

**UNITED STATES BANKRUPTCY COURT
For the Southern District of Iowa**

In the Matter of	:	Case No. 98-01204-WH
	:	
CARING ANGELS, INC.,	:	Chapter 7
	:	
	:	
Debtor.	:	
	:	

ORDER – MOTION FOR RELIEF FROM STAY

On March 20, 1998, Debtor, Caring Angels, Inc., filed a Voluntary Petition for Chapter 7 relief under the U.S. Bankruptcy Code. On June 12, 1998, telephonic hearing was held on the Motion and the Chapter 7 Trustee's Objection thereto. The Trustee, Deborah L. Petersen, appeared, and Creditor, Norwest Bank, was represented by attorney G. Mark Rice. At the conclusion of the telephonic hearing, the Court continued the matter for evidentiary hearing; provided, however, that if a Stipulation of Facts was submitted, the hearing would be canceled. A Stipulation of Facts has been filed, the evidentiary hearing was canceled, and the Court now considers the matter fully submitted.

The Court has jurisdiction of this matter pursuant to 28 U.S.C. § 157(b)(1) and § 1334. This is a core proceeding. 28 U.S.C. § 157(b)(2)(G). The Court, upon review of the briefs, pleadings, evidence, and arguments of counsel, now enters its findings and conclusions pursuant to Fed. R. Bankr. P. 7052.

FINDINGS OF FACT

1. Caring Angels, Inc. ("Debtor") is the owner of Inventory, Equipment, accounts and other rights to payment, and had on deposit with Norwest Bank Iowa N.A. ("Norwest") the sum of approximately \$6,379.59.

2. Norwest has a perfected security interest in the above-described personal property by virtue of a security agreement executed by the Debtor on February 21, 1996. The security agreement was perfected with the Iowa Secretary of State on February 26, 1996. The security agreement was given as security for a promissory note dated February 21, 1996 in the original principal amount of \$80,000.

3. The Debtor is in default on the obligations owing Norwest and the current amount owing is approximately \$63,867.28, plus interest and fees.

4. Debtor filed a Chapter 7 bankruptcy petition on March 20, 1998, and Deborah L. Petersen was appointed Trustee.

5. On April 27, 1998, the Trustee sent a letter to Norwest requesting that it close all of the Debtor's accounts and forward her a cashier's check for the total of their balances. In her letter, the Trustee stated that the fact that the Debtor filed bankruptcy entitled her to such funds.

6. Norwest subsequently complied with the Trustee's request and sent funds in the amount of \$6,379.59 to her.

DISCUSSION

The instant Motion for Relief from Stay was granted in part on September 1, 1998. The parties do not dispute that Norwest had a perfected security interest in the Debtor's inventory, equipment, accounts and other rights to payment, and no objection to the Motion for Relief from Stay was filed as to this property, with the exception of the Debtor's \$6,379.59 deposit balance at Norwest.

The issue in this case revolves around the \$6,379.59 deposit balance which was transferred to the Trustee, who now retains possession of it. The Trustee claims she is entitled to

retain these funds for administration in the bankruptcy estate. She maintains that Norwest's lien lost its perfected status when Norwest turned over the funds to her, and that Norwest is too late in attempting to exercise its right of setoff. Norwest, conversely, claims that it is entitled to a return of the funds so that it may exercise its right of setoff. The parties stipulate that the subject funds were exclusively comprised of proceeds from accounts and other rights to payment and that Norwest had a right of setoff prior to paying the funds to the Trustee.

The Bankruptcy Code, 11 U.S.C. § 542(b), requires the bank to pay a debtor's funds on deposit to the trustee "except to the extent that such debt may be offset under section 553 of this title against a claim against the debtor." 11 U.S.C. § 542(b). The point of contention is the effect Norwest's transfer of the deposit funds had on its right of setoff.

The common law right of setoff is a possessory interest. In re Gehrke, 158 B.R. 465, 468 (Bankr. N.D. Iowa 1993) (citing Olsen v. Harlan National Bank, 162 N.W.2d 755, 759 (Iowa 1968)). Once a bank turns over deposit funds to the trustee, there can be no subsequent claim of setoff by the bank. "The Bank . . . by voluntarily releasing the funds in the checking account to the Debtors . . . waived whatever setoff rights it may have had." Crispell v. Landmark Bank (In re Crispell), 73 B.R. 375, 380-81 (Bankr. E.D. Mo. 1987) (citing In re Wilson, 381 49 B.R. 19, 21 (Bankr. N.D. Tex. 1985); In re Archer, 34 B.R. 28, 30 (Bankr. N.D. Tex. 1983); In re Royal Crown Bottling Co. of Boaz, Inc., 29 B.R. 52, 54 (Bankr. N.D. Ala. 1981)). The United States Bankruptcy Court for the Northern District of Iowa explained the principle aptly: "The deposit is a debt owed by the bank to the depositor. Once the deposit is paid out, there is no longer a debt which the bank may offset against a debt the depositor owes the bank." Gehrke, 158 B.R. at 468. See also In re Cloverleaf Farmers Co-Operative, 114 B.R. 1010 (Bankr. D. S.D. 1990) (denying SBA right of offset against funds disbursed to the debtor by the Agricultural Stabilization and

Conservation Service because the action for offset was brought in court after funds had been released); In re Wilson, 49 B.R. 19 (Bankr. N.D. Tex. 1985) (holding SBA waived any claim it might have had to a setoff by not asserting a setoff right until after the IRS had disbursed the funds to the Trustee); and In re Royal Crown Bottling Co. of Boaz, Inc., 29 B.R. 52 (Bankr. N.D. Ala. 1981) (holding bank's right of setoff was extinguished because bank failed to assert its right of setoff before voluntarily disbursing debtor's account balance to the Trustee).

The Court finds that the right of setoff was extinguished when Norwest Bank failed to assert such right before transferring the Debtor's deposited funds to the Trustee.

ORDER

IT IS THEREFORE ORDERED that the Motion for Relief from Stay as to Debtor's \$6,379.59 deposit balance which Norwest Bank Iowa N.A. transferred to the Trustee is DENIED, and Trustee may retain these funds for administration in the bankruptcy estate.

Dated this _____ day of February 1999.

RUSSELL J. HILL, CHIEF JUDGE
U.S. BANKRUPTCY COURT