

1 **FOR PUBLICATION**

X FILED
ENTERED - 2-14-02
LODGED
RECEIVED
FEB 11 2002
CLERK, U.S. BANKRUPTCY COURT
SOUTHERN DISTRICT OF CALIFORNIA
DEPUTY

2
3
4
5
6
7
8 **UNITED STATES BANKRUPTCY COURT**
9 **SOUTHERN DISTRICT OF CALIFORNIA**

10 In re:) CASE NO. 01-08453-H7
11)
11 Herbert C. Ter Bush and) MEMORANDUM DECISION
12 Betty J. Ter Bush,)
13)
13 Debtors.)
14)
14

15
16 Creditor David Howland ("Howland") moves for an order to
17 confirm an arbitration award and entry of judgment granting him
18 the equitable remedy of specific performance of a written
19 agreement for the sale of real property owned by Herbert C.
20 Ter Bush and Betty J. Ter Bush (collectively, "Debtors").
21 Howland concurrently moves for relief from stay so that he could
22 obtain entry of the arbitration award granting him specific
23 performance. This Court has jurisdiction to determine this
24 matter pursuant to 28 U.S.C. §§ 1334 and 157(b) (1) and General
25 Order No. 312-D of the United States District Court for the
26 Southern District of California. This is a core proceeding
27 pursuant to 28 U.S.C. § 157(b) (2) (B).

28 ///

1 determination by a post arbitration motion filed in the trial
2 court. The arbitrator signed the written arbitration decision on
3 August 2, 2001. Before Howland could get the arbitration award
4 confirmed, Debtors filed their Chapter 7 petition on August 14,
5 2001.

6
7 DISCUSSION
8

9 Howland argues that but for the bankruptcy, a judgment would
10 have been entered in his favor. Howland contends the judgment
11 would have been for specific performance, an equitable remedy,
12 and not a money judgment. Howland contends he is entitled to
13 relief from stay to have the judgment entered so that he can
14 proceed with its execution.

15 Debtors argue that the Agreement for the sale and purchase
16 of the Property is an executory contract and was therefore
17 rejected because the sixty-day time limitation for assumption or
18 rejection under § 365(d)(1) has passed. Debtors contend that
19 because the contract is rejected, Howland has a claim in this
20 case and cannot enforce the arbitration award.

21 A. The Agreement is Not an Executory Contract.

22 A contract for the purchase and sale of real property is no
23 longer executory once that contract has been reduced to judgment
24 in a specific performance action. In re Glaze, 169 B.R. 956
25 (Bankr. D. Ariz. 1994); In re Roxse Homes, Inc., 83 B.R. 185 (D.
26 Mass. 1988). Although Debtors' bankruptcy filing prevented
27 Howland from getting a final judgment because of the automatic
28 stay going into effect, that technicality does not cause the

1 Agreement to remain executory.

2 Under California law, which controls the parties' property
3 rights in this case, an unconfirmed arbitration award is viewed
4 as the equivalent of a final judgment. Thibodeau v. Crum, 4
5 Cal.App.4th 749, 759 (1992); Trollope v. Jeffries, 55 Cal.App.3d
6 816, 822-823 (1976). One court noted that "[o]nce a valid award
7 is made by the arbitrator, it is conclusive on matters of fact
8 and law and all matters in the award are thereafter res
9 judicata." Thibodeau, 4 Cal.App.4th at 759 citing Lehto v.
10 Underground Constr. Co., 69 Cal.App.3d 933, 939 (1977). For
11 purposes of the executory contract analysis, the Court finds that
12 an unconfirmed arbitration award is the equivalent of a final
13 judgment. Therefore, the Court finds that the executory nature
14 of the Agreement has ended and the remaining unperformed
15 obligations are non-material or "ministerial." See Glaze, 169
16 B.R. at 961 citing Roxse, 83 B.R. at 185.

17 B. The Award for Specific Performance is Not a Claim Within the
18 Meaning of the Bankruptcy Code.

19 Under the Bankruptcy Code ("Code") § 101(5)(B) a claim
20 means:

21 (B) right to an equitable remedy for breach of
22 performance if such breach gives rise to a right to
23 payment, whether or not such right to an equitable
24 remedy is reduced to judgment, fixed, contingent,
25 matured, unmatured, disputed, undisputed, secured or
26 unsecured.

27 "[T]he right to an equitable remedy will only constitute a claim
28 if the underlying breach gives rise to a right to the payment of
29 money damages." Roxse, 83 B.R. at 188.

Howland alleged in his complaint against Debtors that he had

1 "no adequate remedy at law because the Property is a single
2 family dwelling which Plaintiff and his wife intend to occupy and
3 because Plaintiff's contract remedy will not compensate Plaintiff
4 for the increase in value of the Property since the date of the
5 Ter Bushes' refusal to perform." Further, California Civil Code
6 § 3387 entitled "Adequate Remedy by Pecuniary Award" states that
7 "[i]t is to be presumed that the breach of an agreement to
8 transfer real property cannot be adequately relieved by pecuniary
9 compensation. In the case of a single-family dwelling which the
10 party seeking performance intends to occupy, this presumption is
11 conclusive."¹ (Emphasis added). Implicit in the arbitrator's
12 award for specific performance is that he considered and followed
13 California law in this regard and that money damages were
14 inadequate. The Court concludes that the arbitrator's award for
15 specific performance is not a claim within the meaning of the
16 Code because the underlying breach in this case does not give
17 rise to a right to the payment of money damages.

18 C. Offset.

19 Howland seeks to offset damages consisting of his reasonable
20 attorney's fees and related costs and an amount not to exceed
21 \$500.00 for continuing escrow services against the purchase price
22 of the Property. Code § 553 provides for setoff, preserving
23 certain rights that exist under relevant non-bankruptcy law. In
24 re TLC Hospitals, Inc., 224 F.3d 1008, 1011 (9th Cir. 2000).
25 Whether to allow setoff pursuant to § 553 is left to the sound
26 discretion of the bankruptcy court. In re Luz Int'l, Ltd., 219

27 ¹
28 The parties stipulated in open court that Howland was purchasing the
Property as his residence.

1 B.R. 837, 840 (9th Cir. BAP 1998). In determining whether the
2 right to setoff should be preserved in bankruptcy under § 553,
3 the party asserting setoff must demonstrate 1) the debtor owes
4 the creditor a pre-petition debt; 2) the creditor owes the debtor
5 a pre-petition debt; and 3) the debts are mutual. Id. at 843.

6 1. The Right to Setoff Exists Under California Law.

7 California law recognizes the equitable right to
8 setoff. Birman v. Loeb, 6 Cal.App.4th 502, 516-18 (1998); Kruger
9 v. Wells Fargo Bank, 11 Cal.3d 352 (1974). However, that right
10 may be limited in order to carry out state policies protecting
11 the interest of the debtor. Kruger, 11 Cal.3d at 352 (1974).

12 2. All the Requirements for Section 553 are Met.

13 Debtors do not dispute that they owe Howland a pre-
14 petition debt nor do they dispute that Howland owes them a pre-
15 petition debt. Debtors argue however that the debts at issue do
16 not arise from the same transaction and are not mutual. The
17 court disagrees.

18 To establish mutuality, a three-prong test must be met: 1)
19 the debts must be in the same right; 2) the debts must be between
20 the same individuals; and 3) those individuals must stand in the
21 same capacity. Luz Int'l, 219 B.R. at 845. "Courts have
22 interpreted debts in the same right to mean that a 'pre-petition
23 debt cannot offset a post-petition debt.'" In re Westchester
24 Structures, Inc., 181 B.R. 730, 739 (Bankr. S.D.N.Y. 1995) citing
25 In re Bay State York Co., Inc., 140 B.R. 608, 614 (Bankr. D.
26 Mass. 1992). Moreover, the concept of the same right "subsumes
27 the separate question of whether any of the obligations sought to
28 be offset are owed jointly with some other entity." 5 Collier on

1 Bankruptcy ¶ 553.03[3][d], at 553-39 (15th ed. revised 2001)
2 [hereinafter Collier]. The Court concludes that both Howland's
3 obligation to pay the purchase price for the Property and the
4 Debtors' obligation to pay the reasonable attorney fees and other
5 costs arising out of the arbitration award are in the "same
6 right." Both parties' debts arose pre-petition and no third
7 party is involved. Therefore, the first prong of the mutuality
8 test is met.

9 The Court finds that the second prong of the mutuality test
10 is also met; the parties are the same in each transaction.
11 Finally, the parties stand in the same capacity in each
12 transaction. An example where this prong may not be met is
13 "[w]here one party owes a fiduciary duty to the other, or has a
14 claim for trust funds, and the other side's claim is a simple
15 unsecured debt...." Westchester Structures, 181 B.R. at 739
16 (citation omitted). Such is not the case here. The Court finds
17 that all the requirements of § 553 have been met.

18 3. Debtors Homestead Exemption Rights.

19 Debtors argue that Howland cannot setoff the attorney
20 and other fees awarded to him in the arbitration against the
21 purchase price because it will deprive Debtors of their fresh
22 start.

23 Relying on § 522(c), several courts have denied setoff when
24 it has not been taken before the commencement of the case and the
25 debtor claims the property as exempt. Collier ¶ 553-
26 03[3][e][iv], at 553-43 n.147; see also In re Pieri, 86 B.R. 208,
27 212 (9th Cir. BAP 1988) (citations omitted). Section 522(c)
28 provides in relevant part:

1 Unless the case is dismissed, property
2 exempted under this section is not liable
3 during or after the case for any debt of the
4 debtor that arose, or that is determined
5 under section 502 of this title as if such
6 debt had arisen, before the commencement of
7 the case....

8 In Pieri, the Bankruptcy Appellate Panel (BAP), reconciled
9 the conflict between § 553 -- which allows setoff of mutual debts
10 owed between a creditor and the debtor which arose before the
11 commencement of the case, and § 522(c) -- which bars exempt
12 property from being liable for any debt, with certain enumerated
13 exceptions, that arose before the commencement of the case. The
14 BAP, in construing the two statutes, noted that "it is long
15 settled that where there is an irreconcilable conflict between
16 different parts of the same act, the last in order of arrangement
17 will control." Id. at 212-13. The BAP concluded therefore that
18 "§ 553 would control over § 522(c) on any point of conflict."
19 Id. (citations omitted). Nonetheless, the BAP recognized that
20 exemption statutes are to be given a liberal construction, and
21 that "this liberal view will be maintained in state policy
22 governing the use of setoff against exempt property." Id. Thus,
23 in the Ninth Circuit, while § 553 would control over § 522(c),
24 this Court must still consider whether any state policy of
25 protecting the rights of the debtor are present in this case.

26 Many California courts have protected exemptions from setoff
27 in order to carry out state policies protecting the interest of
28 the debtor. See Birman, 64 Cal.App.4th at 516-18 (1998)
(disallowing creditors the right to setoff a debt owed by debtor
against a deficiency remaining after a non-judicial foreclosure
under a purchase money trust deed because it would abrogate

1 section 580b) (citations omitted); Kruger, 11 Cal.3d at 369 n.24.
2 For example, California courts have disallowed a setoff against
3 exempt property that provides income necessary to pay daily
4 living expenses. Kruger, 11 Cal.3d at 352 (disallowing setoff
5 against debtor's bank account which contained unemployment
6 compensation and disability benefits); Barnhill v. Robert
7 Saunders & Co., 125 Cal.App.3d 1 (1981) (disallowing employer to
8 setoff debts owed to it by employee's exempt wages due to him
9 against debts owed it by employee). And California courts have
10 disallowed setoff against alimony or child support payments.
11 Williams v. Williams, 8 Cal.App.3d 636 (1970). In each case,
12 state policies protecting the interest of the debtor apparently
13 outweighed the creditor's right to setoff.²

14 Undoubtedly, the public policy prompting homestead
15 exemptions in California is strong.

16 Homestead laws are founded upon
17 considerations of public policy, their
18 purpose being to promote the stability and
19 welfare of the state by encouraging property
20 ownership and independence on the part of the
21 citizen, and by preserving a home where the
22 family may be sheltered and live beyond the
23 reach of economic misfortune. The statutes
24 are intended to secure to the householder a
25 home for himself and family, regardless of
26 his financial condition--whether solvent or
27 insolvent--without reference to the number of
28 his creditors, and without any special regard
to the extent of the estate or title by which

24 ² When an important public policy is not at stake, however, a setoff
25 may be allowed against exempt property. For example, in Pieri, the BAP allowed
26 the landlord the right to setoff her claims for damage to leased premises against
27 the debtors' cause of action against landlord arising out of the same
28 circumstances, even though debtors claimed the cause of action as exempt property
in their bankruptcy case. The Pieri court noted that it was unlikely California
law would recognize the right of setoff against the unliquidated contract claim,
primarily because it could not be relied on to provide a source of income at any
time in the foreseeable future. Pieri, 86 B.R. 208, 212 (9th Cir. BAP 1988).

1 the homestead property may be owned.

2 Rich v. Ervin, 86 Cal.App.2d 386, 390-391 (1948).

3 The homestead exemption is so important in California that
4 it is usually protected in forced sales and in attachment
5 proceedings. See generally California Civil Code of Procedure
6 (CCP) §§ 704.720-90.³ In a forced sale situation, the levying
7 officer is instructed to pay first the liens and the
8 encumbrances, and then the judgment debtor prior to paying
9 his/her own costs and the judgment creditor. CCP § 704.850. None
10 of the statutes addressing homestead exemptions and their
11 protection mention setoff. In Kruger, the California Supreme
12 Court found that "although setoff varied from attachment and
13 execution because it did not require the aid of a state official,
14 'there is no relevant difference between the two procedures as to
15 the state objective of protection of ... benefits from claims of
16 creditors.'"⁴ Kruger, 11 Cal.3d at 370-71. The California

17
18 ³ Debtors rely on these CCP sections for their \$100,000 homestead exemption.

19 ⁴ The Ninth Circuit has noted the tendency of the California Supreme Court
20 to give greater weight to the state policies involved, while paying little
21 attention to the language of the relevant exemption statutes. In re Lares, 188
22 F.3d 1166 (9th Cir. 1999). In Lares, the debtor challenged a bank's exercise of
23 contractual right to setoff funds in the debtor's bank account against
24 preexisting business debt personally guaranteed by the debtor, contending that
25 the funds, as proceeds from the sale of her home, were exempt from setoff under
26 Idaho law. The relevant statute under Idaho law provided that the homestead was
27 exempt from attachment and from execution or forced sale. Lares relied on Kruger
28 v. Wells Fargo Bank, 11 Cal.3d at 352 for the proposition that the funds in the
account were exempt. The Ninth Circuit rejected Lares' reliance on Kruger
stating that 1) the court there was dealing with a general right of setoff versus
a contractual right of setoff in the instant case; and 2) the California court
displayed a ready willingness to rewrite the applicable statute to arrive at the
desired result. The court went on to note that "Idaho courts have not shown
themselves to be so willing to ignore what the legislature has said." The court
found that the statute at issue was "clear on its face and there is no room for
construction of its terms. 'Attachment,' 'execution' and 'forced sale' involve
judicial proceedings. By no stretch of its plain language can the statute be
deemed to include a voluntary, contractual right of setoff." Id. at 1169. The

1 Supreme Court also said that the right of setoff may be
2 "restricted by judicial limitations imposed to uphold a state
3 policy of protecting the rights of the debtor." Id. at 367.
4 California case law therefore supports the proposition that
5 exempt property will be protected from setoff when an important
6 public policy regarding the rights of the debtor is involved,
7 regardless of the statutory language granting the exemption.

8 When interpreting state law, federal courts are bound by
9 decisions of the state's highest court. In the absence of such a
10 decision, a federal court must predict how the highest state
11 court would decide the issue. In re Bartoni-Corsi Produce, Inc.,
12 130 F.3d 857, 861 (9th Cir. 1997). There is no California case
13 directly on point, however, California case law in this area
14 gives the Court guidance.

15 The Court finds it likely that a California court would
16 disallow the setoff in this case. The homestead exemption is
17 highly valued in the State of California from a public policy
18 point of view. Debtors are elderly and in a chapter 7 bankruptcy
19 proceeding which includes approximately \$74,000 in unsecured
20 debt. Debtors must rely on their state exemptions to provide
21 them a minimal standard of living in the future. On their
22 schedules, Debtors have claimed exemptions in their residence
23 (\$100,000), a 1995 Ford Aspire (\$2050), furniture (\$3500) and
24 clothing (\$500). Apparently Debtors income consists of social
25 security because Mr. Ter Bush is unable to work because of his

26 _____
27 Lares court alludes to the fact that it is unlikely a California court would
28 allow setoff in a similar factual situation.

1 poor health. It is unclear what the equity is in the Property
2 because the Court does not know the purchase price agreed to by
3 the parties. However, even assuming a best case scenario,
4 Debtors would be entitled to no more than the \$100,000 they have
5 claimed exempt on their schedules. This amount may allow them to
6 secure a new home which is the purpose behind the homestead
7 exemption. Accordingly, the Court finds that Howland is not
8 entitled to setoff the Debtors' debt against the purchase price
9 of the Property.

10
11 CONCLUSION
12

13 The Court grants Howland limited relief from stay to confirm
14 his arbitration award and execute on the specific performance
15 part of his judgment. Howland is not however given relief from
16 stay to pursue the liquidation of his attorney fees and other
17 costs arising out of the arbitration. Howland may renew this
18 request, if necessary, at a later time.⁵ Howland is also not
19 entitled to setoff any fees or costs owed by the Debtors against
20 the purchase price of the Property.

21 The Court denies Howland's motion for an order to confirm
22 the arbitration award and entry of the judgment as these matters
23 can now be addressed by the state court.

24 ///

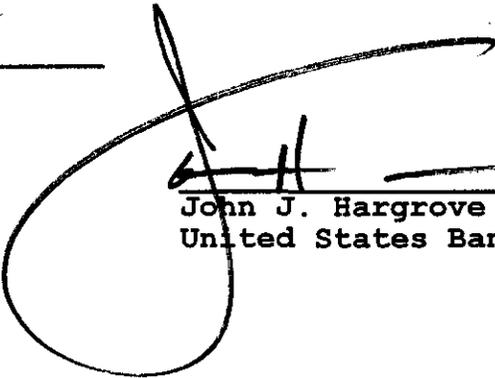
25 ///

26

27 _____
28 ⁵ The Court notes that Howland has an adversary complaint pending
objecting to the Debtors § 727 discharge.

1 This Memorandum Decision constitutes findings of fact and
2 conclusions of law pursuant to Federal Rule of Bankruptcy
3 Procedure 7052. The attorney for Howland is directed to file
4 with this Court an order in conformance with this Memorandum
5 Decision within ten (10) days from the date of entry thereof.

6
7 Dated: 2.11.02



8
9
10 John J. Hargrove
11 United States Bankruptcy Judge

12 S:\Ter Bush.wpd

13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28