

# **In the United States Bankruptcy Court**

## **for the Northern District of Iowa**

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DAVID WILLIAM MALEK  
*Debtor(s).*

Bankruptcy No. 95-60479-W  
Chapter 13

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### **ORDER RE DEBTOR'S MOTION REGARDING PAYMENT OF ACCRUED PATRONAGE DIVIDENDS**

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This matter came before the undersigned on June 25, 1999 on Debtor's Motion regarding payment of accrued patronage dividends. Debtors appeared with Attorney Lewis Churbuck. Winneshiek Coop Association appeared by Attorney Rick Zahasky. After the presentation of evidence and argument, the Court took the matter under advisement. The time for filing briefs has now passed and this matter is ready for resolution. This is a core proceeding pursuant to 28 U.S.C. §157(b)(2)(A), (C), (E).

#### **STATEMENT OF THE CASE**

Debtor requests an order requiring Winneshiek Cooperative Association ("the Coop") to pay accrued patronage dividends in his account to the Chapter 13 Trustee. The Coop resists. It asserts it is entitled to set off the patronage dividends against the amount Debtor owes on the Coop's claim.

#### **FINDINGS OF FACT**

The parties filed a Joint Stipulation of Facts which the Court adopts as part of its findings of fact. Debtor filed his Chapter 13 petition on March 22, 1995. He scheduled the Coop as a secured creditor based on a judgment entered in September 1994. Debtor's confirmed plan treats the Coop as a secured creditor with a claim of \$19,600. Under the plan, the Coop would receive \$256.68 per quarter for the first three years of the plan and \$2,065.18 per quarter for the last two years of the plan. The Court recently confirmed a Fourth Amended Plan reducing the amount of quarterly payments and providing for a balloon payment in June 2000. Neither of the confirmed plans provide for setoffs of Debtor's accrued patronage dividends against the Coop's claim.

The parties stipulate that patronage dividends accrued between 1988 and 1992 which were not paid to Coop patrons prior to the time Debtor filed his Chapter 13 petition. The Coop Board of Directors decided to pay these accrued dividends to its members between August 1995 and August 1998. Rather than paying Debtor directly, the Coop set off the patronage dividends against the remainder of its claim against Debtor. The parties stipulate that the Coop's bylaws provide that it has the right to offset patronage dividends against accounts of Coop members. Debtor did not disclose the patronage dividends as an asset in his schedules.

The Coop concedes that three of the setoffs arose solely from postpetition dividends. These are:

<u>Date Paid</u>	<u>Amount</u>	<u>Year Accrued</u>
5/22/96	\$ 14.01	1995
5/16/97	4.81	1996
3/20/98	404.40	1997
<b>Total</b>	\$ 423.22	

The Coop set off against Debtor's account four other dividend payments which accrued prepetition, as follows:

9/21/95	\$1,427.58	1988-89
9/17/96	2,032.71	1989-90
9/22/97	2,173.83	1990-91
10/9/98	1,955.57	1991-92
<b>Total</b>	\$7,589.69	

Each year, the Coop provides each member a "Form 1099 Dividend" setting out the total amount of patronage dividends declared for that year. The Board of Directors subsequently decides when payment of those dividends will be made. The Board made decisions regarding payment of the dividends accruing between 1988 and 1992 in August of the year the payments were distributed or the offsets were credited. For example, in August 1995, the Board decided to pay the 1988-89 accrued dividends in September 1995.

### CONCLUSIONS OF LAW

The Coop asserts it is entitled to offset Debtor's patronage dividends against its claim under §553(a).

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." Although no federal right of setoff is created by the Bankruptcy Code, 11 U.S.C. §553(a) provides that, with certain exceptions, whatever right of setoff otherwise exists is preserved in bankruptcy.

Citizens Bank v. Strumpf, 516 U.S. 16, 18 (1995).

In order for the Coop to establish its right of setoff, it must demonstrate:

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 commencement of the bankruptcy case.
3. The debt and the claim are mutual obligations.

United States v. Gerth, 991 F.2d 1428, 1431 (8th Cir. 1993). "In other words, it is necessary only that the debt and the claim both arose prepetition and are mutual." Id. The creditor's debt to the debtor must be "absolutely owed" prepetition. Id. at 1433. For setoff purposes, a debt arises when all

transactions necessary for liability occur, regardless of whether the claim was contingent, unliquidated, or unmatured when the petition was filed. Id.

The Coop asserts its "debt" to Debtor consists of the patronage dividends which accrued on Debtor's behalf prepetition. It points out that it reported its annual liability for these dividends on annual Form 1099s issued to Debtor. The Coop's Bylaws provide for the right to offset patronage dividends against accounts of Coop members. Debtor counters that the patronage dividends are not "absolutely owed" until the Coop's Board of Directors decides the dividends should be paid. Such decision depends on the profitability of the Coop.

The Iowa Court of Appeals considered whether a coop member is entitled to offset patronage funds against money due on its account in Mitchellville Cooperative v. Indian Creek Corp., 469 N.W.2d 258, 261 (Iowa App. 1991).

We do not believe the patronage funds sought to be setoff by [the coop member] are an indebtedness of the cooperative which is due and payable to members, but represent an interest which will be paid at some future date to be determined by the board of directors pursuant to the priority set forth in the cooperative bylaws.

Id. at 263. The court noted that patronage funds do not reflect an indebtedness which is presently due and payable by the cooperative to its members. Id. Rather, they reflect the ownership interest of the member in retained, working capital of the cooperative. Id.

Following similar rationales, bankruptcy courts have denied cooperative associations setoffs under §553(a) for patronage dividends or equity credits. In In re Greensboro Lumber Co., 157 B.R. 921, 928 (Bankr. M.D. Ga. 1993), the court stated that under Georgia law equity credits cannot be used as a setoff against a member's present indebtedness to the cooperative association. Another court stated that allocated patronage capital which the coop directors had not yet voted to redeem remains an ownership interest and cannot be treated as a debt under §553(a). In re Eastern Maine Elec. Coop., Inc., 125 B.R. 329, 339 (Bankr. D. Me. 1991); see also In re Beck, 96 B.R. 161, 163 (Bankr. C.D. Ill. 1988) (same); In re Lamar Farmers Exch., 76 B.R. 712, 716 (Bankr. W.D. Mo. 1987) (same); In re Axvig, 68 B.R. 910, 919 (Bankr. D.N.D. 1987) (same).

Under the foregoing, the Coop has failed to prove the first element of a setoff, that it owes a debt to Debtor which arose prior to commencement of the bankruptcy case. Although the patronage dividends accrued prepetition, they did not become absolutely owing until the Coop's Board of Directors decided to pay them to members. The patronage dividends set out above all became due and owing postpetition, making them postpetition debts from the Coop to Debtor. Therefore, the Coop is not entitled to set off the patronage dividends against its prepetition claim against Debtor.

The Court recognizes that, as the parties stipulate, the Coop's Bylaws provide for setoff of the patronage dividends against a member's account. The Bankruptcy Code, however, does not allow a creditor to setoff a postpetition debt against a prepetition claim. Both the debt and the claim must arise prepetition in order for a setoff to be approved. Regardless of the Coop's rights outside the bankruptcy arena, its rights to payment in this case are determined as of the date of the petition and as set out in Debtor's Chapter 13 plan.

Under §542 and in the absence of a right of setoff under §553, the Coop is required to pay its postpetition debt to the Trustee. This postpetition debt is property of Debtor's estate as property which Debtor acquired after commencement of the case but before the case is closed. 11 U.S.C. §1306.

Debtor's motion requesting an order requiring the Coop to pay the patronage dividends in his account to Trustee must be granted.

**WHEREFORE**, Winneshiek Cooperative Association is not entitled to set off patronage dividends paid postpetition against its claim against Debtor.

**FURTHER**, the Coop is ordered to turn over to Chapter 13 Trustee the patronage dividends which became payable to Debtor postpetition.

**SO ORDERED** this 20th day of July, 1999.

Paul J. Kilburg  
U.S. Bankruptcy Judge