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District of New Mexico

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UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF NEW MEXICO

In re:
WESLEY MYERS and
SONJA MYERS,
Debtors. 12-00-11511 SA

MEMORANDUM OPINION ON MOTION FOR RELIEF FROM STAY TO ALLOW A SET-OFF OF FSA PROGRAM PAYMENTS

This matter came before the Court for final hearing on the Motion for Relief from Stay to Allow a Set-off of FSA Program Payments filed by the U.S. Department of Agriculture Farm Service Agency ("FSA"). FSA appeared through the United States Attorney (Manual Lucero). Debtors appeared through their counsel George Moore. The Court took the matter under advisement at the conclusions of the final hearing, then later asked the parties for supplemental briefs on specific questions. Having considered the matter presented at the hearing, and having reviewed the briefs and relevant statutes, rules, and cases, the Court issues this Memorandum Opinion.

FACTS

In 1997 the FSA filed suit against the Debtors in United States District Court to foreclose various mortgages and security interests. On February 26, 1998, Debtors filed a Chapter 12 case, No. 12-98-11177-RR (Bankr. D. N.M.). FSA moved for stay relief. Debtors filed their chapter 12 plan, a

motion to use cash collateral, and a "motion to accept executory contracts and participate in federal farm programs administered through FSA county offices". FSA objected to the plan and the motions. On June 11, 1998 the Court denied confirmation and terminated the automatic stay. On June 25, 1998, the Debtors converted the case to chapter 7. No orders were ever entered on the cash collateral or executory contract motions. Discharge was entered October 28, 1998, and the case was closed.

FSA continued its District Court case and a foreclosure sale was set for March 22, 2000. On March 20, 2000, Debtors filed this second Chapter 12 proceeding. On June 16, 2000, Debtors filed their Chapter 12 plan; FSA objected to the plan. On July 28, 2000, the Court entered a Stipulated Order submitted by the parties that: 1) authorized Debtors to enroll in any available Department of Agriculture ("DOA") programs, 2) preserved DOA's rights as to setoff or recoupment as to any amounts which would become payable to Debtors for the years 2000, 2001, and 2002, 3) stated that the Debtors understood and agreed that they were entering a contract pursuant to 7 CFR § 1412.207(a)(3) as a successor in interest to the production flexibility contract ("PFC") approved June 18, 1996 and that the June 18, 1996 date governed as to the right of

setoff for debts owed to the US government, and that the successor in interest contract would be subject to the regulations governing offsets and withholding found at 7 CFR §§ 1403.7 and 1403.8.

On March 19, 2001, the Court entered an Order Modifying and Confirming Chapter 12 Plan. Paragraph 6(b) provides: "The Court has not ruled on the claimed secured interest of FSA under 11 U.S.C. 506(a) and the right to set-off pursuant to 11 U.S.C. 553 with respect to all program payments which include and are not limited to past and future program payments."

Setoff

11 U.S.C. § 553(a) provides, in part:

> 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...

This section does not create a federal right of setoff. Citizens Bank of Maryland v. Strumpf, 516 U.S. 16, 18 (1995). It does provide, however, that with certain exceptions whatever right of setoff otherwise exists is preserved in bankruptcy. Id.

> If a prepetition right to setoff exists under nonbankruptcy law, § 553(a) only authorizes a creditor to setoff "valid and enforceable"

> prepetition debts owed by it to the debtor against "valid and enforceable" prepetition claims owed by the debtor to the creditor. Conoco, Inc. v. Styler (In re Peterson Distrib., Inc.), 82 F.3d 956, 959 & 963 (10th Cir. 1996) ... The debts and claims in question must be "mutual", i.e., "between the same parties standing in the same capacity." Davidovich v. Welton (In re Davidovich), 901 F.2d 1533, 1537 (10th Cir. 1990)(per curiam.)

Farmers Home Administration v. Buckner (In re Buckner), 218 B.R. 137, 145 (10th Cir. B.A.P. 1998).

Recoupment

Neither of the parties argued that recoupment applies in this case. The Court also finds that recoupment does not apply to the facts of this case, at least in part because FSA seeks to offset payments from the PFC program (which did not come into existence until 1996) against FmHA (now the FSA) loans made in the 1980's. See Davidovich v. Welton (In re Davidovich), 901 F.2d 1533, 1537 (10th Cir. 1990)(Recoupment allows a creditor to offset a claim that arises from the same transaction as the debtor's claim without reliance on the setoff provisions and limitations of section 553.); Ashland Petroleum Company v. Appel (In re B & L Oil Company), 782 F.2d 155, 157 (10th Cir. 1986)(Under recoupment, a defendant meets the plaintiff's claim with a countervailing claim that arose out of the same transaction.)

The Federal Regulations

7 C.F.R. § 1951.101[1] deals generally with offsets of federal payments to "USDA Agency Borrowers":

> Federal debt collection statutes provide for the use of administrative, salary, and Internal Revenue Service (IRS) offsets by government agencies, including the Farm Service Agency (FSA) ..., herein referred to collectively as "United States Department of Agriculture (USDA) Agency", to collect delinquent debts. Any money that is or may become payable from the United States to an individual or entity indebted to a USDA Agency or other individual or entity indebted to a USDA Agency may be subject to offset for the collection of a debt owed to a USDA Agency. ... Amounts collected will be processed as regular payments and credited to the borrower's account. ... Nothing in this subpart affects the agency's common law right of set off.

7 C.F.R. § 1951.102 states that in general "Collections of delinquent debts through administrative offset will be taken in accordance with 7 CFR part 3, subpart B and § 1951.106 [dealing with related parties]." 7 CFR part 3 [Office of the

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[1] 7 C.F.R. 1951.101 and 1951.102 were amended in 2000. "With regard to ... bankruptcy, this rule changes little. ... In the case of bankruptcy, all creditor collection actions cease and the court will determine the uses of income, distribution of security and disposition of debt." Handling Payments from the Farm Service Agency (FSA) to Delinquent FSA Farm Loan Program Borrowers, 65 Fed.Reg. 50598, 50601 (Aug. 21, 2000)(to be codified at 7 C.F.R. 1951). One change in the regulations made it easier for USDA Agency Borrowers to offset by eliminating the requirement that debts be accelerated before being offset. See Handling Payments from the Farm Service Agency (FSA) to Delinquent FSA Farm Loan Program Borrowers (Interim final rule), 62 Fed.Reg. 41794, 41795 (Aug. 1, 1997)(to be codified at 7 C.F.R. 1951). This change is not relevant to this case.

Secretary of Agriculture; Debt Management], subpart B [Debt Collection] § 3.21 provides, in relevant part:

> (a) The regulations in this subpart are issued under the Federal Claims Collection Act of 1966, as amended by the Debt Collection Act of 1982 ... prescribing Government-wide standards for administrative collection ...
> (b) ... An agency head may adopt regulations, in accordance with the Debt Collection Act and the Joint Regulations, setting out agency procedures for the collection by administrative offset of such claims and debts. If the head of an agency of the Department adopts regulations separate from this subpart, the procedures thereby established, rather than those set out in this part, shall be followed for the collection of the claims and debts to which the separate regulations apply.

7 C.F.R. § 1412 deals specifically with "Production Flexibility Contracts for Wheat, Feed Grains, Rice, and Upland Cotton." Producers have the opportunity to enter into a Production Flexibility Contract ("PFC") with the Commodity Credit Corporation ("CCC") for the years 1996 through 2002. 7 C.F.R. § 1412.101. The PFC program is administered under the general supervision of the CCC and is carried out by state and county Farm Service Agency ("FSA") committees. 7 C.F.R. § 1412.102(a). PFCs are 7-year contracts. 7 C.F.R. § 1412.201(a). PFCs begin with the 1996 crop and terminate on September 30, 2002. 7 C.F.R. § 1412.501(b)-(c). See also 7 U.S.C. § 7212(b)(The PFC begins with the 1996 crop and "the term of a contract shall extend through the 2002 crop.") A

transfer (or change) in the interest of an owner or producer subject to a contract results in a termination of the contract unless the transferee agrees to assume all obligations under the contract. 7 C.F.R. § 1412.201(b); 7 U.S.C. § 7217(a). A person may succeed to the PFC if there has been a change in the operation of the farm, such as bankruptcy. 7 C.F.R. § 1412.207(a)(3). The regulations governing offsets and withholdings found at 7 C.F.R. § 1403 are applicable to PFCs. 7 C.F.R. § 1412.406(a). Therefore, FSA's statement in its Supplemental Brief, docket #79, page 1, that § 1403 does not apply to the FSA is incorrect.

7 C.F.R. § 1403 details "Debt Settlement Policies and Procedures" for the CCC. These procedures are made applicable to PFCs through 7 C.F.R. § 1412.406(a). 7 C.F.R. § 1403.7 discusses collection by administrative offset. Subsection (b) provides a general rule that debts due CCC may be collected by administrative offset from amounts payable by CCC provided certain procedural safeguards are followed. Subsection (s) provides, however, that "Offset action will not be taken against payments when: ... (2) A debt has been discharged as provided in § 1403.15." 7 C.F.R. § 1403.15(a)(1) provides, in part:

> [A] debt or part thereof owed CCC shall be discharged and the records and accounts on that debt closed in the following situations:
> (1) When an obligation or part thereof is discharged in bankruptcy.

In fact, the regulations contemplate bankruptcy in several sections. 7 C.F.R. § 1403.15(d) requires that discharged debts be reported to the Internal Revenue Service. 7 C.F.R. § 1403.7(j)(1)(v) deals with the CCC offsetting amounts payable by CCC to the debtor when an agency of the U.S. government has submitted a written request to CCC for offset. The written request must certify that the debtor has not filed for bankruptcy. If the debtor has filed for bankruptcy, a copy of an order terminating the automatic stay must be included.

Discussion

The federal regulations purport not to affect the agency's common law right of set off, 7 C.F.R. § 1951.101, but the language of 1403.7(s)(2) (incorporating 1403.15) is specific: there shall be no setoff when an obligation is discharged in bankruptcy. The Court finds that in this case the specific language prohibiting setoff of discharged debts takes precedence over the more general language that allows setoff. 7 C.F.R. § 3.21(b)(quoted above). In fact, the regulations seem to contemplate a situation where the debtor has filed bankruptcy and received a discharge, and is then

dealing with CCC about getting his/her payments. Although the regulations appear not to explicitly contemplate their use within a subsequent bankruptcy, there is nothing preventing a debtor from using those regulations – and in fact, it would probably be a violation of 11 U.S.C. §§ 362, 524 or 525 not to allow the debtor to use them even the "second time around."

In Buckner, the Bankruptcy Appellate Panel considered a Conservation Reserve Program ("CRP") contract between the debtors and the Farmers Home Administration. 218 B.R. at 139. Like the PFC payments in this case, CRP payments are spread out over several years based on a single prepetition contract. In Buckner, however, there was no discussion of 7 C.F.R. § 1403.7(s)(2) because presumably those debtors had not filed a previous bankruptcy. In other words, the bankruptcy provisions of the regulations only deal with a bankruptcy that has occurred previous to the time that the regulations are invoked and applied[2]. Therefore, while the Buckner decision is helpful, it is not completely on point.

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[2] The language of § 1403.7(s)(2) supports this interpretation: "Offset action will not be taken against payments when: ... (2) A debt has been discharged as provided in § 1403.15." (emphasis added.) Presumably this section regarding discharge would not have applied if FSA tried to offset in the first bankruptcy because the debt would not have yet been discharged.

The July 28, 2000 Stipulated Order does not require a different result. All the parties did in that Order was preserve everyone's rights pursuant to the regulations, and in effect just said that the debt collection regulations were applicable. The debtors did not waive their protections under the regulations. And, by specifically adopting § 1403.7, the Order adopted the bankruptcy related regulations of § 1403.7(s)(2).

Conclusion

For the reasons set forth above, the Court will enter an Order denying FSA's Motion for Relief from Stay to Allow a Set-off of FSA Program Payments.

Honorable James S. Starzynski
United States Bankruptcy Judge

I hereby certify that on April 12, 2002, a true and correct copy of the foregoing was either electronically transmitted, faxed, delivered, or mailed to the listed counsel and parties.

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