

IN THE UNITED STATES BANKRUPTCY COURT  
FOR THE DISTRICT OF KANSAS

IN RE: )  
 )  
JOHN Q. HAMMONS FALL )  
2006, LLC ) Case No. 16-21142  
 ) Chapter 11  
Debtor(s) )

**MOTION OF LG FULFILLMENT TO RETAIN AND APPLY DEPOSITS**

COMES NOW, MDM Commercial Enterprises, Inc. d/b/a LG Fulfillment-Ponte Vedra Beach Florida (“LG Fulfillment”), by and through its counsel of record, Shannon D. Wead of Foulston Siefkin LLP, and for its Motion to Retain and Apply Deposits. In support of this Motion, LG Fulfillment states:

**Background**

1. LG Fulfillment is a creditor of one or more of the Debtor entities in this case. LG Fulfillment provides goods and services to the Debtors relating to audio visual products, including, but not limited to, television products and services for hotel rooms.

2. On June 26, 2016, Debtors filed that certain Motion for Entry of Order Authorizing, but not Directing, Payments of Prepetition Claims of Certain Critical Vendors (the “Critical Vendor Motion”) [Doc# 12].

3. On July 18, 2016, the Court entered that certain Order Authorizing, but not Directing, Payments of Prepetition Claims of Certain Critical Vendors [Doc# 198], which order has been amended on certain occasions thereafter (the “Critical Vendor Order”).

4. On July 12, 2016, Debtors filed that certain Notice of Critical Vendor List in Support of Motion for Entry of Order Authorizing, but not Directing, Payments of Prepetition

Claims of Certain Critical Vendors (the “Notice of Critical Vendors”) [Doc# 128], wherein Debtors identified and designated LG Fulfillment as a critical vendor in these cases.

5. Before Debtors filed these bankruptcy cases, Debtors placed the following orders (the “Orders”) with LG Fulfillment and paid the following deposits (the “Deposits”) to LG Fulfillment for the Orders:

<b>LG Fulfillment Order Number</b>	<b>JGH Order Number</b>	<b>Deposit Amount</b>
ORD00114420 (replaced by ORD00115991)	JC16306-008	\$129,000.00
ORD00114426	JC16794-002	\$120,000.00
ORD00114419	JC16739-009	\$130,000.00
ORD00114422	JC16735-011	\$140,000.00
ORD00114421	JC16301-007	\$131,000.00

6. Since Debtors filed these bankruptcy cases, LG Fulfillment filled the Orders and received payment from Debtors for the balance owed on the Orders, excluding the amount of the Deposits.

7. Counsel for LG Fulfillment and counsel for Debtors have discussed the Deposits. Specifically, counsel for LG Fulfillment requested that Debtors pay the amount of the Deposits to LG Fulfillment under the Critical Vendor Order, after which LG Fulfillment would return the Deposits to Debtors. Counsel for Debtors suggested that LG Fulfillment retain the Deposits, stating that the net result for the bankruptcy estate would be the same.

**Relief Requested and Applicable Law**

8. LG Fulfillment desires to retain the Deposits, as suggested by Debtors' counsel, but desires to obtain the Court's approval for the same so that LG Fulfillment's retention and application of the Deposits is not subject to subsequent attack, for any reason, by any creditor, committee, the Debtors, or any other person or entity.

9. Accordingly, LG Fulfillment files this Motion for an Order (a) permitting LG Fulfillment to exercise its recoupment rights and retain the Deposits, (b) finding and ordering that LG Fulfillment retaining and applying the Deposits is permitted by applicable bankruptcy law and is not a violation of the automatic stay, and (c) finding and ordering that the Deposits are not subject to any preference or avoidance claims or any other claims of any kind or nature to recover the Deposits by any person, entity or committee.

10. The relief requested herein is permitted under applicable law. Security deposits are treated as secured claims under applicable law in that a creditor who holds a deposit is entitled to apply the deposit in satisfaction of its allowable claim. 11 U.S.C. § 506(a) ( "an allowed claim of a creditor . . . that is subject to setoff under Section 553 of this title, is a secured claim . . . to the extent of the amount subject to setoff . . . and is an unsecured claim to the extent that . . . the amount so subject to setoff is less than the amount of such allowed claim"); see also 5 Collier on Bankruptcy §502.03[7][h]; and see *Walton v. Piqua State Bank*, 204 Kan. 741 (1970) (recognizing district court treated deposit of funds in a savings account as a pledge with sufficient delivery of possession and control by a bank to meet requirements of a pledge of security where deposit could not be withdrawn without bank consent).

11. Additionally, a creditor is permitted to exercise recoupment rights under applicable law. Recoupment, while similar to setoff, is a separate, equitable doctrine that is not subject to the setoff limitations of 11 U.S.C. § 553 or the automatic stay. *In re Merriman*, 329 B.R. 710, 717 (D. Kan. 2005); *see also In re Malinowski*, 156 F.3d 131, 133 (2d Cir. 1998) (“The automatic stay is inapplicable because the funds subject to recoupment are not the debtor’s property”). A creditor can recoup its claim against the debtor as long as the claims of the creditor and debtor “arose out of the same transaction.” *In re Merriman*, 329 B.R. at 717. In determining recoupment rights, the court does not consider timing or mutuality. *Id.* As a general rule, the requirements and limitations of Section 553 do not apply to recoupment. *In re Malinowski*, 156 F.3d 131, 133 (2d Cir. 1998). The major benefit of this is that the obligations need not both be pre-petition. *In re Anes*, 195 F.3d 177, 182 (3rd Cir. 1999).

12. The Tenth Circuit uses the strict integrated contract test when deciding what constitutes “the same transaction.” That is, “courts generally have only found this ‘same transaction’ requirement to be satisfied when the debts to be offset arise out of a single, integrated contract or similar transaction.” *In re Adamic*, 291 B.R. 175, 182 (Bankr. D. Colo. 2003) (quoting *In re Davidovich*, 901 F.2d 1533, 1538 (10th Cir. 1990)). Ultimately, recoupment is an equitable doctrine. Therefore, it only applies if the claims “are so closely intertwined that allowing the debtor to escape [his or her] obligation would be inequitable notwithstanding the Bankruptcy Code’s tenant that all unsecured creditors share equally in the debtor’s estate.” *Id.* (quoting *In re Peterson Distrib., Inc.*, 82 F.3d 956, 960 (10th Cir. 1996)).

13. In summarizing the recoupment doctrine, the Tenth Circuit stated that “in most situations in which the recoupment doctrine was applied, the contract at issue expressly

permitted the withholding of overpayments from future payments.” *In re B & L Oil Co.*, 782 F.2d 155, 157 (10th Cir. 1986) (allowing recoupment even without an express agreement). For example, a recording company was allowed to recoup musician royalty advances made prepetition from post-bankruptcy record sales. *Waldschmidt v. CBS, Inc.*, 14 B.R. 309, 314 (M.D. Tenn. 1981). Similarly, the government was allowed to recoup Medicare overpayments from post-bankruptcy reimbursements to a hospital that continued to operate after filing a Chapter 11 Petition. *In re Yonkers Hamilton Sanitarium, Inc.*, 22 B.R. 427, 433 (Bankr. S.D.N.Y. 1982), *aff’d*, 34 B.R. 385 (S.D.N.Y. 1983).

14. The “same transaction” requirement is met for each of the Deposits. Each of the Deposits were paid in connection with a specific, single purchase order. And each of the Deposits would be recouped in connection with only the specific, single purchase order associated with each of the Deposits.

15. Next, a majority of courts, including the Tenth Circuit, hold that the automatic stay does not enjoin recoupment. *Beaumont v. Dept. of Veteran Affairs (In re Beaumont)*, 586 F.3d 776 (10<sup>th</sup> Cir. 2009); *In re Kosadnar*, 157 F.3d 1011, 1014-16 (5th Cir. 1998); *In re Merriman*, 329 B.R. 710, 717 (D. Kan. 2005); *In re Holyoke Nursing Home, Inc.*, 273 B.R. 305 (Bankr. D. Mass. 2002); *In re Pruett*, 220 B.R. 625, 628 (Bankr. E.D. Ark. 1997); *Mercy Hosp. of Water Town v. New York St. Dept. of Social Services*, 171 B.R. 490, 494 (Bankr. N.D.N.Y. 1994). Accordingly, LG Fulfillment is permitted to retain and apply the Deposits under the recoupment doctrine regardless of the automatic stay.

16. Finally, recoupment of the Deposits, or the Deposits themselves, cannot be subject to attack as a preference and are not otherwise avoidable under bankruptcy law. The

reason for this is that the funds that are the subject of a valid recoupment are not an “interest” in the property of the estate. *Folger Adam Security, Inc. Dematteis/McGregor, JV*, 209 F.3d 252, 261 (3<sup>rd</sup> Cir. 2000). Rather, the recoupment doctrine is used to determine what liabilities exist in the first place, and thereby determine what is property of the estate. *Reiter v. Cooper*, 507 U.S. 258, 265 n.2, 113 S.Ct. 1213, 122 L.Ed. 2d 604 (1993) (“[r]ecoupment permits a determination of the ‘just and proper liability on the main issue,’ and involves ‘no element of preference.’”).

17. Finally, handling the Deposits in the manner suggested by Debtors’ counsel makes sense in that it is equitable and it avoids transferring the same funds back and forth between LG Fulfillment and Debtors.

WHEREFORE, LG Fulfillment respectfully requests that the Court grant this Motion and enter an Order (a) permitting LG Fulfillment to exercise its recoupment rights and to retain the Deposits, (b) finding and ordering that LG Fulfillment keeping the Deposits is equitable and avoids transferring the funds back and forth between LG Fulfillment and Debtors, (c) finding and ordering that LG Fulfillment retaining and applying the Deposits is permitted by applicable bankruptcy law and is not a violation of the automatic stay, and(d) finding and ordering that the Deposits are not subject to any preference or avoidance claims or any other claims of any kind or nature to recover the Deposits by any person, entity or committee.

Respectfully submitted,

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**CERTIFICATE OF SERVICE**

The undersigned hereby certifies that a true and correct copy of the above and foregoing **MOTION OF LG FULFILLMENT TO RETAIN AND APPLY DEPOSITS** was uploaded to the CM/ECF system on January 24, 2017, which will send a notice of electronic filing to the parties receiving electronic notice in these proceedings.

By s/Shannon D. Wead  
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