IN THE UNITED STATES BANKRUPTCY COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

IN RE	: CHAPTER 7
AMERICAN REHAB & PHYSICAL THERAPY, INC.	:
	: CASE NO. 04-14562
ROBERT H. HOLBER, TRUSTEE PLAINTIFF V. DOLCHIN SLOTKIN & TODD, P.C., ADVANCED MEDICINE ASSOCIATES, P.C., B.N.A., P.C., AMBULATORY CARE CENTER P.C., ARIE OREN, M.D., AHUVA OREN, M.D., ANDREW BERKOWITZ, M.D. DEFENDANTS	: ADVERSARY PROCEEDING NO. 04-0847
ADVANCED MEDICINE ASSOCIATES, P.C., et al, Third-Party Plaintiffs v. Richard Privitera, et al, Third-Party Defendants	:

OPINION

By: STEPHEN RASLAVICH, UNITED STATES BANKRUPTCY JUDGE.

Introduction

The Plaintiff has filed a motion to dismiss the Counterclaim of Advanced Medicine Associates, P.C., B.N.A., P.C., Ambulatory Care Center, P.C., Arie Oren, M.D., Ahuva Oren, M.D., and Andrew Berkowitz, M.D. (Defendants) for failure to state a claim upon which relief may be granted. The Defendants have filed a Response to the Motion. Hearing on the matter was held on December 1, 2004. For the reasons set forth below, the motion will be denied.

Procedural Background

The Plaintiff has filed suit against the Defendants for their failure to have made certain installment payments under a prepetition agreement to purchase assets. Along with their Answer, the Defendants filed a counterclaim.[1] The Trustee maintains that the counterclaim must be dismissed because it violates the bankruptcy stay. The Defendants insist that their claim is not only proper but required under the applicable rules of procedure or it will be waived.

Legal Standard

The Motion seeks dismissal of the counterclaim pursuant to F.R.C.P. Rule 12(b)(6). Rule 12(b)(6) – which is incorporated by Bankruptcy Rule 7012 – provides for dismissal of a complaint for failure to state a claim upon which relief can be granted. F.R.C.P. 12(b)(6). A claim should not be dismissed for failure to state a claim unless it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief. *Conley v. Gibson*, 355 U.S. 41, 45-46, 78 S.Ct. 99, 101-02, 2 L.Ed.2d 80 (1957). All well-pleaded factual allegations in the claim must be taken as true. *Cruz v. Beto*, 405 U.S. 319, 322, 92 S.Ct. 1079, 1081, 31 L.Ed.2d 263 (1972); *Rocks*, 868 F.2d at 645. The court must draw all reasonable inferences from the allegations and view them in the light most favorable to the non-moving party. *Rocks*, 868 F.2d at 645.

[1]Defendant Dolchin Slotkin & Todd, P.C. filed its own Answer and has not made a counterclaim.

Analysis

The Trustee explains that the counterclaim violates the bankruptcy stay by attempting to effect a setoff of a postpetition debt. According to the Trustee, the counterclaim alleges a breach of a restrictive covenant. But, the Trustee points out, one of the elements of a set off is mutuality of debts, i.e., that both debts existed at the same time, or in this case, prepetition. Because the counterclaim arose postpetition, the Trustee concludes, it may not be set off against the Trustee's claim. Were it otherwise, the effect would be to secure *postpetition* a debt that was *unsecured prepetition. See* Trustee's Motion and Brief; Transcript (T-) 4,5.

In their response, the Defendants do not dispute when their claim arose. In fact, they maintain, a postpetition claim such as theirs *must* be filed as a counterclaim or it is waived pursuant to Bankruptcy Rule 7013.[2] And at the hearing, they clarified that their claim was one for *recoupment* and so would not violate the stay. T-7,8. Does this make a difference?

Recoupment and
the Automatic Stay

The Third Circuit has provided a thorough explication of the doctrines of setoff and recoupment:

> The doctrines of "setoff" and "recoupment" had their origins in the era of common law pleading, under which the scope of a "case" was far less inclusive than it is today, and under which claim joinder was far narrower. Both doctrines permitted countervailing claims, which otherwise could not

[2]The rule provides that "a party sued by a trustee or debtor in possession need not state as a counterclaim any claim that the party has against the debtor, the debtor's property, or the estate, *unless the claim arose after the entry of an order for relief*." B.R. 7013 (emphasis added)

> have been asserted together, to be raised in a case based on any one of them. Both doctrines were subsequently adopted in bankruptcy, setoff by statute, *see* 11 U.S.C. § 108 (1976), repealed by Bankruptcy Reform Act of 1978, Pub.L. No. 95-895, 92 Stat. 2549 (1978); and recoupment by decision, *see In re Monongahela Rye Liquors*, 141 F.2d 864 (3d Cir.1944). In bankruptcy, however, setoff and recoupment play a role very different from their original role as rules of pleading. Setoff, in effect, elevates an unsecured claim to secured status, to the extent that the debtor has a mutual, pre-petition claim against the creditor. *See* 11 U.S.C. § 506(a). Setoff is limited, however, by the provisions of 11 U.S.C. § 553. Among those limitations is that pre-petition claims against the debtor cannot be setoff against post-petition debts to the debtor. *Recoupment, on the other hand, allows the creditor to assert that certain mutual claims extinguish one another in bankruptcy, in spite of the fact that they could not be "setoff" under 11 U.S.C. § 553. The justification for the recoupment doctrine is that where the creditor's claim against the debtor arises from the same transaction as the debtor's claim, it is essentially a defense to the debtor's claim against the creditor rather than a mutual obligation, and application of the limitations on setoff in bankruptcy would be inequitable.*

Lee v. Schweiker, 739 F.2d 870, 875 (3d Cir.1984) (emphasis added); *see also In re Career Consultants, Inc*., 84 B.R. 419, 426 (Bankr.E.D.Va.1988) (“Because recoupment adjusts liability on an individual transaction, recoupment should be allowed regardless whether the breach occurred prepetition or postpetition.”); *In re Video Cassette Games, Inc*., 108 B.R. 347, 352 (Bankr.N.D.Ga.1989) (“Even if Debtor had included allegations of postpetition misconduct, Sanwa could assert its claim as one for recoupment rather than for setoff.”); *In re Thompson*, 182 B.R. 140,147 (Bankr.E.D.Va.1995) (stating that recoupment may be invoked where the creditor’s claim arose prepetition and the debtor’s claim arose postpetition); *In re Abbey Financial Corp*., 193 B.R. 89, 94 (Bankr.D.Mass.1996) (“For reasons best known to Congress (there is no legislative

history), section 362 refers only to setoff. Although this may have been an oversight, the distinction between the two rights is sufficient to prohibit interpreting the statute as covering recoupment, and courts have so held."); *In re Pruett*, 220 B.R. 625, 628 (Bankr.E.D.Ark.1997) (same). The timing of a claim raised by recoupment is not affected by the bankruptcy stay. What matters then is the relationship between the adverse claims.

Does the Claim Raised
By the Defendants Arise
Out of the Same Transaction
As the Trustee's Cause of Action?

Like the Third Circuit in *Lee, supra*, other courts condition recoupment on some nexus between the two claims. One court has explained it as follows:

> The only real requirement regarding recoupment is that the sum can be reduced only by matters arising out of the same transaction as the original sum.' [citation omitted]. An express contractual right to recoupment is not necessary for a creditor to exercise recoupment, nor does the mere fact that a contract exists between a creditor and a debtor automatically allow a creditor to exercise recoupment. [citation omitted]. In bankruptcy, however, recoupment 'has been applied primarily where [the relevant claims] arise out of the same contract.' *Lee*, 739 F.2d at 875 (alteration added), *see also, In re Alpco*, Inc., 62 B.R. at 188 ('a single contract may be considered as one transaction for the purposes of recoupment').

In re Weiner, 228 B.R. 647, 650 (Bankr.N.D.Ohio 1998); *see also Abbey*, 193 B.R. at 95 (holding that in bankruptcy, the recoupment doctrine has been applied primarily where the creditor's claim against the debtor and the debtor's claim against the creditor arise out of the same contract.) And another court explains the practical effect of recoupment:

> In the era of common-law pleading, recoupment functioned as an equitable rule of joinder, enabling parties to litigate in one proceeding claims that would have otherwise been pursued separately. [citation omitted] Since then, *in modern practice, both the counterclaim and the affirmative defense have subsumed the doctrine of recoupment.*

Thompson, 182 B.R. at 146 (emphasis added).

In this case, it is alleged that the two claims arise out of the agreement to purchase assets. That agreement provided that payment for the assets would be made pursuant to a note. *See* Complaint, ¶12. It also provided that the two principals of the seller agreed not to compete against the buyers within a certain geographical area. *See* Counterclaim, ¶3. Because it must be assumed that what the Defendants have pleaded is true for purposes of this motion, the Court finds that each party alleges breaches of different provisions of the same contract. For that reason, the two claims are so related as to allow their joinder. The Trustee's motion will be dismissed.

Must the Court Treat the Motion as Seeking Summary Judgment?

At the hearing, the Trustee contended that the defendants have "put facts in evidence" requiring that the motion be treated as one for summary judgment. T-10. Indeed, Rule 12(b) requires such treatment when "matters outside the pleadings are presented to and not excluded by the court." F.R.C.P. 12(b); *Castle v. Cohen*, 840 F.2d 173, 179 (3d Cir. 1988). Nothing in this record, however, indicates the inclusion of matters extraneous to what was pleaded. It is the Trustee, and not the defendants, who characterized the counterclaim as seeking setoff; the counterclaim does not mention the term. And while the defendants clarified at the hearing that their claim is one for

recoupment, that does not change the underlying substantive claim. For that reason, the motion should not be considered as one filed under Rule 56 (summary judgment).

An appropriate order follows.

By the Court:

Stephen Raslavich
United States Bankruptcy Judge

Dated: December 7, 2004

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

IN RE	: CHAPTER 7
AMERICAN REHAB & PHYSICAL THERAPY, INC.	:
	: CASE NO. 04-14562
ROBERT H. HOLBER, TRUSTEE	:
PLAINTIFF	:
V.	:
DOLCHIN SLOTKIN & TODD, P.C., ADVANCED MEDICINE ASSOCIATES, P.C., B.N.A., P.C., AMBULATORY CARE CENTER P.C., ARIE OREN, M.D., AHUVA OREN, M.D., ANDREW BERKOWITZ, M.D.	:
DEFENDANTS	: ADVERSARY PROCEEDING NO. 04-0847
ADVANCED MEDICINE ASSOCIATES, P.C., et al, Third-Party Plaintiffs	:
v.	:
Richard Privitera, et al, Third-Party Defendants	:

ORDER

AND NOW upon consideration of the Plaintiff's Rule 12(b)(6) Motion to Dismiss Counterclaim, the Defendants' Response, after hearing held on December 1, 2004, and for the reasons stated in the foregoing Opinion, it is

ORDERED that the Motion is Denied.

By the Court:

Stephen Raslavich
United States Bankruptcy Judge

Dated: December 7, 2004

MAILING LIST:

George Conway, Esquire
Office Of The U.S. Trustee
950W Curtis Center
7th & Sansom Streets
Philadelphia PA 19106

Paul A. Bucco, Esquire
DAVIS BUCCO & ARDIZZI
10 East 6th Avenue, Ste. 100
Conshohocken, PA 19428

Dexter K. Case, Esquire
Case & DiGiamberardino, P.C.
541 Court Street
Reading, PA 19601

Dolchin Slotkin & Todd, P.C.
One Commerce Square
24th Floor
2005 Market Street
Philadelphia, PA 19103