminate an opportunity for a creditor to engage in some form of manipulation at the expense of other creditors." *In re Brooks Farms*, 70 B.R. at 372. *See also In re Bohlen Enterps., Ltd.*, 78 B.R. 556, 560-61 (Bankr. N.D. Iowa, 1987), *aff'd,* 91 B.R. 486 (N.D. Iowa 1987), *reversed on other grounds*, 859 F.2d 561 (8th Cir. 1988) (holding, in the context of a bank's right of setoff, where a bank seeks to setoff deposit funds which are not obtained in the ordinary course of business or which are "procured, accepted or 'built up' for the real purpose of allowing the [creditor] to obtain a setoff, the deposits will be considered preferential in effect and the right of setoff is lost under § 553(a)(3)").

The bankruptcy court held Citgo's right to setoff credit card receipts Citgo collected during the 90-day prepetition period is prohibited under § 553(a)(3). However, the bankruptcy court made no specific factual findings in support of the bankruptcy court's conclusion that Citgo retained these credit card receipts for the purpose of obtaining the right of setoff as required by § 553(a)(3)(c). Where a "bankruptcy court's findings are silent or ambiguous as to an outcome determinative fact question, [the appellate court] may

not make [its] own findings, but must remand the case to the bankruptcy court for the necessary factual determination." *Sholdan v. Dietz*, 108 F.3d 886, 888 (8th Cir. 1997). While the facts of this case may well support a finding that Citgo retained credit card receipts during the 90-day prepetition period for the purpose of obtaining a setoff under § 553(a)(3), this court cannot make such finding. Accordingly, the court remands the issue of Citgo's right to setoff credit card receipts collected in the 90-day prepetition period for further findings of fact on the issue of whether Citgo retained the funds at issue for the purpose of obtaining a right to setoff under § 553(a)(3).

C. Citgo's Right to Setoff Postpetition Lanham Act Damages against Credit Card Receipts Collected

Citgo seeks a ruling by this court that Citgo is entitled to setoff Citgo's postpetition claim for damages Citgo has suffered due to Iowa Oil's violation of the Lanham Act against any postpetition credit card receipts retained by Citgo. The bankruptcy court held unless the parties can agree on an appropriate measure of damages an additional hearing will be necessary to allow Citgo to prove up the monetary damages it suffered, if any. The court notes Citgo has not yet proved it suffered any monetary damages as a result of Iowa Oil's violation of the Lanham Act. The court finds Citgo's claim for postpetition setoff under § 553 is best addressed by the bankruptcy court in the first instance after Citgo has established that it actually has suffered monetary damages as a result of Iowa Oil's violation of the Lanham Act in this case. Accordingly, the court declines to determine at this point whether Citgo is entitled to a postpetition setoff in this regard.

D. Citgo's Claim for Recoupment of State Fuel Taxes

Citgo's final issue on appeal is whether the bankruptcy court erred in holding Citgo was not entitled to recoup the fuel taxes it paid to the States of Iowa and Wisconsin on Iowa Oil's behalf. Citgo maintains principles of equity dictate that Citgo should be able

to recoup the $525,438 of excise taxes it paid to the States of Iowa and Wisconsin on Iowa Oil's behalf. In support of this contention, Citgo alleges it neglected to exercise its right to obtain a refund from the States for the motor fuel taxes it paid on Iowa Oil's behalf based upon the express assurances of Iowa Oil that Citgo would be reimbursed for the amounts Citgo expended in this regard. Citgo contends Iowa Oil should be estopped under Iowa law from benefitting from Citgo's reliance on Iowa Oil's false assurances. Citgo further posits the roughly $257,390 it paid to the State of Wisconsin should be considered a preferred claim in the bankruptcy estate under § 78.71 of the Wisconsin Code.

The Bank argues in response the doctrine of equitable estoppel as established under Iowa law does not apply to Citgo's claim in this case. The Bank further contends Citgo seeks to impose a constructive trust in its favor under § 78.71 of the Wisconsin Code and this provision provides a trust is created for the benefit of the State and not for the benefit of a supplier such as Citgo. As such, it is the Bank's position Citgo is not entitled to reimbursement from Iowa Oil's funds paid to Wisconsin or Iowa for fuel taxes because there is no trust for Citgo's benefit and because Citgo failed to seek a refund from these States in the three months after Citgo knew of Iowa Oil's financial difficulties.

The court's review of the applicable law leads it to conclude the bankruptcy court did not err in holding Citgo is not entitled to recoup the prepetition gasoline taxes it paid to the States of Iowa and Wisconsin on Iowa Oil's behalf. Citgo's payment of state gasoline taxes did not arise out of the same transaction as the credit card receipts at issue here for purposes of the doctrine of recoupment and therefore it is not available to Citgo. Moreover, the evidence in the record shows while Citgo knew Iowa Oil was in financial straits and Citgo had the right to go to the States of Iowa and Wisconsin to seek reimbursement for the fuel taxes paid on behalf of Iowa Oil, Citgo neglected to do so. Citgo alleges its failure to do so is based solely upon representations made to Citgo by

Iowa Oil. The court is unconvinced its refusal to allow Citgo to recoup the state fuel taxes will result in unjust enrichment to Iowa Oil. The court agrees with the finding of the bankruptcy court that Citgo's position in this case is no different than that of a party who extended a cash loan to the debtor who then used the funds to pay another creditor. The court further finds the bankruptcy court correctly concluded Citgo simply extended too much credit to Iowa Oil without obtaining a perfected security interest in Iowa Oil's assets. Citgo should not therefore be allowed to obtain preferential treatment regarding these funds through the doctrine of recoupment.[3]

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[3] Citgo urges the bankruptcy court erred in failing to find Citgo has a priority claim under Wisconsin law to the taxes paid in Wisconsin. In support of this proposition, Citgo asserts the bankruptcy court ignored the existence of W.S.A. § 78.71(2), which provides, in pertinent part:

> [W]hen the business of any consumer of motor vehicle fuel, general aviation fuel or alternate fuel is suspended by the action of creditors or put into the hands of any assignee, receiver or trustee, all amounts due any licensee for motor vehicle fuel . . . taxes paid to the state by the licensee on motor vehicle fuel . . . purchased from it by the consumer shall be considered preferred claims and the licensee shall be a preferred creditor to that extend and shall be paid in full for such taxes paid.

The court notes, however, that W.S.A. § 78.01(2s) also provides:

> A licensed supplier who is unable to recover the tax from a purchaser is not liable for the tax and, with proper documentation, may credit the amount of tax against a later remittance of taxes. A wholesaler distributor who is unable to recover the tax from another wholesaler distributor or from a retail dealer is not liable for the tax and, by supplying proper documentation, may apply to the department for a refund.

(continued...)

VI. CONCLUSION

In light of the foregoing, IT IS ORDERED the decision of the bankruptcy court is reversed in part and affirmed in part and the case is remanded to the bankruptcy court for further proceedings consistent with this opinion.

SO ORDERED.

DATED this 30th day of September, 2004.

LINDA R. READE
JUDGE, U. S. DISTRICT COURT
NORTHERN DISTRICT OF IOWA

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[3](...continued)
Citgo cites no authority for the proposition its failure to exercise its right to obtain a credit or refund for the amount of the taxes Citgo paid on behalf of Iowa Oil entitles it to recoup such amounts under bankruptcy law. Additionally, Citgo provides no authority addressing the issue of how the alleged preference to which it is entitled under W.S.A. § 78.71(2) has priority over a prior perfected security interest under Iowa law. Accordingly, the bankruptcy court did not err in ruling Citgo is not entitled to recoup the fuel taxes it paid to the State of Wisconsin.

Other Orders/Judgments

2:04-cv-01002-LRR Iowa Oil Company v. Citgo Petroleum Corporation

U.S. District Court

Northern District of Iowa

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Case Name: Iowa Oil Company v. Citgo Petroleum Corporation
Case Number: 2:04-cv-1002
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Document Number: 14

Docket Text:
ORDER - It is ordered the decision of the bankruptcy court is reversed in part and affirmed in part and the case is remanded to the bankruptcy court for further proceedings consistent with this opinion. Signed by Judge Linda R Reade on 9/30/04. (certified copy to Sean McAvoy, 8th Fl., 425 2nd Street SE, PO Box 74890, CR, IA 52407-4890, copy mailed to non-ecf attorney)(deve)

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