NOT FOR PUBLICATION

UNITED STATES BANKRUPTCY APPELLATE PANEL

OF THE NINTH CIRCUIT

In re:	)	BAP Nos. EC-05-1187-PaNMa
	)	EC-05-1213-PaNMa
COAST GRAIN COMPANY,	)	(Cross-Appeals)
	)	
Debtor.	)	Bk. No. 01-19647
	)	
	)	Adv. No. 03-01466
BOUMA DAIRY,	)	
	)	
Appellant and Cross-Appellee,	)	
	)	
v.	)	**M E M O R A N D U M**[1]
	)	
GREG BRAUN, Plan Agent,	)	
	)	
Appellee and Cross-Appellant.	)	

Argued and Submitted on January 19, 2006
at Sacramento, California

Filed - January 31, 2006

Appeal from the United States Bankruptcy Court
for the Eastern District of California

Honorable W. Richard Lee, Bankruptcy Judge, Presiding.

Before: PAPPAS, NAUGLE[2] and MARLAR, Bankruptcy Judges.

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[1] This disposition is not appropriate for publication and may not be cited except when relevant under the doctrines of law of the case, res judicata, or collateral estoppel. See 9th Cir. BAP Rule 8013-1.

[2] Hon. David N. Naugle, United States Bankruptcy Judge for the Central District of California, sitting by designation.

Bouma Dairy ("Bouma") and Greg Braun ("Braun") both appeal from the judgment entered by the bankruptcy court implementing its order granting, in part, Braun's motion for partial summary judgment and other relief, and denying Bouma's motion for summary judgment. We AFFIRM in part and REVERSE AND REMAND in part.

FACTS

1. The Coast Grain prepayment program.

Bouma operates a dairy business and purchased grain and feed products from Coast Grain Company ("Coast Grain"). Most of Coast Grain's customers were large dairy farms such as Bouma located in the Chino or Central Valley areas of California and Arizona.

Coast Grain sold its feed products under both fixed price agreements using written sales contracts and on a variable "spot market" basis. Under a sales contract, Coast Grain would sell to a customer a certain quantity of a product at an agreed price to be delivered at a particular time, or over a range of times, in the future. Bouma usually purchased products from Coast Grain under one or more contracts as well as making frequent spot market purchases.

Coast Grain accepted cash deposits or advance payments from its dairy customers. The parties refer to this arrangement as Coast Grain's "prepayment program." Apparently, this program was attractive to Coast Grain customers because it allowed them flexibility in obtaining or scheduling feed deliveries during the year.[3] In addition, Coast Grain would pay customers with

[3] There are suggestions in the record that customers also enjoyed tax advantages by participation in this prepayment program. We have no reason to doubt this, but do not find it necessary to consider any tax implications in disposing of the issues.

prepayment accounts what it referred to as "quality adjustments," or, in effect, interest, on the balance in the prepayment accounts.[4]

Coast Grain deposited customer prepayments in its general operating bank account and recorded a corresponding current liability on its books identified as "deferred feed sales." If a customer had established a prepayment account, the costs of any purchases from Coast Grain made by that customer under a sales contract or on the spot market would ordinarily be paid by debiting that customer's prepayment account.

Coast Grain offered another service to customers with a prepayment account. Without restriction, Coast Grain would, upon instruction from the customer, make payments from the prepayment account to third parties on the customer's behalf. Payments would be paid from the prepayment account until it was exhausted. Remarkably, Coast Grain did not require, as a condition of accepting a prepayment deposit from a customer, that the customer agree to purchase any products from Coast Grain. Although most customers made purchases during the year from Coast Grain, under this arrangement, customers were free to direct Coast Grain to pay third parties any sum up to the entire amount of the prepayment deposit, plus all accumulated interest. There were no restrictions on the types of persons or entities to whom a customer could direct a third party payment, nor did Coast Grain

[4] Coast Grain would credit its customers' prepayment accounts additional amounts each month based on the account balances at the end of the previous month. In the several years preceding Coast Grain's bankruptcy, the rate of "interest" earned by customers was either 6.5 percent per annum for a prepayment deposit of less than $1 million or 7.5 percent per annum for a prepayment deposit greater than $1 million. Coast Grain did not report these quality adjustment credits to any taxing authorities.

have any procedure in place to determine the nature of the customer's obligation to the third party to whom the check was being issued or, indeed, whether there was any such obligation.[5]

2. Bouma's Dealings with Coast Grain.

For approximately the fifteen years before Coast Grant filed for bankruptcy, Bouma participated in the Coast Grain prepayment program by paying certain amounts to Coast Grain each year for feed purchases and other expenditures to be made the following year. On November 6, 2000, Bouma exhausted the balance remaining in its Coast Grain account from the $650,000 prepayment deposit Bouma had made in December 1999.[6] Thereafter, Bouma continued to order and receive products from Coast Grain on an open account basis. As of December 29, 2000, Bouma had unpaid Coast Grain invoices on its current account totaling $65,872.71.

On December 29, 2000, Bouma issued Coast Grain a check for $1,630,000 which Coast Grain credited to Bouma's prepayment account. On December 31, 2000, that entire amount was transferred from Bouma's prepayment account to its current account, paying off the accumulated unpaid invoices and creating a credit balance. Bouma made no further prepayment deposits to Coast Grain after December 29, 2000.

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[5] Again, presumably, as a tax planning tool for customers, most of the prepayment deposits Coast Grain received came in the last few days of December each year. Although Coast Grain had accepted prepayment deposits for many years, in the last few years before its bankruptcy filing, the amount of prepayment deposits increased dramatically. In December 1998, Coast Grain received $18,015,945 in deposits, while in December 2000, it received $92,104,832. From January through August 2001, at the request of customers, Coast Grain sent out $27,489,643 in third party payments.

[6] Of this deposit, Coast Grain sent out, at Bouma's direction, $296,628 as third party payments from January through June, 2000.

When Bouma made its December 29, 2000, deposit with Coast Grain, there was only one existing written sales contract between them, for rolled corn (the "Rolled Corn Contract").[7] Delivery under the Rolled Corn Contract began in October 2000; the remaining obligation on December 29, 2000, was $321,510.56. The Rolled Corn Contract did not require that Bouma prepay for any deliveries. The parties entered into no other written contracts for delivery of products before October 2001.

Bouma made 765 separate purchases from Coast Grain of fourteen different feed and grain products between January 1 and August 25, 2001. Except for the Rolled Corn Contract, Bouma did not have any written sales contracts with Coast Grain for any of these products.

Coast Grain generated an invoice for each shipment to Bouma and entered it into the Coast Grain accounting system. From January 1 to August 25, 2001, upon entry, each invoice was paid by deduction (a debit) in the same amount against the credit balance in Bouma's current account. During this time, at Bouma's request, Coast Grain issued seventeen checks totaling $900,371 to third parties, each of which were deducted from the credit balance in Bouma's current account. Four of the third party checks, totaling $381,480.55, were issued and cleared Coast Grain's bank account during the 90-day period prior to Coast Grain's bankruptcy filing. During the same time period, invoices representing product deliveries from Coast Grain to Bouma in the amount of $101,844.92

[7] This was sales contract S-800789, originally entered into by Bouma and Coast Grain on August 1, 2000, for $392,000. The delivery period was October 1, 2000 through September 30, 2001.

were paid by deduction against the credit balance in Bouma's current account.

In August 2001, Coast Grain terminated the prepayment program. On August 25, 2001, Coast Grain announced it would no longer permit product invoices to be paid by debits against prepayment balances. Coast Grain transferred Bouma's remaining prepayment deposit and accumulated interest from its current account back to its prepayment account. As a result of one final charge,[8] Bouma's prepayment account balance was reduced to $65,581.56.

Over the next few months, Bouma continued to make purchases from Coast Grain, presumably on open account. As of November 1, 2001, Bouma's purchases exceeded the amount remaining on its prepayment account by $3,711.28. On December 6, 2001, Bouma paid this amount to Coast Grain and there were no further transactions between the parties.

3. The Coast Grain bankruptcy and this litigation.

On October 17, 2001, an involuntary chapter 11[9] bankruptcy petition was filed against Coast Grain. On November 28, 2001, an order for relief was entered. On March 13, 2002, the bankruptcy court appointed Braun chapter 11 trustee. The bankruptcy court confirmed the "Third Amended Chapter 11 Plan for Coast Grain Company" on October 28, 2003 and appointed Braun as the Plan Agent

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[8] This deduction was for products shipped to Bouma before August 25, 2001 even though the invoice for the shipment was apparently not entered in Coast Grain's system until after the termination date.

[9] Unless otherwise indicated, all references to chapter or section are to the Bankruptcy Code, 11 U.S.C. §§ 101-1330 and references to Rules are to the Federal Rules of Bankruptcy Procedure.

with authority to implement the Third Amended Chapter 11 Plan.

As authorized by the confirmed plan, Braun filed a large number of adversary proceedings against former customers of Coast Grain who held prepayment accounts. Braun's amended complaint in this adversary proceeding includes fifteen separate claims for relief, seeking to recover the amount of all shipments of grain and third party payments made by Coast Grain on Bouma's account during the 90 days preceding the chapter 11 filing, as well as payment for feed delivered from Coast Grain to Bouma after the petition was filed. Braun asserted claims against Bouma for recovery of alleged preferences, fraudulent conveyances, accounts receivable, as well as for avoidance of prohibited setoffs.

The parties filed cross-motions for summary judgment. In a published decision containing findings of fact and conclusions of law, the bankruptcy court concluded that the transactions between Coast Grain and Bouma could not be avoided as preferences, but should instead be analyzed as setoffs under § 553:

> It is the court's conclusion that [Braun] cannot collect Coast Grain's accounts receivable from Bouma as preferential transfers. A pre-petition transfer of property of the debtor may not be avoided under § 547 if the transfer was made in exchange for an asset or property right of equal value, or if the transfer was made in satisfaction of an obligation secured by the right of setoff. Both of these situations existed here. Coast Grain's sales of dairy feed to Bouma, and the third-party payments made for Bouma's benefit, generated contract rights against Bouma of equal value. Bouma's liability for those contracts and Coast Grain's liability on the prepaid account were mutual obligations subject to potential setoff. The actual "transfer of property of the debtor" occurred each time Coast Grain gave up the right to collect its accounts receivable, when Coast Grain debited its claim against Bouma's prepaid account. At that

> time, Bouma was potentially secured by its right of setoff pursuant to § 506(a). If Bouma improved its position through these debits, then the Plan Agent's right to recover from Bouma is through avoidance of the setoff, the debit transaction, under § 553(b). The Plan Agent did not move for summary judgment under § 553(b) and resolution of that issue will require further proceedings.

In re Coast Grain Co., 317 B.R. 796, 805 (Bankr. E.D.Cal. 2004) (emphasis added) (hereafter "the First Bouma Decision" and cited as Coast Grain).[10]

Although Braun had not moved for summary judgment to avoid the debits made to Bouma's accounts during the 90-day period before Coast Grain's bankruptcy filing under § 553(b), in the First Bouma Decision the bankruptcy court was able to address several aspects of Bouma's setoff and recoupment defenses.[11]

First, the bankruptcy court held that Bouma could not properly claim an offset under § 553(a) for any purchases made after Coast Grain terminated the prepay program and before its bankruptcy filing. Coast Grain, 317 B.R. at 806. The court found that an affidavit from Bouma's manager showed that Bouma continued to make purchases from Coast Grain after August 25, 2001, solely for the purpose of creating offsets against amounts on deposit in its prepayment account. Id. at 801, n. 4; 806. Therefore, the bankruptcy court concluded, setoff of these purchases was barred

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[10] Although the First Bouma Decision is the bankruptcy court's most complete analysis of the parties' setoff and recoupment arguments, further proceedings were necessary to finally resolve Braun's claims. Coast Grain, 317 B.R. at 805. The bankruptcy court made several subsequent rulings, including the Second Bouma Decision, based upon which the Final Judgment was entered giving rise to this appeal.

[11] Bouma moved for summary judgment on its asserted recoupment defense. Braun, in turn, moved for summary judgment striking this defense and also Bouma's setoff defense.

under § 553(a)(3) (disallowing a claim for offset based upon debt incurred within 90 days pre-bankruptcy "for the purpose of obtaining a right of setoff from the debtor"). Id. at 806.

The bankruptcy court also concluded that Bouma could not assert a recoupment defense. For recoupment to apply, the court reasoned, the competing claims of the parties must arise out of the same transaction or occurrence. Id. at 806, citing Newbery Corp. v. Fireman's Fund Ins. Co. (In re Newbery Corporation), 95 F.3d 1392, 1399 (9th Cir. 1996). To determine whether claims arise from the same transaction, the bankruptcy court determined that it must apply the "logical relationship test," as adopted in Sims v. United States Department of Health and Human Services (In re TLC Hospitals, Inc.), 224 F.3d 1008, 1011 (9th Cir. 2000); see also Aetna U.S. Healthcare, Inc. v. Madigan (In Re Madigan), 270 B.R. 749, 754 (9th Cir. BAP 2001). Although in applying that test, the Ninth Circuit notes that the term "transaction" is a flexible one, Newbery, 95 F.3d at 1402 (citing Moore v. New York Cotton Exchange, 270 U.S. 593 (1926)), the bankruptcy court was "not persuaded that Bouma's prepayment in December 2000, and the subsequent purchases and third party payments which benefited Bouma months later, had such a 'logical relationship' that they should be deemed to constitute the same transaction." Coast Grain, 317 B.R. at 809. As a result, the bankruptcy court concluded that the competing claims of Bouma and Coast Grain arising from the prepayment account and the post-termination purchases did not arise out of a single transaction and, therefore, Bouma could not assert a recoupment defense.

Following the First Bouma Decision, Braun filed a motion for a partial summary judgment on the twelfth, thirteenth and fourteenth claims for relief of his complaint. After another hearing, in an extended oral ruling, the bankruptcy court concluded that Braun was entitled to a judgment on the twelfth claim, which sought to recover the amount of the purchases made during the 90 days pre-bankruptcy as prohibited offsets under § 553, the claim that was not before the court in the First Bouma Decision. Transcript of hearing (March 24, 2005), pp. 74-86. As it had suggested it would, the bankruptcy court found that the prepayment agreement between Coast Grain and Bouma was in the nature of a global setoff agreement.

> The Court can only characterize the prepayment agreement on December 29th, 2000, as an agreement to create a debit account on Coast Grain's records for Bouma's benefit, against which future goods and services delivered and provided for Bouma's benefit would be paid or compensated by a debit transaction against the account.
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> In other words, in my view, the prepayment agreement that we've been talking about was nothing more than a . . . global setoff agreement. . . . Bouma here offers that there were no actual setoffs taken during the preference period and that there's no evidence that it exercised the right of setoff. The court disagrees.
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> One, Mr. Schoenveld's declaration clearly establishes that the prepayment was made to create future debit rights, and there's no showing that Bouma ever made any effort to otherwise pay for the goods and services that it received. And it's clear that Bouma knew and understood at all times that the goods and services . . . would be debited against the prepayment account.
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> In this context, the court's directly equating the term "debit" with the concept of . . . a setoff.
>
> Accordingly, the court finds that if setoff were taken against the prepayment accounts [in the 90-day pre-petition period], that those setoffs did improve Bouma's

> position by the amounts that were debited and that the setoffs are voidable pursuant to § 553(b). So judgment will be entered for [Braun].

Transcript of hearing (March 24, 2005), pp. 79-80. We refer to this ruling as the "Second Bouma Decision."

The bankruptcy court made one alteration to its earlier First Bouma Decision. In the Second Bouma Decision, the court decided that because the Rolled Corn Contract between Bouma and Coast Grant was in existence, and that approximately $321,000 of that contract still remained to be performed on the day Bouma's prepayment deposit was made, and that $35,403 of that Rolled Corn Contract was performed during the 90 days prior to the commencement of the bankruptcy case, Bouma was entitled to recoup that $35,403.

Since the court had decided that neither the recoupment doctrine nor § 553(a) offered Bouma a defense to Braun's claims, except for the Rolled Corn Contract, the bankruptcy court granted Braun a summary judgment for the avoidable setoffs (§ 553(b)-twelfth claim), for the accounts receivable (§ 542 - thirteenth claim) and for the post-bankruptcy purchases (§ 549 - fourteenth claim). On April 29, 2005, the bankruptcy court entered an Order Granting Plaintiff's Motion for Partial Summary Judgment, Bifurcating Claims, Dismissing Claims, and Directing Entry of Final Judgment, and then issued the Final Judgment.[12]

The bankruptcy court certified the Final Judgment under Fed. R. Civ P. 54(b), as incorporated by Fed. R. Bankr. P. 7054. Bouma

[12] The Final Judgment effectively incorporates by reference the First Bouma Decision, as well as the court's oral findings of fact and conclusions of law stated on the record at the March 24 hearing.

timely appealed, arguing that recoupment was an absolute defense to all Braun's claims. Braun then timely cross-appealed, arguing that the $35,403 recoupment should not have been allowed.

JURISDICTION

The bankruptcy court had jurisdiction pursuant to 28 U.S.C. § 1334 and § 157(b). This Panel has jurisdiction over the appeal pursuant to 28 U.S.C. § 158(a)(1) and (b).

STANDARD OF REVIEW

Both Bouma's appeal and Braun's cross-appeal arise from the bankruptcy court's entry of Final Judgment, which in turn is based upon the bankruptcy court's Order Granting [Braun's] Motion for Partial Summary Judgment, Bifurcating Claims, Dismissing Claims, and Directing Entry of Final Judgment. A bankruptcy court's decision to grant summary judgment is reviewed de novo. See Thrifty Oil Co. v. Bank of America Nat. Trust and Sav. Ass'n, 322 F.3d 1039, 1046 (9th Cir. 2003); In re Stanton, 303 F.3d 939, 941 (9th Cir. 2002); In re Betacom of Phoenix, Inc., 240 F.3d 823, 828 (9th Cir. 2001; In re Home America T.V.-Appliance Audio, Inc., 232 F.3d 1046, 1050 (9th Cir. 2000); In re Bakersfield Westar Ambulance, Inc., 123 F.3d 1243, 1245 (9th Cir. 1997); In re Madigan, 270 B.R. at 753. A bankruptcy court's decision to grant partial summary judgment is reviewed de novo. Guerin v. Winston Industries, Inc., 316 F.3d 879, 882 (9th Cir. 2002).

ISSUES ON APPEAL

1. Did the bankruptcy court err in concluding that there was a "global setoff agreement" covering all transactions between Bouma and Coast Grain, and that any setoffs effected in the 90-day period before the filing of Coast Grain's bankruptcy petition were avoidable by Braun under § 553(b)?

2. Did the bankruptcy court err in finding that the competing claims of Bouma and Coast Grain, arising from the prepayment account and the post-termination purchases, did not arise out of "the same transaction" and therefore Bouma could not assert a recoupment defense?

3. Did the bankruptcy court err in allowing Bouma a partial recoupment for the Rolled Corn Contract?

BOUMA'S REQUEST FOR JUDICIAL NOTICE

On August 30, 2005, Bouma filed a Request for Judicial Notice in which it asked the Panel to take judicial notice of the decisions of the bankruptcy court in two other adversary proceedings in the Coast Grain bankruptcy case: (i) Memorandum Decision regarding Plaintiff's Motion for Partial Summary Judgment in Braun v. Schakel Dairy, Adv. No. 03-1432; and (ii) Amended Findings of Fact and Conclusions of Law re Motion for Summary Judgment in Braun v. Walter H. Jensen Cattle Co., Inc., Adv. No. 03-1419-B (together, the "Requested Decisions"). Bouma stated no reasons or justification for its request, other than quoting case law holding that a federal court "may take notice of proceedings in other courts, both within and without the federal judicial system, if those proceedings have a direct relation to matters at issue." United States Ex Rel. Robinson Rancheria Citizens Council v. Borneo, Inc., 971 F.2d 244, 248 (9th Cir. 1992). Bouma's Request for Judicial Notice at p. 1. However, Braun has not objected to Bouma's request.

The Panel will grant Bouma's Request for Judicial Notice. The Panel will consider the bankruptcy court's decisions in the two adversary proceedings for at least two reasons.

First, the parties acknowledge that Braun is pursuing a large number of adversary proceedings against various Coast Grain customers involving similar (but not identical) facts and legal theories, all presided over by the same bankruptcy judge. Bouma asks that we consider the court's decisions in two of those adversary proceedings. In those decisions, the bankruptcy court applied a legal analysis similar to that employed in the decisions on appeal. Indeed, the court references the First Bouma Decision to serve as a foundation of the legal analysis of setoff and recoupment in the two other decisions. For example, in Jensen, the bankruptcy court distinguished the facts from those in Bouma and explains why recoupment is available under the Jensen circumstances but not (or only to a very limited extent) in our case. Arguably, a review of these decisions may be helpful to the Panel to understand the bankruptcy court's application of the same law to three fact patterns that are both similar and dissimilar. In effect, the Panel has considered these decisions in the same fashion at it would any non-binding decision of a bankruptcy court to support, or to oppose, a particular interpretation or application of the Bankruptcy Code.

Second, Braun does not oppose Bouma's request. Presumably, Braun agrees it is appropriate for the Panel to consider the bankruptcy court's decisions in the other adversary proceedings, or, in the alternative, concedes that he will suffer no prejudice if the Panel does so.

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DISCUSSION

1. The bankruptcy court did not err in finding that there was a "global setoff agreement" and that the setoffs effected during the 90-day period before the filing of the bankruptcy petition were avoidable by Braun.

Under certain circumstances, a creditor's right of "setoff" is recognized in the Bankruptcy Code. Section 553(a) specifies that "Except as otherwise provided . . . 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." The Ninth Circuit has described the right of setoff allowed in bankruptcy cases in these terms:

> The defining characteristic of setoff is that "the mutual debt and claim . . . are generally those arising from different transactions." 4 Collier on Bankruptcy ¶ 553.03, at 553-14 (15th ed. 1995). . . .
> Under section 553(a), each debt or claim sought to be offset must have arisen prior to filing of the bankruptcy petition. In addition, "a claim may . . . be set off without regard to whether it is contingent or unliquidated, as long as the claim qualifies as 'mutual' under applicable non-bankruptcy law. . . ." 5 Collier ¶ 553.01[4] at 553-6 (citation omitted [in original]). In order for countervailing debts to be "mutual," they must be "in the same right and between the same parties, standing in the same capacity." 5 Collier ¶ 553.04[2], at 553-22 (citing England v. Industrial Comm. Of Utah (In re Visiting Home Services, Inc.), 643 F.2d 1356, 1360 (9th Cir. 1981).

Newbery Corp. v. Fireman's Fund Ins. Co., 95 F.3d 1392, 1398-99 (9th Cir. 1996).

Under § 553 and the relevant Ninth Circuit case law, a creditor's right to offset is recognized and preserved under three conditions: (1) The creditor holds a claim against the debtor that

arose before the commencement of the case; (2) The debtor owes a debt to the creditor that also arose before the commencement of the case; (3) The claim and debt are mutual, as determined by applicable non-bankruptcy law.[13] See In re Luz Int'l, Ltd., 219 B.R. 837, 843 (9th Cir. BAP 1998).

As discussed earlier, the bankruptcy court in the First Bouma Decision determined that the three conditions required for setoff were present in the transactions between Bouma and Coast Grain: "Coast Grain's sales of dairy feed to Bouma, and the third-party payments made for Bouma's benefit, generated contract rights against Bouma of equal value. Bouma's liability for those contracts and Coast Grain's liability on the prepaid account were mutual obligations subject to potential setoff." Coast Grain, 317 B.R. at 805. Later, in the Second Bouma Decision, the bankruptcy court determined that there were actual setoffs. Based on the deposition testimony of Bouma's managing director, Mr. Schoenveld, the court concluded that the prepayment agreement created a debit account on Coast Grain's records for Bouma's benefit, against which Coast Grain offset the cost of the goods and services provided to Bouma, and third party payments made for Bouma, via a debit against the account. The court observed that Bouma made no other payments to Coast Grain for these goods or third party payments other than by debit to its account. Therefore, the

[13] The applicable non-bankruptcy law in the instant appeal is that of California. Neither of the parties have examined the mutuality of the parties' obligations to one another under California law. The bankruptcy court correctly noted that the Coast Grain account receivable created when it sold products to Bouma would be independently enforceable under California law. Coast Grain, 317 B.R. at 802. Regarding the mutuality of the Coast Grain obligation, the court noted that "[i]t is undisputed that Bouma's prepaid account represented a liability for Coast Grain and a claim for Bouma." Id.

bankruptcy court concluded that the parties' prepayment agreement constituted a global setoff agreement.

Having determined that the transactions were subject to setoff, the bankruptcy court then found that the setoffs effected during the 90-day period preceding the filing of Coast Grain's bankruptcy petition improved Bouma's position by the amounts that were debited from its prepayment account.[14] Consequently, the bankruptcy court concluded that the setoffs were avoidable pursuant to § 553(b)(1). The bankruptcy court also concluded that any of these setoffs that occurred after termination of the prepayment program by Coast Grain should be disallowed and were recoverable by Braun because the purchases made by Bouma were, according to the testimony of its officer, "for the purpose of obtaining a right of setoff from the debtor." § 553(a)(3)(C). Finally, the bankruptcy court decided that any post-petition setoffs were not debts "arising before the commencement of the case," not protected by § 553(a), and therefore recoverable by Braun.

Bouma objects to the bankruptcy court's decision on two grounds: (1) that no mutual debts existed between Bouma and Coast

[14] The "improvement of position" standard is a shorthand reference to § 553(b)'s requirement that, to be avoidable, a creditor's offset reduce any "insufficiency" in accounts existing between the debtor and creditor during the 90 days before the bankruptcy petition is filed. § 553(b)(1). An "insufficiency" is in turn defined by the Code as "that amount, if any, by which a claim against the debtor exceeds a mutual debt owing to the debtor by the holder of such claim." § 553(b)(2). Given this complicated statutory formulation, it can be understood how the reference to "improvement of position" developed. At oral argument, this "improvement of position" test was conceded by Bouma.

Grain; and (2) the facts do not satisfy the requirements for a setoff.[15] We disagree.

First, Bouma insists there were no mutual debts owing by the parties to one another under these facts. In Bouma's view, at the time Bouma received products from Coast Grain, or whenever Coast Grain made third party payments on Bouma's behalf, it was simply taking delivery of a product, or accepting a service, for which it had already paid Coast Grain. Under this approach, given its positive prepayment account balance, Bouma argues no debt to Coast Grain arose from such transactions.

The parties illustrate their positions concerning Bouma's "mutual debts" argument in their respective reply briefs by offering conflicting interpretations of the same analogy. In its brief, Bouma argues the facts of this case resemble a situation where an individual overpays a credit card account by $1,000, thereby creating a credit balance on the account. When the cardholder then incurs a $500 additional charge on the card, Bouma suggests no new independent debt arises in favor of the credit card issuer. Instead, the existing credit balance is simply reduced by the amount of the new charges. So long as there is a credit balance on the account, in Bouma's view, the cardholder is never indebted to the issuer for new charges that do not exceed the credit balance.

Braun acknowledges that the cardholder's overpayment/prepayment of $1,000 properly reflects Bouma's status

[15] As near as we can tell from its briefs, while Bouma argues the transactions in question do not qualify as setoffs for purposes of § 553, if indeed we conclude setoffs did occur, Bouma does not challenge the bankruptcy court's decision that they are recoverable by Braun under § 553.

when it made its $1.6 million deposit with Coast Grain in December 2000. Braun also agrees that, under the analogy, such an overpayment created an obligation on the part of the credit card issuer in favor of the cardholder. However, it is Braun's position that this debt must be balanced by the cardholder's obligation to pay the credit card company for any charges made on the account. In other words, to Braun, whenever the cardholder uses the card to make a purchase, a new debt arises that the issuer then sets off against the cardholder's credit balance. To Braun, the analogy applied to the Bouma-Coast Grain relationship evidences a classic setoff arrangement.

In our opinion, Braun's interpretation of the analogy more accurately reflects legal reality. When Bouma gave Coast Grain its funds in December, 2000, Coast Grain became indebted to Bouma for the amount deposited. However, each time Bouma purchased feed from Coast Grain, or on each occasion when Bouma directed Coast Grain to make a payment to a third party on its behalf, a separate, distinct debt was created which Bouma owed to Coast Grain for the cost of the product or the amount of the third-party payment. This characterization of the parties' relationship is evidenced by the fact that for purchases, Coast Grain created an invoice and then "paid" that invoice by making an entry in its books debiting the amount of the invoice against Bouma's prepayment account. For third party payments, Coast Grain issued its check and then debited Bouma's account for the amount of that check. When Coast Grain made these entries in its books, Bouma's debt to Coast Grain was effectively satisfied and a setoff for purposes of § 553(a) occurred. To the extent these setoffs

occurred within 90 days before Coast Grain's bankruptcy, and thereby improved Bouma's position, they were avoidable by Braun under § 553(b).

Bouma's second objection to the bankruptcy court's setoff conclusion is that the facts here do not satisfy the requirements for a setoff according to the U.S. Supreme Court. Bouma points out that, as set forth in Citizens Bank of Maryland v. Strumpf, 516 U.S. 16, 116 S.Ct. 286, 133 L.Ed.2d 258 (1995):

> . . . [A] setoff has not occurred until three steps have been taken: (i) a decision to effectuate a setoff; (ii) some action accomplishing the setoff; and (iii)a recording of the setoff.

Strumpf, 116 S.Ct. at 289. Bouma argues that there was no showing here that Coast Grain intended to effectuate a setoff in these transactions, or that Bouma ever effected a setoff.

As an initial matter, it is unclear whether, under California law, to constitute an offset, there must be a conscious decision to offset by the one of the parties, or, indeed, the specific use of some "magic words." Strumpf considered the application of the automatic stay under § 362(a)(3) and (7) to a bank's right to set off amounts in a debtor's account against debts owed by the debtor to the bank after bankruptcy. The full text of the first line of the quotation from the Court's decision actually reads as follows:

> A requirement of such an intent [the intent to permanently reduce an account by the amount of the claim asserted against the account] is implicit in the rule followed by a majority of jurisdictions addressing the question, that a setoff has not occurred until three steps have been taken . . . .

Id. In Strumpf, the Supreme Court acknowledged that there is no federal right of setoff created by the Bankruptcy Code but that

any such right must be based upon state law – in that case, Maryland law. Id.[16] The Strumpf Court derived the requirement that a creditor intend to permanently settle accounts as a condition for setoffs under § 362(a) from what it perceived to be the majority rule of law in the states. Strumpf did not cite any California cases to support its conclusion.

California recognizes setoffs as an equitable right at common law. Meherin v. Saunders, 131 Cal. 681, 684, 63 P. 1084, 1087 (Cal. 1901), Salaman v. Bolt, 141 Cal.Rptr. 841, 847 (Cal.Ct.App. 1977)(cited with approval in Keith G. v. Suzanne H., 52 Cal.App.4th 853, 859, 72 Cal.Rptr.2d 525, 530 (Cal.Ct.App. 1998)). There is also a statutory right to offset mutual debts pursuant to California Code of Civil Procedure ("CCP") § 431.70. The principal concern of the California cases and statute seems to be that setoff be allowed only where the debts being offset against one another are mutual, fully matured obligations. Eistrat v. Humiston, 160 Cal.App.2d 89, 90, 324 P.2d 957, 958-959 (Cal.Ct.App. 1958). There is no California statutory provision, and we have found no case law, that supports Bouma's alleged three-part requirement for a setoff.

Moreover, it is apparent to us from the record that, by debiting Bouma's prepayment account for the cost of each purchase of product or third-party payment, Coast Grain intended to effect an offset. Both in establishing the prepayment account[17]

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[16] Indeed, as Bouma notes, the Supreme Court's decision is described by one source as establishing the "general rules" for setoffs. See 4 Colliers on Bankruptcy ¶ 553.05[1]. Transcript of hearing (March 24, 2005), pp. 62-63.

[17] Indeed, there is no evidence in the record that Bouma ever objected to the custom and practice of the parties.

relationship and in documenting each transaction, Coast Grain obviously intended that Bouma's charges be settled by debit against its account. If an intent by a creditor to effect an offset is indeed required, the debit process employed here sufficiently evidences this intent.

But Bouma argues that it never set off any debts; Coast Grain did. As a result, it argues that Braun can not recover. This argument also ignores the realities of its arrangement with Coast Grain. Bouma indeed effected setoffs by making purchases of product from Coast Grain, and by having Coast Grain send checks to others, just as surely as it would have benefited from taking money out of an account it held for Coast Grain. Under its arrangement with Coast Grain, Bouma had the ability to control and, as it turned out, to improve its position vis-à-vis its debt to Coast Grain, by simply buying more product from Coast Grain, or instructing Coast Grain to make payments to others on its behalf. In this sense, we agree with the bankruptcy court that both Bouma and Coast Grain were "creditors" and that both were involved in setting off the obligations of each other. That Coast Grain acted as the "bank", and Bouma as the customer, is of no significance in this case.

For these reasons, we conclude that the bankruptcy court correctly determined that a global setoff agreement existed between Bouma and Coast Grain and that the purchases and third-party payments and corresponding debits to Bouma's account, made in the 90-day period before the filing of the bankruptcy petition, were avoidable by Braun pursuant to § 553(b).

2. The bankruptcy court did not err in finding that Bouma could not assert a recoupment defense.

The Panel has previously examined in depth the application of the equitable doctrine of recoupment in bankruptcy cases. Madigan, 270 B.R. at 753-56. However, a summary of the lessons of Madigan and other decisions regarding that doctrine, its relationship to setoff, and the application of the logical relationship test, is again appropriate here.

First, recoupment is an equitable, common law doctrine that is not expressly recognized in the Bankruptcy Code but is preserved through judicial decisions. The U.S. Supreme Court has allowed the use of recoupment in bankruptcy cases. Reiter v. Cooper, 507 U.S. 258, 265, 113 S.Ct. 1213, 122 L.Ed.2d 604 (1993).

Recoupment is "the setting up of a demand arising from the same transaction as the plaintiff's claim or cause of action, strictly for the purpose of abatement or reduction of such claim." Newbery, 95 F.3d at 1399. It involves "netting out of debt," Oregon v. Harmon (In re Harmon), 188 B.R. 421, 425 (9th Cir. BAP 1995) and is allowed "because it would be inequitable not to allow the defendant to recoup those payments against the debtor's subsequent claim." Newbery, 95 F.3d at 1401.

The justification for the defensive use of recoupment in bankruptcy is that there is no independent basis for a "debt," and therefore there is no "claim" against estate property. Harmon, 188 B.R. at 425.

The respective claims involved in a recoupment may arise either before or after the commencement of the bankruptcy case, but they must arise out of the same transaction. Newbery, 95 F.3d

at 1399. It is this "same transaction" requirement that essentially distinguishes recoupment from setoff.

In order to determine if two claims arose from the same transaction, in the Ninth Circuit, we apply the logical relationship test. TLC Hosps., 224 F.3d at 1012; Newbery, 95 F.3d at 1403. In other words, the two dealings that support a recoupment must be logically related to one another for the doctrine to be available.

It is this "same transaction" requirement that lies at the heart of Bouma's appeal. The bankruptcy court decided that, under these facts, it could not find a logical relationship between Bouma's prepayment arrangement with Coast Grain and the subsequent discretionary purchases from, and third party payments made on its behalf by, Coast Grain to support application of the doctrine of recoupment.

> The court cannot connect Bouma's pre-payment to the subsequent purchases and third party payments to find a "logical relationship" sufficient to support the doctrine of recoupment. The opposing obligations between Bouma and Coast Grain were effectuated as separate and distinct contracts in the continuous commercial relationship between the parties. At the time of the prepayment, Bouma was not legally obligated to purchase $1.5 million of product to Bouma. Those contracts came into existence months later, when Bouma purchased dairy feed on the "spot market." Coast Grain clearly was under no legal obligation to make third party payments to Bouma's vendors–the court can describe that activity as nothing more than a gratuitous accommodation to Coast Grain's customers, a marketing ploy to promote participation in the prepayment program.

Coast Grain, 317 B.R. at 808.

The bankruptcy court supported its conclusion that there was no logical relationship between Bouma's claims and the prepayment arrangement by applying the analysis required under two Ninth Circuit decisions, Newbery and TLC Hosps. In Newbery, the Court of Appeals applied a "proximate cause" test to connect the parties' competing claims. Fireman's Fund had issued performance and payment bonds to an electrical subcontractor, Newbery Electric Inc., to insure its involvement in several construction projects. Newbery abandoned the projects and Fireman's Fund was required to take them over. Newbery and Fireman's Fund executed a contract providing that Fireman's Fund could use Newbery's equipment to complete the jobs and, in return, would pay rent to Newbery's secured lender, Citibank. Citibank then assigned the right to collect such rent back to Newbery. When Fireman's Fund failed to make the rent payments, Newbery sued. The court noted that, but for Newbery's breach of the construction contracts, Fireman's Fund would not have needed to rent the equipment. As Newbery was contractually obligated to indemnify Fireman's Fund for its losses, the parties' opposing claims, according to the Ninth Circuit, arose from and were intertwined in the same contracts and acts of the parties. As a result, the court allowed Fireman's Fund to recoup its claims against Newbery from the rent it owed.

In TLC Hosps., the Ninth Circuit allowed a recoupment when it found evidence of Congressional intent in enacting the Medicare statutory scheme to connect the estimated payments and reimbursements based on the ongoing Medicare contract. Based upon the intricate system established in the legislation, the court

allowed the Government to withhold the amount of overpayments made to a hospital from future payments due to the hospital.

In both Newbery and TLC Hosps., the Court of Appeals looked to the legal relationships among the parties to determine the "logical relationship" between the competing claims. Comparing the Bouma-Coast Grain relationship with those examined in Newbery and TLC Hosps., the bankruptcy court concluded that the opposing claims of Bouma and Coast Grain lacked any causal connection or that they were entwined by anything "but an unwritten, noncommittal, amorphous 'understanding' based on their prior course of business." Coast Grain, 317 B.R. at 808-09. The bankruptcy court opined that for recoupment to be available, Bouma needed to establish, at a minimum, that the prepayment arrangement had a legally cognizable relationship to the subsequent sale of goods and third party payments made by Coast Grain. The court found that, given the "loose knit structure" of the parties' understandings, as well as the lack of a "definite agreement" to memorialize the terms of the prepayment agreement, Bouma had failed to establish the requisite logical relationship.

Bouma argues that the logical relationship between the prepayment and the subsequent shipments and third party transfers can be established by deposition testimony and the conduct of the parties, and cites authorities for its contention that the prepayment agreement and subsequent sales and transfer formed a unitary contract. Bouma reminds us that in Newbery, the court stated that "transaction is a word of flexible meaning. It may comprehend a series of many occurrences, depending not so much upon the immediateness of their connection as upon their logical

relationship." Newbery, 96 F.3d at 1402(quoting Moore v. New York Cotton Exchange, 270 U.S. 593 (1926)). Bouma also relies upon Ashland Petroleum Company v. Appel (In re B&L Oil Co.), 782 F.2d 155 (10th Cir. 1986) which, in turn, had been favorably cited by the Supreme Court in Reiter v. Cooper, supra.

In B&L Oil, the debtor granted Ashland Oil the right, but with no obligation, to purchase unspecific amounts of crude oil from B&L. Ashland purchased oil and, prior to B&L's filing for bankruptcy, overpaid for the oil. After bankruptcy, Ashland withheld payments for subsequent deliveries from B&L to recover the amount of overpayment. In the litigation that followed, B&L argued that the original contract between B&L and Ashland never required Ashland to purchase any oil and, therefore, that Ashland's payment obligation arose independently for each delivery. Ashland argued that there was a contract and that all purchases under it should be treated as arising from the same transaction. The Tenth Circuit settled the dispute by finding that there was a single contract, despite the fact that orders were entered at different times and for varying amounts.

Although we find B&L informative, we are more persuaded by Braun's arguments, which liken the facts of this appeal with those presented in our decision in Cal. Canners and Growers v. Military Distributors of Va., Inc. (In re Cal. Canners and Growers), 62 B.R. 18 (9th Cir. BAP 1986)(cited with approval in Madigan, 270 B.R. at 758). Cal. Canners filed for bankruptcy in 1983. Before bankruptcy, Cal. Canners sold and delivered goods to Military Distributors, which thereafter, on the order of Cal. Canners, shipped the goods to various military installations. Cal. Canners

received payment from the U.S. government for these shipments but did not pay Military Distributors for several separate orders and shipments before the bankruptcy filing. Military Distributors admitted that it owed Cal. Canners for post-bankruptcy purchases but asserted that the defense of recoupment applied to the payment of the pre-petition debt. This Panel held that each delivery under a single distributor's agreement was a separate transaction for recoupment purposes. It also found significant that "the purchaser's claim involved the purchase and sale of different goods. Id. at 20-21.

Cal. Canners is indeed on point in this case. Bouma made a prepayment deposit, not to guarantee that it would have a secure supply of feed products or to nail down favorable contract terms, but presumably to take advantage of tax savings or other financial advantages it could hopefully realize. This prepayment relationship was not evidenced by any formal contract and, as the bankruptcy court found, was at best a nebulous "oral arrangement." Under this vague understanding, Bouma was not required to purchase goods from Coast Grain and Coast Grain was not required to sell goods to Bouma on any specified terms. Bouma's act of making a prepayment deposit with Coast Grain simply cannot reasonably be connected in any logical fashion to the 765 separately invoiced purchases of fourteen different products it thereafter made from Coast Grain. Moreover, these purchases amounted to considerably less than 50 percent of the prepayment deposit and we are at a loss to connect the prepayment deposit to the over $900,000 distributed by Coast Grain on seventeen different occasions to various third parties, who were not even identified at the time of

the original oral prepayment agreement. It seems undisputed that, had it instructed Coast Grain to do so, all of the prepayment deposit could have been distributed to third parties, with any product purchases carried by Coast Grain on open account, something that actually occurred after the prepayment deposit was exhausted in years past and again in 2001.

As the Ninth Circuit noted in TLC Hosps., "the logical relationship concept is not to be applied so loosely that multiple occurrences in any continuous commercial relationship would constitute one transaction." TLC Hosps., 244 F.3d at 1012. Although there was a continuing commercial relationship between Bouma and Coast Grain through the period at issue in this appeal, that relationship is best characterized as an on-going series of separate transactions. We therefore agree with the bankruptcy court that "the opposing obligations between Bouma and Coast Grain were effectuated as separate and distinct contracts in the continuous commercial relationship between the parties." Coast Grain, 317 B.R. at 808.

The bankruptcy court correctly determined that there was no logical relationship between the prepayment agreement and the subsequent purchases and third party payments. There was no single transaction or contract which is a fundamental requirement for exercise of recoupment rights. Consequently, the bankruptcy court did not err in its decision that recoupment could not be applied in the instant case, a conclusion that was consistent with the case law of this Circuit and well-reasoned.[18]

[18] Before leaving this issue, we note the following from the bankruptcy court's opinion: "Recoupment is an equitable doctrine which may be denied based on the parties' conduct or other

(continued...)

3. The bankruptcy court erred in allowing Bouma a partial recoupment for the Rolled Corn Contract.

After rejecting Bouma's recoupment defense in the First Bouma Decision, the bankruptcy court partly reversed positions in the Second Bouma Decision by allowing Bouma a partial recoupment for purchases and payments made by Coast Grain on the Rolled Grain Contract during the 90-day pre-petition period. This ruling is the subject of Braun's cross-appeal. To us, the allowance of a partial recoupment to Bouma under these facts is inconsistent with the bankruptcy court's persuasive and cogent analysis of the "same transaction" requirement. Because the bankruptcy court did not identify specific facts sufficient to justify why a "logical relationship" existed between the Rolled Corn Contract and the prepayment deposit, the bankruptcy court's allowance of partial recoupment to Bouma for the Rolled Corn Contract must be reversed.

We find no indication in the record that, at the time Bouma made its prepayment deposit, the parties intended to treat Bouma's obligations under the Rolled Corn Contract in any special manner, as compared with its other purchases, vis-à-vis Bouma's prepayment account. Significantly, the Rolled Corn Contract was entered into by the parties in October, 2000 and deliveries to Bouma from Coast Grain commenced the same month. In fact, some $70,000 in purchases had already been made by Bouma prior to the date it made the December prepayment deposit. Although the Rolled Corn

[18](...continued)
'equitable factors' which the court does not need to address here." Coast Grain, 317 B.R. at 809, n.7. We also do not rest our decision on "the equities". However, given Bouma's sophistication and purely financial motives for engaging in this inherently risky quasi-banking arrangement with its feed supplier, it is doubtful that we could be persuaded that Bouma should be spared its loss in preference to Coast Grain's other creditors.

Contract obligates Bouma to make purchases from Coast Grain, in describing his intentions at the time he tendered the $1.63 million prepayment to Coast Grain, Mr. Schoenveld makes no special mention of the Rolled Corn Contract. On the contrary, he stated that, after paying off the accumulated account balance, any remaining prepayment credits were for "feed" to be delivered in the future. The Coast Grain accounting records show that deliveries of rolled corn to Bouma were treated in the same manner as any other product purchased by Bouma during 2001: an invoice was created on or near the delivery date and was paid by debiting the prepayment balance. As noted above, there is no evidence that, had Bouma asked Coast Grain to do so, all amounts in the prepayment account could be debited to pay non-Rolled Corn Contract invoices or to make third party payments, without regard to the status of the Rolled Corn Contract.

Although the existence of a written contract between the parties is one factor the bankruptcy court could consider in deciding whether transactions are logically related for purposes of application of the recoupment doctrine, we think the bankruptcy court assigned far too much weight to the existence of the Rolled Corn Contract. Contrary to Bouma's argument, the facts in Jensen, as compared with those here, are very different. The business relationship between Coast Grain and Jensen was almost completely based on the terms of written contracts. The remaining value of the Jensen contracts was almost exactly equal to the full amount of the prepayment deposit Jensen provided to Coast Grain less amounts due. Jensen did not ask Coast Grain to make third party payments from its account.

In this case, the Rolled Corn Contract comprised a relatively small portion of the amount of purchases executed on Bouma's account. Bouma had made substantial purchases from Coast Grain under the Rolled Corn Contract before the December, 2000, prepayment deposit was made. There was nothing in the Contract tying Bouma's performance to the existence of the prepayment deposit. Bouma also made significant purchases of goods from Coast Grain on open account. In addition, Bouma directed that the bulk of the prepayment account be disbursed to third parties.

We find little support in the record to show that Bouma's obligations to Coast Grain under the Rolled Corn Contract were in any way "logically related" to the existence and operation of the 2001 prepayment account. Absent factors other than the mere existence of the written contract, application of the recoupment doctrine is inappropriate. The bankruptcy court's decision to apply a partial recoupment in Bouma's favor must be reversed and this action must be remanded to the bankruptcy court for recalculation of the award to Braun under the Twelfth Claim of the Amended Complaint.

CONCLUSION

The decision of the bankruptcy court granting Braun's request to disallow and recover setoffs made from Bouma's prepayment account during the 90 days before Coast Grain's bankruptcy filing, and thereafter, and denying Bouma's recoupment defense, are AFFIRMED. The bankruptcy court's allowance of a partial recoupment to Bouma for the Rolled Corn Contract is REVERSED and the adversary proceeding is REMANDED to the bankruptcy court for

recalculation of the award to Braun and entry of a judgment consistent with this decision.