UNITED STATES BANKRUPTCY COURT
DISTRICT OF DELAWARE

In Re:	)	Chapter 11
	)	
RELIANCE ACCEPTANCE GROUP, INC., et al.,	)	Case No. 98-288 (PJW)
	)	
	)	Jointly Administered
Debtors.	)	
	)	
	)	
CLARENCE WILLIAMS,	)	
	)	
Plaintiff,	)	
	)	
vs.	)	Adv. Proc. No. A-98-310
	)	
RELIANCE ACCEPTANCE CORPORATION,	)	
	)	
Defendant.	)	

MEMORANDUM OPINION

Laura Davis Jones
Pachulski, Stang, Ziehl, Young & Jones
Suite 1600
919 North Market Street
P.O. Box 8705
Wilmington, DE 19899-8705

Robert S. Brady
Edwin J. Harron
Young, Conaway, Stargatt & Taylor, LLP
11th Floor, Rodney Square North
P.O. Box 391
Wilmington, DE 19899-0391

Francis A. Monaco, Jr.
Joseph J. Bodnar
Walsh, Monzack and Monaco, P.A.
1201 Orange Street, Suite 400
Wilmington, DE 19801

Albert E. Fowerbaugh, Jr.
Lord, Bissell & Brook
115 South LaSalle Street
Suite 3100
Chicago, Illinois 60603

Counsel for Interstate Indemnity Company

James H. M. Sprayregen
Steven C. Florsheim
Adam P. Merrill
J. Chad Mitchell
Kirkland & Ellis
200 E. Randolph Drive
Chicago, Illinois 60601

Co-Counsel to the Debtors
and Debtors in Possession

Robert D. Goldberg
Biggs and Battaglia
1800 Mellon Bank Center
P.O. Box 1489
Wilmington, DE 19899

Lawrence E. Abernathy
Lawrence E. Abernathy, P.A.
P.O. Box 4177
Laurel, Mississippi 39441

Ronald S. Goldser
J. Gordon Rudd, Jr.
Zimmerman Reed, P.L.L.P.
901 North Third Street
Minneapolis, Minnesota 55401

Counsel for Plaintiff

Date: December 6, 2000

WALSH, J.

Before the Court is the motion of Reliance Acceptance Corporation ("Reliance") to stay or dismiss this adversary proceeding (Doc. # 28) and the request (Doc. # 32) by Interstate Indemnity Company ("Interstate") to stay a related lawsuit previously consolidated with the adversary proceeding (the "Consolidated Suit"). For the reasons set forth below, I grant Reliance's motion to dismiss the adversary proceeding. I also order the Consolidated Suit stayed.

BACKGROUND

At issue is whether the plaintiff, Clarence Williams ("Williams"), may continue to assert a right of setoff against Reliance after having paid his indebtedness to Reliance in full. The relevant facts are not in dispute.

Williams is the plaintiff in two legal actions against Reliance. His first action is the Consolidated Suit against Reliance and Interstate, which he originally filed as a state court action in Tennessee. Williams' second suit is this adversary proceeding. Interstate removed and transferred the Tennessee action to this District and on June 22, 1999, the District Court ordered it consolidated with this adversary proceeding.

Williams filed both actions on behalf of himself and "others similarly situated," but has not yet obtained class certification in either suit. Williams also filed a class proof of claim in Reliance's bankruptcy case. Claim No. 1911. The proof of

claim is described as secured based on "setoff rights with respect to unpaid loan balances of those class members who have not paid their loans in full." Claim No. 1911 at § 5.

In his suits, Williams essentially alleges that Reliance force-placed unauthorized and excessive collateral protection insurance on automobiles and other personalty purchased by consumers and financed by Reliance. Interstate allegedly issued the contested policies. Williams himself purchased a 1994 Dodge which he financed by an installment loan contract subsequently assigned to Reliance. Williams claims that Reliance, through Interstate, force-placed automobile insurance on his car in violation of, and beyond the scope of, that permitted under his loan agreement. Based on these allegations, Williams asserts a number of class action claims against Reliance and Interstate including breach of contract, lack of good faith and fair dealing, negligence, and common law fraud and deceptive trade practices. In his adversary proceeding complaint Williams also asserts a right of setoff against Reliance based on Williams' then outstanding loan balance to Reliance.

Reliance and related entities filed for chapter 11 relief on February 9, 1998. Williams filed this adversary proceeding complaint on June 18, 1998. On July 2, 1998, I entered an order confirming the debtors' Fourth Amended Joint Plan of Reorganization (the "Plan"). Article VI of the Plan sets forth a process for treatment of disputed, contingent and unliquidated claims against

Reliance, including pre-petition legal actions. Plan, Doc. # 264, art. VI. The Plan otherwise permanently enjoins all legal actions against Reliance that are based on previously accrued causes of action. Id., art. IV, ¶ J at p. 38.

At the Plan confirmation hearing, Williams objected to confirmation on grounds that it would preclude his ability to setoff his claim against his outstanding indebtedness to Reliance. Williams did not otherwise object to the Plan, or its proposed treatment of pending litigation claims against Reliance. To resolve Williams' objection, the parties stipulated on the record that the Plan would not "impair any setoff rights of the Williams' class action group as a result of the confirmation of the plan of reorganization." A-98-310 Hearing Transcript, dated June 30, 1998, at p. 38, ll 21-23. The parties agreed that Williams could prosecute the adversary proceeding to establish his setoff rights, but no further. His other claims would be resolved pursuant to Article VI of the confirmed Plan.

In connection with the adversary proceeding, Reliance deposed Williams on July 8, 1999. At his deposition, Williams testified that in May 1999, he purchased a new automobile to replace the 1994 Dodge financed by Reliance. According to Williams, as part of the purchase transaction, an unrelated lender, Community Bank, and the new car dealer, Action Nissan, paid off Williams' outstanding loan to Reliance. Williams testified that both he and Action Nissan called to obtain a payoff figure on the

1994 Dodge. He testified that his balance with Reliance is now zero.

On discovering that Williams no longer owed it money, Reliance filed the present motion to stay or dismiss the adversary proceeding. According to Reliance, Williams cannot have a right of setoff in the absence of a mutual obligation, i.e., both a claim against, and a debt owed to, Reliance. Accordingly, it asks to dismiss the adversary proceeding because Williams is now relegated to pursing his claims under the process established by Article VI of the Plan.

Williams does not contest the procedural posture of this proceeding but denies that paying off his loan altered or modified his ability to assert a setoff. He argues that a right of setoff is established at the time the debtor files bankruptcy and is not affected by a subsequent transfer of funds. Furthermore, Williams claims that a setoff right may only be resolved in one of two ways, either by adjudication of his claims against Reliance or by an intentional waiver. Williams submits that he lacked the required intent for waiver because he did not mean to extinguish his setoff right when he bought his new car.

Interstate supports Reliance's motion and requests that I also stay the Consolidated Suit until Reliance commences the claim resolution process set forth in the Plan. According to Interstate, the resolution of Williams' proof of claim in the bankruptcy process involves the same issues as those implicated in

the prosecution of the Consolidated Suit against Interstate. Interstate argues that absent a stay, Reliance will be adversely impacted by discovery in the Consolidated Suit and will incur significant costs. Furthermore, maintaining two separate actions may subject the parties to conflicting rulings. Williams has not filed an objection to Interstate's request.

DISCUSSION

Setoff under 11 U.S.C. § 553.

Setoff in bankruptcy is governed by § 553(a)[1] which states:

> 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...
>
> 11 U.S.C. § 553(a).

As is apparent from the statute, a prerequisite of a setoff is the existence of a mutual debt and claim between the creditor and the debtor. Cohen v. The Sav. Bldg. & Loan Co. (In re Bevill, Bresler & Schulman Asset Mgmt. Corp.), 896 F.2d 54, 57 (3d Cir. 1990); Public Serv. Co. of New Hampshire v. New Hampshire Electric Coop., Inc. (In re Public Serv. Co. of New Hampshire), 884

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1 Unless otherwise indicated, all references to " §___ " are to a section of the Bankruptcy Code, 11 U.S.C. § 101 et seq.

F.2d. 11, 14 (1st Cir. 1989)("setoff may flourish in bankruptcy proceedings only where mutuality of obligation exists."). Thus, courts have held that a setoff cannot exist when the creditor pays the debt because "[o]nce a debt is paid it is no longer owed, and therefore the required mutual debts do not exist." United States v. Morris (In re McCormick), 1993 WL 246001, at *2 (D.Kan. 1993); Nat'l Bank of Boaz v. Royal Crown Bottling Co. of Boaz, Inc. (In re Royal Crown Bottling Co. of Boaz, Inc.), 29 B.R. 52, 54 (Bankr. N.D.Ala. 1981) (any right of setoff "was a right which could be exercised only before [payment of the] sum to the trustee, which is another way of saying that this payment by [the bank] extinguished any such right which it might have had."); accord In re Cloverleaf Farmer's Cooperative, 114 B.R. 1010, 1018 (Bankr. D. S.D. 1990)("An offset cannot occur unless funds to be set off are in existence in a location where the creditor may effect setoff.").

Based on this analysis, it seems clear to me that Williams lost his right to assert a setoff when he voluntarily paid his loan to Reliance in full. By paying his indebtedness Williams extinguished his liability to Reliance and thereby destroyed a required element of his cause of action, i.e., a mutual claim or obligation.

Williams acted voluntarily and under no compulsion or duress. His case is therefore distinguishable from those in which a creditor transfers money pursuant to a bankruptcy court order or at a bankruptcy trustee's request. In those cases, a creditor's right to assert setoff may survive because there is no intent to

extinguish the underlying liability which gives rise to the requisite mutuality of obligation. See, e.g., In re Public Serv. Co., 884 F.2d at 13 (payment of indebtedness pursuant to bankruptcy court judgment does not render the creditor ineligible to seek setoff where creditor otherwise asserted and maintained its rights).

Williams' argument that he did not knowingly extinguish his setoff and that he thus lacked the requisite intent to waive the right is of no avail. Williams' payment to Reliance is not a waiver, but rather, negates a required element of § 553(a). In the absence of a mutual obligation, there is no ability and accordingly no right to assert a setoff.

Even if I were to accept Williams' argument that a right of setoff is created at the outset of the bankruptcy case which somehow survives payment of the underlying debt, I find Williams is not entitled to relief here because his subsequent conduct constitutes a waiver of any such right. The law is well-settled that setoff is a privilege which a creditor can waive and lose. See, e.g., In re Metro. Int'l, Inc., 616 F.2d 83, 85 (3d Cir. 1980). A waiver is generally defined as "an intentional relinquishment or abandonment of a known right or privilege." United States v. Killen (In re Killen), 249 B.R. 585, 587 (Bankr. D.Conn. 2000) quoting Johnson v. Zerbst, 304 U.S. 458, 464, 58 S.Ct. 1019 (1938). A waiver may also be found where the creditor's conduct is inconsistent with a claim of setoff. See, e.g., In re Metro. Int'l, 616 F.2d at 85-86; In re Holder, 182 B.R. 770, 776

(Bankr. M.D.Tenn. 1995).

Williams relies on Scherling v. Chase Manhattan Bank, N.A. (In re Tilston Roberts Corp.), 75 B.R. 76 (S.D.N.Y. 1987) for the proposition that ignorance of the law negates the requisite intent for waiver. In Tilston Roberts, the bankruptcy court refused to find a waiver based on a creditor's mistaken belief that it had no right of setoff. The creditor, a bank, had agreed to turn over $252,887 to the chapter 7 trustee which the debtor had on deposit at the bank. The bank believed that the debtor had no other loans or obligations owed to the bank. Unbeknownst to the bank, however, the debtor had a second account at the bank which was overdrawn by $133,126. The bank discovered the overdrawn account after it authorized transfer of the debtor's deposit but before it had transferred the funds. The bank immediately asserted its right of setoff and put a hold on the $252,887. The trustee then moved the bankruptcy court for an order directing the bank to disgorge the funds on the theory that the bank waived its right to a setoff at the time the Bank authorized the transfer. Tilston Roberts, 75 B.R. at 77-78.

The bankruptcy court refused to find a waiver and the district court affirmed. The district court first noted that the "Second Circuit has repeatedly favored the allowance of setoffs." Id. at 79. It then affirmed the bankruptcy judge's finding that the bank could not have intended to waive that of which it had no knowledge, i.e., a right of setoff based on the existence of the debtor's second, overdrawn account. Id.

The facts of Tilston Roberts do not support Williams' argument.[2] The court there found that the bank lacked an intent to waive based on the bank's ignorance of the existence of a mutual obligation, i.e., the bank initially failed to assert a setoff based on a mistake of fact. Williams' case would be more analogous

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I also note that contrary to the Second Circuit, the Third Circuit has consistently restricted efforts by creditors to apply setoff in bankruptcy. See, e.g., United States v. Continental Airlines (In re Continental Airlines), 134 F.3d 536, 542 (3d Cir. 1998) (holding that the "right of a creditor to setoff in a bankruptcy reorganization proceeding must be duly exercised in the bankruptcy court before the plan of reorganization is confirmed; the failure to do so extinguishes the claim.") cert. denied 525 U.S. 929, 119 S.Ct. 336, 142 L.Ed. 277 (1998); In re Bevill, Bresler & Schulman, 896 F.2d at 58-59 (denying bank's right to setoff against coupon interest on bonds held by bank where bank was merely a trustee for the debtor and there was no mutual debt and claim between creditor and the debtor); Lee v. Schweiker, 739 F.2d 870, 876 n.10 (3d Cir. 1984) (holding that a post-bankruptcy setoff is substantively barred by § 553); Cooper-Jarrett, Inc. v. Central Transport, Inc., 726 F.2d 93, 96-97 (3d Cir. 1984)(holding that there was no right to setoff the debt which creditor owed debtor under a post-petition settlement agreement which resolved a pre-petition claim against the debtor); United States v. Norton, 717 F.2d 767, 774 (3d Cir. 1983)(bankruptcy court clearly acted within its powers in staying IRS from setting-off chapter 13 debtors' prepetition tax liability against post-petition tax refund where IRS failed to object to debtors' chapter 13 plan prior to confirmation); In re Mauch Chunk Brewing Co., 131 F.2d 48, 50 (3d Cir. 1942)(holding that bank relinquished whatever right to setoff it may have had when the bank manifestly and without reservation did all it possibly could have done to transfer debtor's account balances to the bankruptcy trustee); Lessig Constr., Inc. v. Schnabel Assocs., Inc. (In re Lessig Constr. Inc.), 67 B.R. 436, 441 (Bankr. E.D.Pa. 1986)("Our Court of Appeals has, consistently . . . restricted efforts by creditors, even governmental creditors, to utilize setoff."); accord In re Public Serv. Company, 884 F.2d at 13 ("[T]he circle of creditors entitled to exercise setoff rights in bankruptcy is tightly circumscribed.").

to Tilston Roberts had Williams, for example, intended to pay off a debt to another creditor and by mistake, made out the check to Reliance instead of the other creditor, thereby paying off Reliance without intending to do so. But Williams does not dispute that he intended to extinguish his liability to Reliance by having Community Bank and Action Nissan pay off the Reliance loan in full. There is no mistake of fact.

Williams' predicament is more like that of the creditor in Metro. Int'l, *supra*. In that case the Third Circuit held that a creditor's reliance on erroneous legal advice does not negate its intent to waive setoff. See Metro Int'l, 616 F.2d at 86. According to the court:

> [The bank's] contention that the waiver was not valid because it lacked the requisite intent is untenable. The [bank] can take no solace in the fact that it acted based upon a miscomprehension of the law. When the [bank] expressed its position regarding the alleged right of setoff, it did so fully cognizant of the action it was taking. The fact that it may have been misinformed regarding the current state of the law does not negate the intent it possessed at the time of its action.
>
> Indeed, intent is evidenced by clear actions or language which is indicative of the actor's resolve. It is distinguishable from motive. In this case, though the [bank] was motivated by a misunderstanding of the law, it cannot be disputed that it fully intended to waive its right of setoff.
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> Id.

It seems to me that the reasoning of Metro. Int'l is applicable here. Williams does not dispute he intended Community

Bank to pay off his existing loan to Reliance to secure the purchase of a new car. In fact, Williams himself made calls to obtain the loan pay-off amount. His ignorance of the legal effect of such pay-off on his rights under § 553 does not negate his intent. It is sufficient that Williams intended the actions which constitute the waiver.

I note in closing that Williams is not precluded from pursuing his other claims against Reliance. However, Williams must do so pursuant to the process established in Reliance's confirmed Plan.

The Request to Stay the Consolidated Suit.

Interstate requests a temporary stay of the Consolidated Suit until Reliance initiates the Plan's claim resolution process. Interstate maintains that permitting prosecution of the Consolidated Action will undermine the benefits of the claim resolution process because Williams' complaint against Interstate will inevitably require the substantial involvement of Reliance. Williams has not opposed Interstate's request.

I have the authority to stay a lawsuit "against non-debtors where an identity of interest exists between the debtor and non-debtor defendants such that the debtor is the real party defendant and the litigation will directly affect the debtor and, more particularly, the debtor's assets or its ability to pursue a successful plan of reorganization." Rickel Home Ctr. Inc. v. Baffa (In re Rickel Home Ctr., Inc.), 199 B.R. 498, 500 (Bankr. D.Del.

1996) citing In re Continental Airlines, 177 B.R. 475 (D.Del. 1993).

I hold that the Consolidated Suit falls within this standard and that a stay of the action is warranted. Williams' claims against Interstate are based on Interstate's alleged improper conduct engaged in with Reliance. The discovery in the litigation will therefore directly implicate Reliance and interfere with its ability to conclude the consummation of its Plan. It will also generate duplicate proceedings when Reliance addresses the same issues under the Plan's claim resolution process. I will therefore stay prosecution of the Consolidated Suit until Reliance initiates the claim resolution process against Williams' proof of claim.

CONCLUSION

For the reasons stated above, Reliance's motion (Doc. # 28) to dismiss this adversary proceeding is granted. Williams extinguished his right to assert a setoff against Reliance when Williams voluntarily paid in full his debt to Reliance as part of a non-bankruptcy, third-party transaction. The dismissal is without prejudice to Williams to pursue his remaining allegations against Reliance under the terms of Reliance's confirmed Plan. Interstate’s request (Doc. # 32) to stay the Consolidated Suit is also granted. All proceedings in the Consolidated Suit against Interstate are stayed until Reliance commences the claims resolution process against Williams' proof of claim.

UNITED STATES BANKRUPTCY COURT
DISTRICT OF DELAWARE

In Re:	)	Chapter 11
	)	
RELIANCE ACCEPTANCE GROUP, INC., et al.,	)	Case No. 98-288 (PJW)
	)	
	)	Jointly Administered
Debtors.	)	
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CLARENCE WILLIAMS,	)	
	)	
Plaintiff,	)	
	)	
vs.	)	Adv. Proc. No. A-98-310
	)	
RELIANCE ACCEPTANCE CORPORATION,	)	
	)	
Defendant.	)	

ORDER

For the reasons set forth in the Court's Memorandum Opinion of this date, the motion (Doc. # 28) of Reliance Acceptance Corporation ("Reliance") to stay or dismiss this adversary proceeding is GRANTED and this adversary proceeding is hereby DISMISSED. The request (Doc. # 32) of Interstate Indemnity Company ("Interstate") to stay the proceedings in action captioned Clarence Williams v. Reliance Acceptance Corp. and Interstate Indemnity Company (the "Consolidated Suit") which has been consolidated with this adversary proceeding is GRANTED. All proceedings in the Consolidated Suit against Interstate are stayed until Reliance commences the claims resolution process against Clarence Williams' proof of claim.

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Peter J. Walsh
Bankruptcy Court Judge

Date: December 6, 2000