

In the United States Bankruptcy Court

for the Northern District of Iowa

STICKLE SALVAGE FEED INC.
Debtor(s).

Bankruptcy No. 99-02452-C
Chapter 7

Appealed to B.A.P. on 9/29/00

ORDER RE TRUSTEE'S APPLICATION TO AUTHORIZE CORRECTION OF BANK ERROR

This matter came before the undersigned for hearing on August 10, 2000 on Trustee's Application to Authorize Correction of Bank Error. Habbo Fokkena appeared as Chapter 7 Trustee. Attorney Wesley Huisinga appeared for Endres Processing LLC. Attorney Mark Rice appeared for Norwest Bank, now known as Wells Fargo Bank ("Norwest"). After hearing arguments of counsel, 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).

STATEMENT OF THE CASE

Trustee seeks Court approval for Norwest Bank's correction of a bank error. Endres Processing objects that correction of the "bank error" constitutes an improper setoff or postpetition transfer in violation of the automatic stay which adversely affects its rights to the proceeds of Debtor's bank account.

FINDINGS OF FACT

An involuntary petition was filed against Debtor Stickle Salvage Feed, Inc. on September 14, 1999. Debtor consented to the petition and the Court entered an Order for Relief under Chapter 7 on September 24, 1999. At that time, Habbo Fokkena was appointed Chapter 7 Trustee. Trustee filed a report of abandonment on October 7, 1999, abandoning all accounts receivable generated prior to the petition date.

Postpetition, Endres Processing, LLC, purchased all assets of Debtor. The Court ordered approval of the sale December 28, 1999. Endres also purchased security interests held by Norwest Bank covering all of Debtor's assets. The date of this transfer does not appear in the record. Endres has succeeded to Norwest's senior security interest in Debtor's account receivables and deposits. The bank account in question consisted of Debtor's accounts receivables.

Debtor used its account at Norwest Bank, Acct. No. 5050002898, to fund operating expenses. It made daily bank deposits to the account through a courier. Near the time the involuntary petition was filed,

Debtor began using cashiers checks to pay bills. On September 16, 1999, a bank teller at Norwest debited twelve cashiers checks for Debtor, totaling \$16,887.89, from an account which was not Debtor's. On that date, Debtor's account held a balance of \$24,232.48. Further deposits that day totaled \$135,700 and further withdrawals totaled \$30,332. Debtor's account balance has never been lower than \$16,887.89 since the cashiers checks were issued.

The account that Norwest's teller erroneously debited for Debtor's cashier checks, Acct. No. 5050002880, belonged to Don Stickle, Sr., the father of Debtor's primary owners, Donald Stickle, Jr. and David Stickle. Don Stickle, Sr. is also a minority shareholder of Debtor.

The parties stipulate Norwest's error was unintentional. The fact that Don Stickle, Sr.'s account was debited rather than Debtor's was not discovered until sometime after the parties received their October 1999 bank statements. In February 2000, after communication between Trustee, Norwest Bank and Debtor's officers and owners, Trustee authorized Norwest to correct the error and close the account. Endres Processing, LLC was entitled to the balance in the account as purchaser of Norwest's security interest in Debtor's accounts receivable. Trustee paid over to Endres \$29,372.72, the balance remaining in the account after correction of the bank error.

Endres asserts it is entitled to receive the entire account balance without deduction for the \$16,887.89 in cashier checks issued September 16, 1999. Endres argues that by correcting the error, Norwest Bank improperly performed a setoff in violation of §553. It also argues release of the funds to Norwest was an unauthorized postpetition transfer in violation of §549 and was void ab initio as a violation of the automatic stay. Endres asserts Trustee, having previously abandoned Debtors' accounts receivable, was not qualified to release the funds to Norwest. It argues the error should be treated as if Norwest loaned money to Debtor during the gap period after the filing of the petition and before the Court entered the order for relief. This would give Norwest an unsecured, "gap period" claim.

Trustee argues the \$16,887.89 remaining in Debtor's account because of the bank error is not property of the estate. Trustee states all the parties, including Endres, were aware of the error in October or November 1999. He argues if Endres receives those funds it would be unjustly enriched. Trustee suggests that under ordinary circumstances outside of bankruptcy, the account holder would be required to return the funds to Norwest or be liable for conversion or, possibly, a crime.

SETOFF, §553

A creditor's right to set off mutual obligations between it and a debtor is protected by §553. In order for a creditor to exercise a §553 right of setoff, the following circumstances must exist:

1. A debt exists from the creditor to the debtor which arose prior to commencement of the bankruptcy case.
2. The creditor has a claim against the debtor which arose prior to commencement of the case.
3. The debt and claim are mutual obligations.

United States v. Gerth, 991 F.2d 1428, 1431 (8th Cir. 1993). In other words, it is necessary that the debt and the claim both arise prepetition. Id. Where the claim or debt arise postpetition, §553 does not apply. In re Dartco, Inc., 197 B.R. 860, 872 (Bankr. D. Minn. 1996). As Norwest's error occurred postpetition in this case, §553 is not applicable.

POSTPETITION TRANSFER, §549

Avoidance of postpetition transfers is controlled by §549. The four elements of a §549 claim are: 1) the action takes place postpetition, 2) property of the bankruptcy estate is involved, 3) debtor transfers the property and 4) the transfer is not authorized by the court or the Code. In re Russell, 927 F.2d 413, 417-18 (8th Cir. 1991). In an involuntary case, a transfer occurring after the petition is filed and before the order for relief is entered, i.e. during the "gap period", is excepted from avoidance under §549(b) if the transfer is made in exchange for value. In re Pucci Shoes, Inc., 120 F.3d 38, 41 (4th Cir. 1997). Thus, transfers made during the involuntary gap period are not avoidable to the extent any postpetition value is given in exchange for the transfer. In re Rainbow Music, Inc., 154 B.R. 559, 562 (Bankr. N.D. Cal. 1993); In re Ft. Dodge Creamery Co., 121 B.R. 831, 834 (Bankr. N.D. Iowa 1990).

Generally, standing to invoke §549 avoidance powers is granted to the trustee or, if applicable, the Chapter 11 debtor-in-possession. In re New York Int'l Hostel, Inc., 157 B.R. 748, 753 (Bankr. S.D.N.Y. 1993). A duly qualified trustee is the proper party to maintain a §549 action and creditors have no right to proceed independently in their own names or on behalf of the estate. Id.

Endres points out it is not attempting to avoid a postpetition transfer under §549, which would require an adversary proceeding, see Fed. R. Bankr. P. 7001, and standing. Instead, it is merely objecting to the transaction whereby Trustee allowed Norwest to take possession of funds from Debtor's bank account which Endres considers to be part of its accounts receivable collateral. The Court notes, however, that the §549(b) exception to avoidance for gap period transfers made in exchange for value may be applicable in this situation. Also, Trustee is the appropriate party to make the decision to allow Norwest to correct its debiting error rather than seek return of the funds through §549.

RECOUPMENT

Recoupment is an equitable principle applicable in bankruptcy by focusing on the facts and equities of each case. United States v. Dewey Freight Sys., Inc., 31 F.3d 620, 623 (8th Cir. 1994). In considering recoupment, the claims of the creditor and the debtor must arise from the same transaction so that it would be inequitable for the debtor to enjoy the benefits of the transaction without meeting its obligations. Id. Generally, recoupment is applicable where there has been some type of overpayment. In re Pruett, 220 B.R. 625, 628 (E.D. Ark. 1997). The right of recoupment is not subject to the automatic stay. Id. Recoupment, which is ultimately guided by equity, may only be allowed in a manner consistent with and within the confines of the Bankruptcy Code. In re Dartco, Inc., 197 B.R. 860, 873 (Bankr. D. Minn. 1996).

In In re B & L Oil Co., 782 F.2d 155, 159 (10th Cir. 1986), the court found a classic case of unjust enrichment warranting the application of the doctrine of recoupment. The court noted that recoupment is a narrow exception to the rule that all unsecured creditors stand on equal footing in bankruptcy. Id. at 157. It allowed recoupment where the creditor had not consciously made the debtor a loan, money was paid by mistake and allowing other creditors to share in the money would give them a windfall. Id. at 159. In In re McCoy, 65 B.R. 673, 675 (Bankr. C.D. Ill. 1986), the court allowed an employer to recoup wages inadvertently paid to the debtor. It stated that permitting the debtor to retain wages he had not earned would be unjust enrichment. Id. This court in In re American Central Airlines, Inc., 60 B.R. 587, 592 (Bankr. N.D. Iowa 1986), adopted the reasoning of B & L Oil Co., and applied the doctrine of recoupment to allow a creditor to withhold postpetition subsidy payments to cover prepetition subsidies overpaid to the debtor.

UNJUST ENRICHMENT

State law controls issues concerning the nature and extent of a debtor's interest in property. In re Broadview Lumber Co., 118 F.3d 1246, 1250 (8th Cir. 1997) (considering Missouri law on constructive trusts and fiduciary duty). A bank deposit creates a debtor-creditor relationship. In re Gehrke, 158 B.R. 465, 468 (Bankr. N.D. Iowa 1993). "The deposit is a debt owed by the bank to the depositor." Id. The relationship between a bank and its customer is based on contract. Clinton Nat'l Bank v. Saucier, 580 N.W.2d 717, 719 (Iowa 1998). Absent agreement to the contrary, the provisions of Article 4 of the Uniform Commercial Code (UCC) are made express provisions of the contract. Id.; Iowa Code §§554.4101-554.4504. Additionally, Iowa Code sec. 554.1103 is applicable to bank accounts. That section provides that principles of law and equity, including, among other principles, the law of "principle and agent, estoppel, fraud, misrepresentation, duress, coercion, [and] mistake" shall supplement provisions of the UCC. See Ellefson v. Centech Corp., 606 N.W.2d 324, 332 (Iowa 2000). Thus, common law rights under the law governing mistake and restitution and the right to recover money paid under a mistake remain affirmative rights through UCC 1-103. See Iowa Code §554.3418 cmt. 3; §554.4407 cmt. 5.

CONSTRUCTIVE TRUST

In Iowa, a constructive trust is a remedial device by which the holder of a legal title is held to be a trustee for the benefit of another who in good conscience is entitled to the beneficial interest. Slocum v. Hammond, 346 N.W.2d 485, 493 (Iowa 1984). It is an equitable doctrine applied for purposes of restitution to prevent unjust enrichment. Id. The constructive trust remedy may be imposed where a defendant has profited inequitably at the expense of a plaintiff. Neimann v. Butterfield, 551 N.W.2d 652, 654 (Iowa App. 1996) (finding defendant held legal title to funds for the benefit of plaintiff). Generally, if trust property is traceable, and superior rights of innocent third parties have not intervened, the beneficiary of the trust may follow and recover the trust property. State v. Hawkeye Oil Co., 110 N.W.2d 641, 647 (Iowa 1961).

There are three categories of constructive trusts: (1) those arising from actual fraud; (2) those arising from constructive fraud; and (3) those based on equitable principles other than fraud. In re Estate of Peck, 497 N.W.2d 889, 890 (Iowa 1993); Koster v. City of Davenport, 183 F.3d 762, 769 (8th Cir. 1999). "A constructive trust is an appropriate remedy against unjust enrichment whether initially tainted with fraud or not." Regal Ins. Co. v. Summit Guar. Corp., 324 N.W.2d 697, 705 (Iowa 1982). The party who seeks the imposition of a constructive trust must establish the right by clear, convincing, and satisfactory evidence. In re Estate of Farrell, 461 N.W.2d 360, 361 (Iowa App. 1990).

MISTAKE

According to Iowa law, a person who pays money based on an erroneous belief induced by a mistake of fact is entitled to restitution of the amount paid. Reeves v. Better Taste Popcorn Co., 66 N.W.2d 853, 856-57 (Iowa 1954); Shoenhair v. Merrill, 145 N.W. 919, 920 (Iowa 1914). The Iowa Supreme Court has stated: "The right to recover money paid by mistake is too well established to require argument." Fidelity Savs. Bank v. Reeder, 120 N.W. 1029, 1030 (Iowa 1909).

This rule was recently discussed in In re Ocean Petroleum, Inc., ___ B.R. ___, 2000 WL 1210513, slip op. at *5 (Bankr. E.D.N.Y. Aug. 23, 2000), applying "well settled" New York law. A party who has made a mistaken payment based on a unilateral mistake of fact may recover the payment unless that payee has changed its position in reliance on the mistaken payment. Id.; Reeves, 66 N.W.2d at 857. Similarly, "where depositors in certain banks would have been unjustly enriched were they to be allowed to retain the money they had received because of the banks' mistakes, . . . the banks could recover from their depositors the money mistakenly paid to them." Wanda Ellen Wakefield,

Annotation, Recovery of Bank of Money Paid Out to Customer by Mistake, 10 A.L.R. 4th 524, §7 (1981).

A case decided under the Bankruptcy Act, In re Country Club Casuals, Inc., 1 B.R. 274 (Bankr. S.D. Fla. 1979), is strikingly similar to the case at bar. Through a clerical error, the debtor's commercial agent transferred money to the debtor's bank account, although the money was intended to go to the accounts of two other, unrelated clients of the agent. Id. at 275. No party had acted in reliance on the error and the funds were readily traceable in the bank's custody. Id. The court stated that any court with equitable powers, under these circumstances, would grant relief. Id. at 276. The fact of the bankruptcy did not generate any defense against return of the money to the agent. Id.

CONCLUSIONS

The unusual facts of this matter require the conclusion that Trustee's authorization of payment to Norwest to correct its teller's debiting error is the appropriate solution. Because the error occurred postpetition, setoff under §553 is inapplicable. Endres does not have standing under §549 to attempt to avoid the error correction as a postpetition transfer. Trustee apparently made the decision not to invoke §549 based on equitable principles. Pursuant to the foregoing, the Court holds that equitable principles require that the funds, which were nominally property of the estate, be returned to Norwest.

Permitting Debtor, and ultimately Endres as secured creditor, to benefit from the funds erroneously retained in Debtor's bank account would constitute unjust enrichment. Concededly, the funds remained in Debtor's bank account purely through mistake. This is analogous to an overpayment for which recoupment is allowed in bankruptcy.

The parties have not presented evidence of any agreement or law which covers this situation, and the Court is aware of none. In this situation the law of constructive trusts and mistake applies. Trustee has established by clear, convincing and satisfactory evidence that equitable principles require the funds be returned to Norwest. The funds remain traceable in Debtor's account at Norwest and no superior rights of third parties have intervened.

Norwest failed to debit Debtor's account by mistake. Its right to recover the money paid out by mistake is well established under Iowa law. Debtor and Endres have not changed positions in reliance on the mistake and would unjustly be enriched if they were allowed to retain the money retained through Norwest's mistake. The fact of the bankruptcy does not require a contrary result. The Court concludes that, as a matter of equity, Norwest is entitled to return of the funds remaining in Debtor's bank account through Norwest's mistake.

WHEREFORE, Trustee's Application to Authorize Correction of Bank Error is GRANTED.

FURTHER, the Court approves return of \$16,887.89 to Norwest Bank, now known as Wells Fargo Bank, as previously permitted by Trustee.

SO ORDERED this 19th day of September, 2000.

Paul J. Kilburg
Chief Bankruptcy Judge