ENTERED
JUL 23 2002
U.S. BANKRUPTCY COURT
MDNC - YHP

UNITED STATES BANKRUPTCY COURT
MIDDLE DISTRICT OF NORTH CAROLINA
GREENSBORO DIVISION

IN RE:	)	
	)	
Lincoln-Gerard USA, Inc.,	)	Case No. 01-11986C-11G
	)	
Debtor.	)	
	)	

MEMORANDUM OPINION

This case came before the court on July 16, 2002, for hearing upon cross motions for summary judgment filed on behalf of Kurt J. Lance and the Debtor, Lincoln-Gerard USA, Inc. Neale T. Johnson appeared on behalf of Kurt J. Lance and R. Bradford Leggett appeared on behalf of the Debtor.

FACTS

Prior to the filing of this case, the Debtor was engaged in the retail sale of high-end furniture and accessories, principally eighteenth century mahogany antique replicas and reproductions manufactured in plants located in the Philippines and Indonesia. The Debtor operated its business from a large showroom facility located in High Point, North Carolina, where Debtor's furniture and accessories were exhibited.

On February 6, 1999, Kurt J. Lance ("Claimant"), a retail customer, entered into a sales contract with the Debtor pursuant to which the Debtor was to manufacture and deliver to the Claimant a large dining table, eight side chairs, two arm chairs and a china cabinet. The purchase price of the furniture was $27,732.25, which was prepaid by the Claimant. Although the sales contract did not

specify a delivery date, the Debtor represented that the furniture would be delivered to the Claimant within six to eight months.

In August of 1999, the Debtor notified the Claimant that delivery of the furniture would be delayed. The Claimant followed up with the Debtor by telephone and was reassured that the furniture would be shipped from the factory in about one month. After some ten weeks, the Claimant again called the Debtor and was told that the furniture had not been shipped, but would be on the next container. During the next nine months, the Claimant contacted the Debtor regularly to check on the status of the ordered furniture and was assured repeatedly that the furniture would be in the next monthly shipment.

In June of 2000, some fifteen months after the payment of the purchase price for the furniture, the Claimant telephoned the Debtor and demanded that Debtor refund the purchase price or the Claimant would seek legal counsel. Although the Debtor was not willing to refund the purchase price, the Debtor did offer to deliver similar furniture from Debtor's showroom ("the showroom furniture") for the Claimant to use until the Debtor delivered the ordered furniture. In exchange, the Claimant agreed to give the Debtor additional time to deliver the ordered furniture.

On June 21, 2000, Debtor shipped the showroom furniture to the Claimant by common carrier. The showroom furniture, consisting of a Georgian china cabinet, six Chippendale side chairs, two

Chippendale armchairs and a large dining table, was delivered to the Claimant on June 22, 2000. When the showroom furniture arrived on June 22, 2000, the Claimant received and signed a delivery receipt prepared by the Debtor, which was then returned to the Debtor. The delivery receipt described and valued the showroom furniture and stated that the showroom furniture was "supplied 'on loan' and will be collected by Lincoln-Gerard U.S.A., Inc. upon the delivery of the items ordered by Mr. Lance on sales contract # 10649."

When the Debtor had not delivered the ordered furniture by October of 2000, the Claimant began calling the Debtor frequently, each time demanding that Debtor refund the purchase price. Having not received the furniture that he had ordered or a refund of the purchase price, the Claimant filed suit against the Debtor in Guilford County Superior Court on May 8, 2001. Thereafter, on July 19, 2001, while the Guilford County action was still pending, the Debtor filed for relief under Chapter 11 of the Bankruptcy Code.

On August 1, 2001, the Claimant filed a proof of claim in this case in the amount of $27,732.25, the amount he had prepaid to the Debtor. On December 12, 2001, counsel for the Debtor made demand upon the Claimant that the Claimant surrender the showroom furniture to Debtor, which was refused by the Claimant. The Claimant then filed a motion to amend his proof of claim to assert

that his claim was secured by a security interest in the showroom furniture and for relief from the automatic stay in order to foreclose his security interest or, alternatively, to retain the showroom furniture and apply the value of the showroom furniture as a credit against his claim by setoff or recoupment. The motion to amend was allowed on April 1, 2002. On April 8, 2002, the Debtor filed an amended response to Claimant's motion for relief from stay which included a counterclaim against the Claimant in which the Debtor asserted that the Claimant had converted the showroom furniture as a result of his refusal to return it to the Debtor and prayed for damages of $26,005.80, the value of the showroom furniture. Thereafter, following a period for discovery, the motions for summary judgment which are now before the court were filed.

In his motion for summary judgment the Claimant requests that the court allow his claim in the amount of $27,732.25 and that the court adjudge that his claim is secured by a security interest in the showroom furniture and that he not be required to surrender the showroom furniture to the Debtor unless the Debtor first provides adequate protection of Claimant's security interest in the furniture. In the alternative, Claimant requests that the court adjudge that he is entitled to retain the showroom furniture and reduce his claim by the value of the showroom furniture based upon setoff or recoupment.

In its motion for summary judgment the Debtor requests that the court adjudge that the delivery of the showroom furniture to the Claimant gave rise to a gratuitous bailment of Debtor's furniture and that a conversion of the furniture by Claimant occurred when the Claimant, as a mere gratuitous bailee, refused to surrender the furniture to the Debtor. Debtor requests that a judgment be entered against the Claimant in the amount of $26,005.80, the value of the furniture that was delivered to the Claimant.

DISCUSSION

I. Standard for granting summary judgment

Under Rule 56 of the Federal Rules of Civil Procedure which is incorporated into Rule 7056 of the Federal Rules of Bankruptcy Procedure, summary judgment is proper when there is no genuine issue as to any material fact and the moving party is entitled to judgment as a matter of law. "Where the moving party has carried its burden of showing that the pleadings, depositions, answers to interrogatories, admissions and affidavits in the record construed favorably to the nonmoving party, do not raise a genuine issue of material fact for trial, entry of summary judgment is appropriate." Gutierrez v. Lynch, 826 F.2d 1534, 1536 (6th Cir. 1987)(citing Celotex Corp. v. Catrett, 477 U.S. 317, 106 S. Ct. 2548, 91 L.Ed.2d 265 (1986)).

In order to carry this burden a plaintiff who is moving for

summary judgment must show through affidavits, depositions or admissions all facts required to support each element of the claim and that none of those facts are disputed. See MOORE'S FEDERAL PRACTICE, § 56.13, p. 56-134 (3d ed. 1998). In determining whether the evidence is sufficient to establish the claim, the evidence must be viewed in the light most favorable to the nonmoving party, and inferences to be drawn from the underlying facts must be viewed in the light most favorable to the party opposing the motion. See In re Trauger, 101 B.R. 378 (Bankr. S.D. Fla. 1989); In re Graham, 94 B.R. 386 (Bankr. E.D. Pa. 1988). However, the existence of a factual dispute is material and precludes summary judgment only if the disputed fact is determinative of the outcome under applicable law. See Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 248, 106 S. Ct. 2505, 2510, 91 L.Ed.2d 202 (1986). If the moving party makes the required showing, then the opposing party must set forth the specific facts showing there is a genuine issue for trial. See In re Trauger, 101 B.R. at 380.

II. Application of Substantive Law

For the reasons that follow, the court has concluded that Claimant's motion for summary judgment should be granted based upon the undisputed facts of record and that Debtor's motion should be denied. This decision has been reached even though the evidence did not establish a security interest in the showroom furniture in favor of Claimant. Instead, under the undisputed facts, the

Claimant is entitled to invoke the equitable doctrine of recoupment which entitles Claimant to the relief sought in his motion for summary judgment.

A. No security interest established

Claimant asserts a security interest in the showroom furniture based, alternatively, upon either Article 2 or Article 9 of Chapter 25 of the North Carolina General Statutes. The record is insufficient to establish a security interest under either Article.

Claimant's Article 2 claim is based upon G.S. §§ 25-2-607 and 25-2-711. Claimant argues that under G.S. § 25-2-607(2) acceptance of nonconforming goods may be revoked if such acceptance was on the reasonable assumption that the nonconformity would be seasonably cured. Claimant argues that this provision is applicable to his acceptance of delivery of the showroom furniture, and that he revoked such acceptance when the furniture described in the sale contract was not delivered within a reasonable time. As a result, Claimant argues that he has a security interest in the showroom furniture under G.S. § 25-2-711(3), which provides that on justifiable revocation of acceptance a buyer has a security interest in goods in his possession for any payments made on their price. Neither of these provisions are applicable to the delivery of the furniture that occurred in June of 2000.

It is undisputed that the furniture that was delivered to Claimant in June of 2000 was not the furniture described in the

February 6, 1999 sales contract. It likewise is undisputed that such furniture was not shipped by Debtor as fulfilling the sales contract or as a substitute for the furniture that the Claimant agreed to buy under the sales contract. In other words there was no shipment of furniture by the Debtor that purported to constitute the goods described in the sales contract. Rather, the showroom furniture was shipped to the Claimant for his temporary use pursuant to an amendment of the original sales contract and was not sent or accepted as the sale goods. As a result, G.S. § 25-2-607 has no application with respect to the furniture that was delivered to the Claimant in June of 2000.

G.S. § 25-2-711 likewise has no application in this case and therefore cannot operate to create a security interest in the showroom furniture. The price that the Claimant paid in February of 1999 was intended as the price for the specific "goods" described in the sales contract and this never changed. It was never suggested or agreed by either party that such payment would become the price for the showroom furniture. The security interest under G.S. § 25-2-711 is a "security interest in goods in his possession or control for any payments made <u>on</u> <u>their</u> <u>price</u> . . . ." (Emphasis supplied). The price paid by the Claimant always was intended for the furniture described in the original sales contract. There was never any intention or agreement that the money paid by Claimant in February of 1999 would constitute a

payment or price for the purchase of the showroom furniture. The language of G.S. § 25-2-711(3) does not operate to grant a security interest in goods other than those for which the price was paid by the Buyer, which clearly would not include the furniture shipped in June for the Claimant's temporary use.

In claiming a security interest under Article 9, the Claimant relies upon the June 21, 2000 delivery receipt, and argues that such receipt amends the original sales contract and is sufficient to constitute a security agreement granting the Claimant a security interest in the showroom furniture that secures Debtor's obligations under the sales contract. While the delivery receipt does evidence an amendment to the sales contract, it is not sufficient to constitute a security agreement.

Claimant correctly points out that a security agreement need not contain any particular language, such as a specific granting clause, to be enforceable under North Carolina law. See Evans v. Everett, 279 N.C. 352, 357-58, 183 S.E.2d 109, 113 (1971). However, there must be language in the instrument which leads to a logical conclusion that it was the intention of the parties that a security interest be created. See id. at 358, 183 S.E.2d at 113. As observed in In re Murray Bros., Inc., 53 B.R. 281 (Bankr. E.D.N.C. 1985), "one common thread" that is found in the North Carolina cases is that "the intent to create a security agreement must appear on the face of a written document or documents executed

by the debtor." The first step in determining whether a security agreement exists is for the court to determine as a question of law whether there is a written document or documents that contain language which "objectively indicates that the parties intended to create a security interest." In re Murray Bros., Inc., 53 B.R. at 284. If such a document or documents are present, "then the factfinder must determine whether the parties actually intended to create a security interest."

The delivery receipt in the present case does not objectively reflect any intent to create a security interest in favor of the Claimant. The delivery receipt states that the furniture is being supplied "on loan" to the Claimant. Neither this language nor any other language in the delivery receipt objectively evidences an intent to create a security interest. By definition, lending or making a loan of something is to furnish it to another for temporary use on the condition that it be returned. See WEBSTER'S NEW TWENTIETH CENTURY DICTIONARY 1036, 1060 (2d ed. 1983). This also is the meaning ascribed to lending or making a loan in everyday parlance. Thus, in the context of the delivery receipt, the court concludes that "on loan" was used to indicate that the furniture was supplied for temporary use by the Claimant and indicates nothing about the creation of a security interest. It follows that there is no security agreement in this case and hence no security interest in the showroom furniture under Article 9.

B. Recoupment

Recoupment is a common law doctrine that, like setoff, permits parties to net their cross obligations. The difference between recoupment and setoff is that setoff involves mutual debts arising from unrelated transactions while recoupment covers reciprocal obligations arising out of the same transaction. Because it is based upon the same transaction, recoupment is essentially a defense to the debtor's claim against the creditor. See Epstein, Nickles & White, BANKRUPTCY § 6-45 (1992). Although recoupment is not expressly recognized in the Bankruptcy Code, recoupment nonetheless is allowed in bankruptcy cases when the requisite circumstances are present. See id. Because recoupment works a preference not provided for in the Bankruptcy Code, the bankruptcy courts have been careful to limit the application of recoupment to situations in which the subject matter of the creditor's claim arises from the same transaction or contract as the debtor's claim against the creditor. See In re Tidewater Hosp., 106 B.R. 876, 882 (Bankr. E.D. Va. 1989); In re Fiero Prods., Inc., 102 B.R. 581, 586 (Bankr. W.D. Tex. 1989). Also, recoupment generally has been applied in bankruptcy cases in situations in which it would be inequitable for the debtor to enjoy the benefits of the transaction or contract giving rise to the conflicting claims of the debtor and the creditor without also meeting its obligations under that transaction or contract. See In re Flagstaff Realty Assoc., 60

F.3d 1031, 1035 (3rd Cir. 1995). In such situations, the courts have allowed recoupment provided that the conflicting claims arise from the same transaction or contract. See e.g. In re TLC Hosps., Inc., 224 F.3d 1008 (9th Cir. 2000); In re B & L Oil Co., 782 F.2d 155 (10th Cir. 1986); In re Telephone Warehouse, Inc., 259 B.R. 64 (Bankr. D. Del. 2001); In re Rooster, Inc., 127 B.R. 560, 567-68 (Bankr. E.D. Pa. 1991); In re Public Service Co., 107 B.R. 441 (Bankr. D.N.H. 1989); In re Vaughter, 109 B.R. 229 (Bankr. W.D. Tex. 1989); In re A-1 Hydro Mechanics Corp., 92 B.R. 451 (Bankr. D. Haw. 1988).

In determining whether conflicting claims arose from the same transaction or contract for purposes of recoupment, the courts generally have focused on the facts and the equities of each case, rather than resorting to a precisely defined test or standard. See United States v. Dewey Freight System, 31 F.3d 620, 623 (8th Cir. 1994). Focusing in this manner in the present case reveals that the Claimant's claim against the Debtor and the Debtor's claim against the Claimant for return of the showroom furniture arose from the sales contract which the parties entered into on February 6, 1999, and amended on June 22, 2000. As originally embodied, the sales contract was one under which the Debtor agreed to manufacture and deliver the described furniture to the Claimant in exchange for the sales price of $27,732.25, which the Claimant prepaid to the Debtor. Apart from the verbal assurance by Debtor

that the furniture would be delivered within six to eight months, the Debtor was obligated to deliver the furniture within a reasonable time. See G.S. § 25-2-309. The Debtor failed to comply with this term of the contract when the furniture had not been delivered by June of 2000, and was faced with having to refund the $27,732.25 paid by Claimant or be subjected to a lawsuit. In order to amend the sales contract and obtain additional time within which to deliver the furniture, the Debtor offered to provide the showroom furniture for the Claimant to use until the contract furniture was delivered. The Claimant signed the delivery receipt and accepted this proposal, and the sales contract was amended accordingly. It would be inequitable to now permit the Debtor to recover the showroom furniture or its value from the Claimant without having provided the Claimant with the furniture that the Debtor agreed that it would provide prior to the Claimant having to return the showroom furniture. The court concludes therefore that the Claimant's plea for recoupment should be granted and that the Claimant should be permitted to retain the showroom furniture, with the result that the Claimant's claim in this case will be reduced by the value of the showroom furniture. It is undisputed that the amount of the claim is $27,732.25 and that the value of the showroom furniture is $26,005.80. Thus, when the value of the showroom furniture is credited against Claimant's claim, the Claimant is left with a claim in the amount of $1,726.45. Because

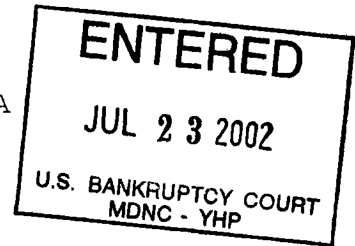
the Claimant thereby has in effect received a payment in this case in excess of the $2,100.00 priority afforded by § 507(a)(6), the $1,726.45 balance of Claimant's claim will be allowed as a general unsecured claim. An order so providing will be entered contemporaneously with the filing of this memorandum opinion.

This 18th day of July, 2002.

William L. Stocks

WILLIAM L. STOCKS
United States Bankruptcy Judge

UNITED STATES BANKRUPTCY COURT
MIDDLE DISTRICT OF NORTH CAROLINA
GREENSBORO DIVISION



IN RE:	)	
	)	
Lincoln-Gerard USA, Inc.,	)	Case No. 01-11986C-11G
	)	
	)	
Debtor.	)	
	)	

ORDER

For the reasons stated in the memorandum opinion filed contemporaneously with this order, it is ORDERED, ADJUDGED AND DECREED that the motion for summary judgment filed on behalf of Kurt J. Lance is granted as follows:

(1) Kurt J. Lance shall be entitled to retain the furniture that was delivered by the Debtor to Kurt J. Lance on June 22, 2000;

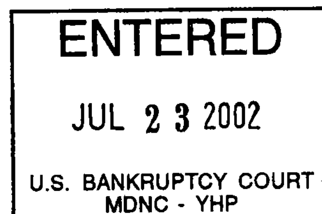
(2) The value of such furniture in the amount of $26,005.80 shall be credited against the $27,732.25 proof of claim filed by Kurt J. Lance in this case, thereby reducing the amount of the claim of Kurt J. Lance to $1,726.45; and

(3) Kurt J. Lance is left with a claim of $1,726.45 in this case which hereby is allowed as a unsecured nonpriority claim.

This 18 day of July, 2002.

William L. Stocks
WILLIAM L. STOCKS
United States Bankruptcy Judge

UNITED STATES BANKRUPTCY COURT
MIDDLE DISTRICT OF NORTH CAROLINA
GREENSBORO DIVISION



IN RE:	)	
	)	
Lincoln-Gerard USA, Inc.,	)	Case No. 01-11986C-11G
	)	
Debtor.	)	
	)	

ORDER

For the reasons stated in the memorandum opinion filed contemporaneously with this order, it is ORDERED, ADJUDGED AND DECREED that the motion for summary judgment filed on behalf of the Debtor is denied.

This 18th day of July, 2002.

William L. Stocks

WILLIAM L. STOCKS
United States Bankruptcy Judge