

SAIF v. Harmon, BAP No. OR-93-2179-VHAs  
Adv. No. 93-3422

In re Harmon, Case No. 392-35798-hlh7

10/25/95                      BAP, reversing DDS                      Published

Debtor suffered a workers' compensation injury in 1985 for which she filed a workers' compensation claim against SAIF in 1987. SAIF paid debtor more than \$28,000 between 1987 and 1992 for "time loss" or temporary total disability. In 1992 SAIF determined debtor was medically stationary and had no permanent disability. SAIF thereafter determined that debtor had received overpayments of approximately \$10,000. Debtor appealed the denial of permanent disability and filed bankruptcy. SAIF brought a declaratory judgment action to determine whether SAIF could present its counterclaim for offset of the overpayment against the debtor's appeal for permanent disability payments. Debtor had asserted that SAIF would violate either §362 during the bankruptcy or §524 after discharge by pursuing the counterclaims. Judge Sullivan adopted the conclusion of a prior advisory letter by Judge Hess relying on Lee v. Schweiker, 739 F.2d 870 (3d Cir. 1984) in determining that SAIF could not recover excess temporary disability payments from any future permanent disability award. SAIF appealed to the BAP; the appeal was dismissed as not ripe for review because no permanent award had been established. The Workers' Compensation Board adopted the state referee's permanent disability award. Debtor did not appeal this decision. SAIF thereafter reinstated the appeal to the BAP.

The BAP reversed. The BAP discussed the doctrines of setoff and recoupment. Because debtor's entitlement to both the temporary and permanent awards arose with and are based upon debtor's initial injury, the overpayments constitute a pre-existing charge against debtor's right to permanent disability award. Either setoff or recoupment should have been permitted.

# ORDERED PUBLISHED

CLERK, U.S. BANKRUPTCY COURT  
DISTRICT OF OREGON

# FILED

OCT 25 1995 *led 11/24/95*

OCT 25 1995 *C.A.*

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U.S. BKCY. APP. PANEL  
OF THE NINTH CIRCUIT

## UNITED STATES BANKRUPTCY APPELLATE PANEL OF THE NINTH CIRCUIT

In re	)	BAP No. OR-93-2179-VHAS
VERDA KATHLYN HARMON,	)	BK. No. 392-35798-H7
	)	Adv. No. 93-3422
Debtor.	)	
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STATE of OREGON, acting by	)	
and through SAIF CORP.,	)	
	)	
Appellant,	)	
v.	)	<u>OPINION</u>
VERDA KATHLYN HARMON,	)	
	)	
Appellee.	)	

Argued and Submitted on June 22, 1995  
at Portland, Oregon

Filed - OCT 25 1995

Appeal from the United States Bankruptcy Court  
for the District of Oregon

Honorable Donal D. Sullivan, Chief Bankruptcy Judge, Presiding

Before: VOLINN, HAGAN, and ASHLAND, Bankruptcy Judges.

1 VOLINN, Bankruptcy Judge:

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OVERVIEW

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FACTS AND PROCEEDINGS BELOW

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<sup>1</sup>The debtor's disability award is approximately \$15,000; SAIF overpaid her some \$10,000 for time lost from work due to injury.

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<sup>2</sup>Unless otherwise stated, all references to "sections" hereinafter refer to the Bankruptcy Code, 11 U.S.C. §§ 101 et seq.

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1 April 15, 1992, for a total of \$28,495. The State of Oregon  
2 ultimately determined that a substantial portion of this amount,  
3 \$10,436.67, was an overpayment.

4 Under Oregon law, SAIF is entitled to "credit"<sup>3</sup> the amount  
5 of such overpayment against a permanent disability award. In  
6 June 1992, SAIF issued Ms. Harmon a notice of case closure which  
7 stated that she had not sustained any permanent injury. The  
8 notice of closure commenced the state proceedings which led to a  
9 finding of overpayment referred to above. These proceedings  
10 were ongoing at the time debtor filed her chapter 13 petition on  
11 August 28, 1992.

12 SAIF's right to reduce the amount of any permanent  
13 disability award by the amount of excess time-loss payments was  
14 first presented to the bankruptcy court in a motion for civil  
15 contempt, filed by the debtor in December 1992. The motion  
16 alleged that SAIF had violated the automatic stay of § 362 and  
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18 <sup>3</sup> Any determination or notice of closure made  
19 under this section may include necessary  
20 adjustments in compensation paid or payable  
21 prior to the determination or notice of  
22 closure, including disallowance of permanent  
23 disability payments prematurely made,  
crediting temporary disability payments  
against current or future permanent or  
temporary disability awards or payments and  
requiring the payment of temporary disability  
payments which were payable but not paid.

24 O.R.S. § 656.268(13)(1993 as amended 1995). The amended language  
25 allows SAIF to credit overpayments against temporary awards as  
26 well as permanent awards. The statutory language affecting the  
instant proceedings restricted such adjustments to permanent  
awards. Application of the amended language would not affect the  
outcome of the instant proceedings.

1 the permanent injunction of § 524 by asserting a right of  
2 recoupment against the debtor's right to an as yet undetermined  
3 permanent disability award. In the reply memorandum to the  
4 motion for civil contempt, debtor's counsel stated that, absent  
5 recoupment by SAIF, the debtor would be entitled to some \$15,000  
6 in permanent partial disability funds.

7 The debtor dismissed this proceeding voluntarily, but  
8 revisited the issue by way of a motion in which she sought a  
9 declaratory judgment that withholding of any portion of a  
10 permanent award would violate the stay. For various procedural  
11 reasons, the parties and the court determined that a ruling on  
12 the issue was not necessary at that time. Instead of entering a  
13 formal disposition of the motion, Bankruptcy Judge Hess drafted  
14 a letter opinion, dated June 22, 1993, which stated that in his  
15 view, if SAIF reduced a permanent disability award, it would  
16 violate the automatic stay. The court's analysis was based on  
17 its reading of Lee v. Schweiker, 739 F.2d 870 (3rd Cir. 1984), a  
18 case that barred the government from offsetting or recouping  
19 prepetition overpayments of social security benefits from  
20 benefits due to the debtor post-petition.

21 The debtor converted her case to one under chapter 7 on May  
22 13, 1993, and it was assigned to Bankruptcy Judge Sullivan. On  
23 July 8, 1993, SAIF filed a complaint for declaratory relief to  
24 resolve whether it was entitled to credit its alleged  
25 overpayment of time-loss benefits against a permanent award to  
26 which the debtor might be entitled. The parties brought cross-

1 motions for summary judgment. While articulating some  
2 reservations about the letter opinion, Judge Sullivan adopted  
3 its conclusion in favor of the debtor. The judgment provided  
4 that SAIF could not recover excess temporary disability payments  
5 from any future permanent disability award.<sup>4</sup> SAIF filed this  
6 timely appeal on September 22, 1993.

7 In February 1994, a BAP panel determined that the issue  
8 presented was not ripe for review because no permanent award had  
9 yet been established. Accordingly, it dismissed the appeal  
10 without prejudice to reinstatement. In November 1994, the  
11 Workers' Compensation Board of the State of Oregon issued its  
12 order. The Board adopted a state referee's permanent disability  
13 award and affirmed his finding that the debtor had become  
14 "medically stationary" on May 18, 1991. The Board authorized  
15 SAIF to "offset" the excess temporary disability payments as of  
16 that date against the permanent disability payment due. The  
17 debtor did not appeal the order of the Workers' Compensation  
18 Board. SAIF reinstated the instant appeal in January 1995.

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20 STANDARD OF REVIEW

21 The doctrines of setoff and recoupment are equitable in  
22 nature, and their use by the bankruptcy court is permissive. As  
23 such, the court's decision is reviewed for an abuse of  
24 discretion. In re Pieri, 86 B.R. 208, 210 (9th Cir. BAP 1988).

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26 <sup>4</sup>The parties agreed to proceed with the state administrative  
process, allowing SAIF to establish the fact of overpayment.

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ISSUE PRESENTED

Whether the bankruptcy court abused its discretion by denying SAIF the right to deduct the amount of excess temporary disability payments made prior to the filing of the bankruptcy petition from the debtor's permanent disability award.

DISCUSSION

I.

Setoff and recoupment originated as equitable rules of joinder to expand the strict rules of pleading under the common law, allowing creditors to offset mutual and reciprocal debts with the debtor. In bankruptcy, the doctrine of setoff is governed by § 553,<sup>5</sup> and its application is restricted by the automatic stay of § 362(a)(7).<sup>6</sup>

Analysis of the difference between setoff and recoupment in

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<sup>5</sup> 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).

<sup>6</sup>Section 362 stays, inter alia:  
the setoff of any debt owing to the debtor that arose before the commencement of the case under this title against any claim against the debtor . . . .

11 U.S.C. § 362(a)(7).

1 a given transaction does not easily lend itself to a bright-line  
2 resolution. Compare, for example, the holding of In re  
3 California Cannery and Growers, 62 B.R. 18 (9th Cir. BAP 1986),  
4 with that of In re B&L Oil Co., 782 F.2d 155 (10th Cir. 1986).  
5 California Cannery concluded that various claims arising under  
6 an ongoing distribution agreement constituted a series of  
7 separate transactions for the purpose of determining whether  
8 recoupment could be applied and, accordingly, refused to allow  
9 recoupment between pre- and post-petition claims. B&L Oil  
10 reached the opposite result under similar circumstances and  
11 allowed recoupment of prepetition overpayments from post-  
12 petition purchases performed under an ongoing oil purchase  
13 agreement.

14 Although the terms have come to be used somewhat  
15 interchangeably, there are distinctions which remain relevant in  
16 bankruptcy. Setoff allows adjustments of mutual debts arising  
17 out of separate transactions between the parties. Recoupment,  
18 on the other hand, involves a netting out of debt arising from a  
19 single transaction. To invoke setoff, § 553 requires that each  
20 of the mutual debts arise before commencement of the case. In  
21 recoupment, the elements of the debt may arise either before or  
22 after the commencement of the case.

23 Both doctrines have application in the bankruptcy setting,  
24 where the distinctions between them continue to be valid:

25 [T]he doctrine of recoupment can clearly be  
26 distinguished from setoff in a bankruptcy setting. It  
has no greater effect than a defense to a claim, and

1 hence should not be subject to the limitations on  
2 setoff. A recoupment claim arises out of the same  
3 transaction that forms the basis of the plaintiff's  
4 cause of action. Its function is to reduce the amount  
5 demanded, but only to the extent of the plaintiff's  
6 claim. "In other words, recoupment goes to the  
7 justice of plaintiff's claim and no affirmative  
8 judgment for any excess over the claim of plaintiff  
9 can be awarded thereon." Therefore, allowing  
10 recoupment will not affect property of the estate  
11 other than the subject claim.

12 Furthermore, the invocation of the recoupment  
13 doctrine promotes no preference problem. It is  
14 applied when there are countervailing claims arising  
15 from the same transaction "strictly for the purpose of  
16 abatement or reduction . . . ." In effect, the  
17 application of recoupment goes to the equity of the  
18 claim. It provides for the adjudication of the just  
19 apportionment of liability relative to a dispute  
20 regarding a singular transaction.

21 In re Hiler, 99 B.R. 238, 243 (Bankr. D.N.J. 1989) (internal  
22 citations omitted). See also In re Clowards, Inc., 42 B.R. 627,  
23 628 (Bankr. D. Idaho 1984).

24 Because recoupment only reduces a debt as opposed to  
25 constituting an independent basis for a debt, it is not a claim  
26 in bankruptcy, and is therefore unaffected by the debtor's  
discharge. See In re Brown, 152 B.R. 935 (W.D. Wis. 1993),  
where the District Court held that the right of a private  
employee benefit plan to reduce its payments to a bankrupt  
debtor who was a participant in the plan in order to recover  
past overpayments was a right of recoupment and not a claim.  
"Because of its unique nature as a limited equitable defense the  
right of recoupment does not constitute a claim within the  
meaning of 11 U.S.C. § 101(5) . . . ." Id. at 938.

II.

1           On the facts here, two awards were made, time-loss and  
2 permanent disability: on the one hand, income lost from work  
3 interruption, and on the other, loss of future income-earning  
4 capacity based on permanent disability. Each liability was  
5 asserted by the debtor pre-petition and were treated  
6 independently. The trial court concluded that the two awards  
7 should be considered as separate or independent transactions  
8 precluding application of recoupment. This analysis focused on  
9 the sequelae of the injury rather than on their common origin,  
10 which was the work-related injury.<sup>7</sup> While there may be a facial  
11 issue as to whether the obligations between the parties arose  
12 from a single transaction thereby warranting recoupment, logic  
13 requires the conclusion that both claims flow from the same  
14 prepetition injury. Thus, whatever rights or remedies the  
15 debtor had, accrued prepetition. Further, the court should view  
16 the claims of the parties as perceived by the unitary  
17 perspective of the Oregon statute, which created the remedies  
18 for these rights. See Butner v. United States, 440 U.S. 48, 55

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21           <sup>7</sup>The instant circumstances can be compared to and  
22 distinguished from various other benefit schemes, such as that  
23 presented by In re Thompson, 182 B.R. 140, 145 (Bankr. E.D. Va.  
24 1995), where the creditor sought to recoup an excess of disability  
25 payments from retirement benefits owed to the debtor. Although  
26 both obligations were governed by one over-arching agreement,  
these liabilities clearly arose from separate and independent  
transactional bases. Accordingly, the Thompson court did not  
permit recoupment. However, the court determined that the  
debtor's disability claims and retirement benefits both arose on  
the date he joined the police force. Therefore, both were  
prepetition claims and setoff was appropriate. Id. at 153.

1 (1979) ("Property interests are created and defined by state  
2 law").

3 The liabilities at issue in the instant case are governed  
4 by a statutory plan which provides coverage to all workers in  
5 the State of Oregon for work-related injuries. The State of  
6 Oregon intended to provide indemnity for employee injuries in  
7 the work-place through a comprehensive statute governing the  
8 rights and liabilities of employers and their employees. See  
9 O.R.S. § 656.012.<sup>8</sup>

10 Lee v. Schweiker, referred to by the bankruptcy court  
11 below, is inapposite. There, the court reasoned that post-  
12 petition social security payments were in the nature of future  
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14 <sup>8</sup>Findings and policy.

15 (1) The Legislative Assembly finds that:

16 (a) The performance of various industrial enterprises  
17 necessary to the enrichment and economic well-being of  
18 all the citizens of this state will inevitably involve  
19 injury to some of the workers employed in those  
20 enterprises; and

21 (b) The method provided by the common law for  
22 compensating injured workers involves long and costly  
23 litigation, without commensurate benefit to either the  
24 injured workers or the employers, and often requires the  
25 taxpayer to provide expensive care and support for the  
26 injured workers and their dependents.

21 (2) In consequence of these findings, the objectives of  
22 the Workers' Compensation Law are declared to be as  
23 follows:

24 (b) To provide a fair and just administrative system for  
25 delivery of medical and financial benefits to injured  
26 workers that reduces litigation and eliminates the  
adversary nature of the compensation proceedings, to the  
greatest extent practicable.

26 O.R.S. § 656.012 (1993, amended 1995). See also O.R.S. § 656.018  
(1993), restricting employer liability and employee remedies.

1 earnings, and, therefore, constituted a post-petition asset of  
2 the debtor not subject to offset by a pre-petition claim. The  
3 court also reasoned that where a federal social welfare statute  
4 was involved, conventional rules relating to recoupment incident  
5 to contractual relationships were inapplicable. Here we are  
6 dealing with a state statute which specifically provides for  
7 such a remedy.

#### 8 CONCLUSION

9 The debtor's entitlement to both of the awards arose with  
10 and are based upon her initial injury. The overpayments  
11 constitute a pre-existing charge against the debtor's right to  
12 her permanent disability award, which came into being pre-  
13 petition at the time of the original injury. Thus, either  
14 setoff or recoupment should have been permitted.

15 The order of the bankruptcy court is REVERSED so that  
16 judgment may be entered which would entitle SAIF to deduct  
17 excess temporary disability payments from the debtor's permanent  
18 disability award.