

UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF NEBRASKA

IN THE MATTER OF)
)
 JEROME M. KRAMMER,) CASE NO. BK86-1242
)
 DEBTOR) A86-290
)
 JEROME MARTIN KRAMMER) CH. 7
)
 Plaintiff)
)
 vs.)
)
 HONEYWELL, INC.,)
)
 Defendant)

MEMORANDUM

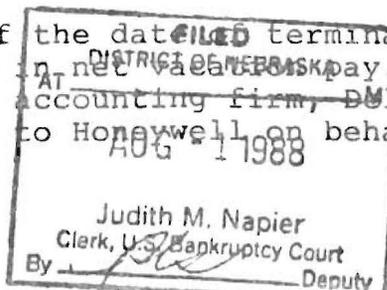
An evidentiary hearing on Jerome Krammer's, plaintiff/debtor, complaint was held April 6, 1988. Howard Duncan, P.C., Omaha, Nebraska, appeared on behalf of Jerome Krammer; Terrence Michael of Baird, Holm, McEachen, Pedersen, Hamann & Strasheim, Omaha, Nebraska, appeared on behalf of Honeywell, Inc., defendant.

The parties agreed that the pretrial statement with its attached exhibits would constitute a stipulation of facts. At the conclusion of the hearing, the Court ordered both parties to submit legal arguments which have been received and reviewed. This memorandum is the Court's findings of fact and conclusions of law as required by Bankr. R. 7052.

Statement of Facts

Jerome Krammer (debtor) was terminated from his employment with defendant, Honeywell, Inc., (Honeywell) on May 17, 1985. Upon termination, debtor signed a promissory note to Honeywell in the amount of \$19,830.27. This debt, owed by debtor to Honeywell, arose out of his employment with Honeywell. Debtor agreed to repay the amount due in 60 consecutive installments beginning on June 1, 1985.

As of the date of termination, debtor had accumulated \$3,763.65 in net pay. In addition, sometime in May, 1985, the accounting firm, Deloitte, Haskins & Sells, had submitted to Honeywell on behalf of debtor a claim of \$5,010 for



reimbursement of excess United States taxes paid by debtor. This amount represented funds to be paid to debtor as part of Honeywell's tax equalization plan for employees who worked outside of the United States and was generated during debtor's 1984 tax year. Exhibit No. 8 attached to the pretrial statement entitled an "expense advance statement" credits the \$5,010 to debtor. The credit was entered May 11, 1985.

Debtor did not make the first payment on the promissory note which was due June 1, 1985. Sometime after June 6, 1985, Honeywell declared the entire note due and payable and set off both the accrued vacation pay and the tax equalization sum against the amount due on the promissory note.

In April, 1986, debtor filed his petition for Chapter 7 relief. Debtor's schedule B-3 listed the tax equalization sum and the accrued vacation pay. Trustee abandoned these assets on June 19, 1986, and the Court discharged debtor in September, 1986. After the Court sustained debtor's motion to reopen his Chapter 7 case, debtor filed this adversary proceeding in October, 1986, requesting Honeywell, pursuant to 11 U.S.C. § 542, to turn over the withheld vacation pay and tax equalization sum to debtor, or in the alternative to trustee. Trustee did not receive notice of the complaint and again abandoned the assets in September, 1987.

Discussion

Because the promissory note states that it will be governed by Arizona law, debtor relies on Arizona Revised Statutes to support his turnover request. He claims that the vacation pay and tax equalization sum are wages as defined by state law and that wages cannot be withheld from an employee more than three working days after termination--the exceptions provided in the statute are not applicable here. Thus, he argues, the set-off was improper as he had an absolute right to the funds before he defaulted on the note.

Honeywell claims that the present case does fit one of the exceptions permitting an employer to withhold employee wages. Even though the exception requires the amount to be in dispute, the right of set-off is a common law right which cannot be asserted without a liquidation of the amount claimed. Further, pursuant to 11 U.S.C. § 553, set-off is a valid defense to a 11 U.S.C. § 542 turnover request because both debts arose prepetition.

The relevant Arizona statutes read as follows:

- 1) "Wages" means nondiscretionary compensation due an employee in return for labor or services rendered by an employee for which the employee has a reasonable expectation to be paid whether determined by a

time, task, piece, commission or other method of calculation. Wages include sick pay, vacation pay, severance pay, commissions, bonuses and other amounts promised when the employer has a policy or a practice of making such payments.

Ariz. Rev. Stat. § 23-350(5).

2) No employer may withhold or divert any portion of an employee's wages unless one of the following applies:

1. The employer is required or empowered to do so by state or federal law.

2. The employer has prior written authorization from the employee.

3. There is a reasonable good faith dispute as to the amount of wages due, including the amount of any counterclaim or any claim of debtor, reimbursement, recoupment or set-off asserted by the employer against the employee.

Ariz. Rev. Stat. § 23-352.

3) When an employee is discharged from the service of an employer, he shall be paid wages due him within three working days or the end of the next regular pay period, whichever is sooner.

Ariz. Rev. Stat. § 23-353(A).

4) If an employer, in violation of the provisions of this chapter, shall fail to pay wages due any employee, such employee may recover in a civil action against an employer or former employer an amount which is treble the amount of the unclaimed wages.

Ariz. Rev. Stat. § 23-355.

Applying the Arizona statutes to the instant facts, the Court finds as follows:

1. The accrued vacation pay and the tax equalization sum are wages as defined by Arizona law. Ariz. Rev. Stat. § 23-350(5);

2. These wages were due to debtor within three business days of debtor's termination from employment, May 17, 1985. Ariz. Rev. Stat. § 23-353(A);

3. Honeywell's right of set-off originated when debtor defaulted on the promissory note, June 6, 1985;

4. The accrued vacation pay and the tax equalization sum were liquidated debts owed to debtor prior to debtor's default on the promissory note.

Thus, the questions before the Court are:

1) Whether Honeywell may properly assert the defense of set-off in a Section 542 turnover action when Honeywell's right of set-off did not exist at the time the vacation pay and tax equalization sum became due and payable to debtor under Arizona law?

2) Whether debtor is the proper party to bring this action?

First, the statutory language of Section 23-352(3) which permits an employer to withhold wages if there "is a reasonable good faith dispute as to the amount of wages due, including the amount of any ... set-off asserted by the employer against the employee" is not relevant because, based on the Court's findings, Honeywell had no right of set-off at the time it withheld debtor's wages. However, under Arizona law, debtor could have initiated a civil action to recover his unpaid wages. Ariz. Rev. Stat. § 23-355. If debtor had exercised this right prior to his default on the promissory note, Honeywell's right of set-off would not have matured.

Generally, a party cannot assert set-off unless the subject matter of the set-off is such that it could be maintained as an independent cause of action. Scoville v. Vail Investment Co., 103 P.2d 662, 668 (Ariz. 1940); 80 C.J.S. Set-off and Counterclaim § 25 (1953). Therefore, during the window of time between debtor's termination and his default on the promissory note, Honeywell could not have claimed set-off as a defense. However, Honeywell's right to set-off matured as a separate cause of action on the date debtor defaulted on the promissory note. In other words, on June 6, 1985, Honeywell could have initiated an action against debtor for enforcement of the terms of the note and, similar to debtor's right to initiate civil action, had a continuing right to do so until debtor filed his Chapter 7 petition for relief in April, 1986.

Further, the general rule of set-off does not require "the set-off [to] have been a legal subsisting claim at the time the right of action accrued to plaintiff on his claim in suit." 80 C.J.S. Set-off and Counterclaim § 27 (1953). The Court finds no Arizona decision which contradicts this rule.

One of the purposes of set-off is to prevent independent suits between like parties particularly when one claimant is as entitled to payment as the other. In the instant case, following

debtor's default upon the note, Honeywell and debtor were mutually indebted. Federal bankruptcy law is in accord with this principle. See 11 U.S.C. § 553(a). In the bankruptcy setting, if a creditor could not assert set-off as a defense, the creditor would have no other adequate means for recovery of its claim.

Debtor's motion to turn over the accrued vacation pay and tax equalization sum is overruled. Honeywell may properly assert set-off as a defense.

Second, trustee's abandonment of the disputed assets could permit debtor to bring this turnover action. However, trustee abandoned the assets in September, 1987, eleven months after debtor initiated this adversary proceeding and trustee did not receive notice of debtor's complaint. Additionally, Honeywell's counsel did not receive notice of trustee's September, 1987, abandonment.

As a result, the Court's order overruling debtor's motion will not be final for thirty days to allow trustee an opportunity to intervene and present evidence or additional legal arguments.

Separate journal entry to be filed this date.

DATED: July 29, 1988.

BY THE COURT:


Chief Judge