UNITED STATES BANKRUPTCY COURT
DISTRICT OF MINNESOTA

In re:

ANDERBERG-LUND PRINTING CO., a/k/a Lane Envelope ak/a Great Way Publications,

Debtor.

BKY 4-93-6995

GENERAL INSURANCE COMPANY OF AMERICA,

Plaintiff,

ADV 4-94-398

-v.-

ANDERBERG-LUND PRINTING CO., a/k/a Lane Envelope, a/k/a Great Way Publications,

and

W.A. LANG CO.,

Defendants.

FINDINGS OF FACT, CONCLUSIONS OF LAW AND ORDER FOR JUDGMENT

At Minneapolis, Minnesota, December 9, 1994.

The above-entitled matter came on for trial before the undersigned on November 21, 1994, on a Complaint filed by General Insurance Company of America ("GICA") and cross-claims by Anderberg-Lund Printing Co. ("Debtor") and W. A. Lang Co. ("WAL"). At the commencement of trial, I dismissed the case against GICA. Judgment in favor of GICA has now been entered. Based upon all the files, records and proceedings herein, the Stipulation of Facts, the evidence adduced, and the arguments of counsel, I make the following:

FINDINGS OF FACT

1. This is a dispute between WAL and Debtor over which of them is entitled to an unearned premium on workers' compensation

30-1

insurance calculated by the insurer and deposited in court after Debtor filed its bankruptcy petition.

2. Debtor is in the printing business. WAL was Debtor's insurance agent. GICA is a member of the SAFECO Insurance Companies ("SAFECO").

3. WAL is in the business of selling commercial insurance. Its agents sell policies for a number of insurance companies. WAL had separate agreements with various insurance companies, including GICA.

4. WAL and GICA were parties to a SAFECO Property and Casualty Insurance Agreement (the "agency agreement") which authorized WAL to, inter alia, "receive, request, and bind . . . proposals for contracts for insurance . . . ." The agency agreement contained a number of limitations under which WAL could sell GICA policies. It specifically allowed WAL to choose between two different methods of billing relating to commercial policies; i.e., direct billing or agency billing. If WAL chose direct billing, the customer received its bill from SAFECO and the customer paid SAFECO directly. If WAL chose agency billing, the billing relationship was governed by Paragraph 3.5.1 of the agency agreement which provided, in relevant part, that the insurance agent agrees,

> to pay [GICA] net premiums due on all insurance policies placed by or through [the Agent] . . . whether such premiums are collected.

and by Paragraph 3.5.2 of the agency agreement which provided:

> [The agent] agree[s] on all policies of insurance [that the agent] produce[s] for [GICA] to either finance the premium or collect it promptly.

Thus, under the terms of the agency agreement, if the insurance was agency billed, WAL was obligated to make the periodic premium payments to GICA whether or not WAL was paid.

5. In the summer of 1993, GICA issued a workers' compensation insurance policy to Debtor which became effective on July 1, 1993 and had a termination date of July 1, 1994. The policy was sold to Debtor by WAL. Part Five, Section E of the policy provided in relevant part:

> The final premium will be determined after this policy ends . . . . If the final premium is more than the premium you paid to us, you must pay us the balance. If it is less, we will refund the balance to you.

Paragraph 3.A of the policy incorporated a Minnesota Cancellation and Nonrenewal Endorsement. This endorsement provided in relevant part:

> **Refunds Due You.** If this policy is cancelled, we will send you any premium refund due.

Pursuant to the terms of the policy "we" means GICA and "you" means the Debtor. At WAL's election, the policy sold to Debtor was dealt with on an agency billed basis.

6. During the policy period, WAL made periodic premium payments directly to GICA, which amounts included a reduction for commissions retained by WAL. Debtor made periodic payments to WAL

as reimbursement of WAL's payments. By late 1993 Debtor was in financial difficulty and failed to pay WAL the premiums on the policy even though WAL was committed to and did pay those premiums to GICA. Because of Debtor's delinquencies WAL requested GICA to issue a Notice of Cancellation or Nonrenewal of Policy on December 14, 1993, effective January 16, 1994.

7. Debtor filed its petition for relief under Chapter 11 of the Bankruptcy Code ("Code") on December 15, 1993. By operation of § 108 of the Code, the cancellation of the policy was deferred to February 14, 1994. On the filing date, because Debtor was behind in paying WAL, WAL held an unsecured claim for premiums it had paid GICA without being reimbursed by Debtor.

8. Debtor was in need of replacement insurance if it was to continue in business. WAL made minimal efforts at finding replacement insurance for Debtor. Debtors then turned to another agent, Daly Agency ("Daly"), for assistance in obtaining a replacement policy in a timely manner. Daly arranged for a replacement policy to be issued by American Compensation Insurance Co. ("American"). Despite Daly's efforts, WAL requested that the Debtor appoint WAL as the agent of record for the replacement policy and Debtor did. This maneuver cut Daly out of a commission it could have earned. It also placed Debtor in the position of having to deal through WAL to obtain the replacement coverage from American.

9. On February 11, 1994, WAL asked Debtor to deliver the initial payment for the premium to American. At the same time WAL

insisted it be paid its prepetition unsecured claim. In conversations between a representative of WAL and the Debtor, WAL suggested that Debtor would violate the law if it did not pay the premium deposit so as to be covered by workers' compensation insurance. However, WAL did not, as Debtor originally argued, threaten to not deliver the initial premium on the replacement policy to American unless it was paid its prepetition debt. It simply placed Debtor in a very awkward position of believing it might not get new coverage if it did not pay the prepetition debt as well as the deposit on the replacement insurance.

10. As a result of conversations between WAL and Debtor on Friday, February 11, 1994, Debtor was briefly (for a few hours) without workers' compensation coverage. This problem was rectified when Debtor paid the initial premium on the replacement policy directly to American on Monday, February 14, 1994. The resolution of this issue did require Debtor's counsel to become involved.

11. Based upon the cancellation of the policy prior to the expiration date of June 30, 1994, GICA performed a final audit and found a net unearned premium of $22,067.24.

12. GICA commenced this interpleader action alleging that both the Debtor and WAL were demanding that the unearned premium be delivered to each of them. GICA calculated the amount of the unearned premium and sought an order which, inter alia, would direct the Debtor and WAL to interplead and determine their respective rights to the unearned premium. By order dated July 28, 1994, I found that GICA had deposited a check in the amount of

$22,067.24 representing the unearned premium with the clerk of the bankruptcy court and directed the clerk to deposit said funds in an interest bearing account. By order dated November 22, 1994, I dismissed GICA from this interpleader action.

13. Debtor filed an Answer to the Complaint and a Cross-claim against WAL. Debtor seeks inter alia: (1) a declaratory judgment that it is entitled to the unearned premium; (2) actual damages incurred, including attorneys' fees and expenses, based upon WAL's willful violation of the automatic stay of § 362 of the Code; and (3) punitive damages with respect to WAL's willful violation of the automatic stay pursuant to § 362(h). WAL filed an Answer to the Debtor's Cross-Claim seeking inter alia: (1) dismissal of the Cross-Claim; (2) attorney's fees and expenses under Bankruptcy Rule 9011(a); and (3) an order allowing WAL to "recoup from, and to setoff its resulting prepetition claim against Debtor on any portion of the return premium on the policy.

CONCLUSIONS OF LAW

1. The policy defines the rights between the insurer and the insured. The policy explicitly provides that upon termination or cancellation, any refund (including an unearned premium) would be delivered to the insured. This result follows from a reading of Part Five, Section E, which requires return of excess premiums paid by the insured to the insured and the Cancellation and Nonrenewal Endorsement which explicitly requires return of any cancellation premium to the insured. Read together, these sections of the policy contemplate that excess premiums be returned to Debtor. The

policy does not provide, as WAL implies, that refunds are to be paid to the agent, who can then offset them against amounts due from Debtor. The policy does not, as WAL implies, extinguish Debtor's right to a return of the refund if the premium is paid through a financing arrangement such as that in place here. The policy could have easily included language that would require that payments of unearned premiums be paid to the insured only to the extent that the insured itself had paid the premium or only to the extent the insured had paid the agent which had financed the premiums. It did not.

2. The arrangement between Debtor and WAL was not only one of purchase and sale of insurance but was also a financing arrangement. In its agency agreement with GICA, WAL specifically undertook an obligation to finance the premiums and to take a risk that it might not be paid for them. WAL could have avoided the risk by requesting a direct billing arrangement, but chose not to do so presumably for business reasons. Therefore, as of the filing date, WAL held an unsecured claim for amounts due under the financing arrangement.

3. The bankruptcy court for the Western District of Virginia was faced with an identical fact pattern in In re Virginia Block Co., 16 B.R. 771 (Bankr. W.D. Va. 1982). In Virginia Block, the insurance agent claimed a right to an "unused premium" relating to a workers' compensation insurance policy. The policy between the insurer and the insured explicitly provided that premium refunds

were to be paid to the "named insured." The court, therefore stated:

> The funds here in question are the subject of an express contract between [the debtor] and [the insurer]. The contract provides that any premium refunds or policy dividends shall be paid to the "named insured," [the debtor]. There is no ambiguity in that contract, ... They are property of [the debtor] as of the date . . . remitted.

In re Virginia Block, 16 B.R. at 774.

4. Thus, based upon the terms of the policy, Debtor is entitled to the unearned premium and WAL holds an unsecured claim against the Debtor for the difference between the premiums it paid to GICA and the premiums Debtor paid to it.

5. Section 553(a) of the Code provides in relevant part:

> Except as otherwise provided . . . this title does not affect any right of a creditor to offset a mutual debt owing by such creditor to the debtor that arose before the commencement of the case under this title against a claim of such creditor against the debtor that arose before the commencement of the case.

11 U.S.C. § 553(a).

6. The threshold issue in determining the right to setoff is mutuality of parties. In re Pineview Care Ctr., Inc., 142 B.R. 677, 683 (Bankr. D.N.J. 1992), aff'd, 152 B.R. 703 (D.N.J. 1993). "As a general rule, for mutuality to exist, each party must own his claim in his own right severally, with the right to collect it in his own name against the debtor in his own right and severally." In re Virginia Block Co., 16 B.R. at 774. Also, both debts must arise prepetition.

7. I need not address the issue of whether the debt for unearned premiums is a prepetition debt because in this case there is no mutuality of parties. The debt for unpaid premiums is a debt owed by Debtor to WAL; the debt for unearned premiums is a debt owed by GICA to Debtor. The parties are different. See In re V.N. DePrezio Constr. Co., 52 B.R. 283, 287 (Bankr. N.D. Ill. 1985); In re Virginia Block Co., 16 B.R. at 774-75. In DePrezio, the agency agreement between the insurer and the agent provided that "the Agent may pay premiums on behalf of the insured, and, in the event it does, the Agent is deemed to have extended its credit . . . " Id. at 286 (emphasis added). The court found that with respect to premium payments made on behalf of the debtor, the agent became an unsecured creditor and "has the same rights, obligations and risks, including bankruptcy, as any other unsecured creditor." Id. The DePrezio court concluded that mutuality did not exist because the parties did not have full and concurrent rights against each other. Id. at 287.

8. The bankruptcy court of Nebraska reached what appears to be an opposite conclusion in Matter of Nickerson & Nickerson, Inc., 62 B.R. 83 (Bankr. D. Neb. 1986). That case, however, is based on Nebraska law which specifically provided that the insurer could offset deposit premiums against return premiums and that an insurance agent is an agent of the insurance company "for all intents and purposes." Id. at 85. Nickerson reached this result by finding that under state law an insurance agent is merely a

conduit for the insurance company with respect to receipt of insurance premiums.

9. Because of the specific provisions of the agency agreement, the reasoning employed in Nickerson is not applicable in this case. The agency agreement does not make WAL a mere conduit for collection of premiums; it specifies that WAL is the source of payment even if the insured does not pay.

10. Further, there is no state law, as there was in Nebraska, making WAL an agent for all purposes. Minn. Stat. § 60K.15 provides that: "Any person who solicits insurance is the agent of the insurer and not the agent of the insured." Minn. Stat. § 60K.15 (1994). This statute clarifies the insurance agent's right to bind the insurance company in order to protect the consumer of insurance. It is not intended and does not create a principal-agent relationship for all purposes. WAL's claim that it is an "agent" of the insurer under Minnesota state statute ignores its status as a broker for numerous insurance companies and the realities of modern insurance where the insurance agent is an independent business soliciting business on its behalf. In fact, Minnesota law appears to preclude setoff because, as set forth in the Minnesota cancellation endorsement, the unearned premium belongs to the insured, i.e., the Debtor. The endorsement does not include language which allows the insured to receive only a net refund as under the relevant Nebraska state statutes.

11. In In re H. Wolfe Iron & Metal Co., 64 B.R. 754 (Bankr. W.D. Pa. 1986), the insurance agent had forwarded amounts due under

various insurance policies and then claimed a right of setoff or recoupment as to returned dividends. The court distinguished between an agent and a broker, implying that an agent may have a right of setoff but a broker clearly does not. The Wolfe court found that the "agent is tied to his company . . . . The broker on the other hand, is an independent middleman, not tied to a particular company." Id. at 756 (quoting Osborn v. Ozlin, 310 U.S. 53, 61 (1940)). The Wolfe court also asserted:

> [The] modern insurance agent is no longer analogous to the traditional principal-agent relationship. The insurance agent is not an employee of the insurance company soliciting business on its behalf but rather is an independent businessman soliciting business on his own behalf . . .. The agent pays his own sales expenses and overhead, has the responsibility of financing premiums beyond the companies' initial credit period, and bears personally and directly the risk of nonpayment . . .. In a real sense the agent and not the insured is the company's customer.

In re Wolfe, 64 B.R. at 757 (quoting In re Roy A. Dart Ins. Agency, Inc. 5 B.R. 207, 209-10 (Bankr. D. Mass. 1980)). Because the insurance agent failed to establish a principal-agent relationship, the court found that the requisite mutuality did not exist.

12. This result is not inequitable; there is no unjust enrichment. If the agent, such as WAL, provides financing for a policy, it assumes a risk which is no different from the risk assumed by all other creditors. See DePrezio, 52 B.R. at 286. Returning the unearned premium to the debtor or trustee for the benefit of creditors provides for equal pro rata distribution to all unsecured creditors who assumed the risk of providing credit to

the debtor. To allow WAL to setoff its claim would be to allow WAL to inequitably elevate its unsecured claim to secured status.

13. Based upon the foregoing, there is no right of setoff.

14. Nor does WAL have a right of recoupment. Recoupment, although distinguished from setoff, has the same effect of preferring one creditor over others. Whereas setoff is specifically limited by the Code, recoupment exists independent of the Code. Recoupment "should be narrowly construed as an exception to the general rule against preferring one creditor over another." In re Public Serv. Co. of New Hampshire, 107 B.R. 441, 444 (Bankr. D.N.H. 1989) (quoting Electronic Metal Prod., Inc. v. Honeywell, Inc., 95 B.R. 768, 770 (D. Colo. 1989)); see also In re Village Craftsman, Inc., 160 B.R. 740, 746 (Bankr. D.N.J. 1993).

15. Recoupment is an equitable rule of joinder to avoid the bringing of two separate actions for two claims. In re Denby Stores, Inc., 86 B.R. 768, 781 (Bankr. S.D.N.Y. 1988). As asserted by the Denby court, "[Recoupment] permits a defendant to defend against the plaintiff by asserting a countervailing claim that arose out of the "same transaction." Id. The major consideration is whether the various claims arise from a single transaction. Id; United States v. Dewey Freight Sys., Inc., 31 F.2d 620, 623 (8th Cir. 1994).

16. In an analysis of whether the reciprocal obligations arose from a single or different transactions, "The fact that the same parties are involved and that a similar subject matter gave rise to both claims . . . does not mean that the two arose from the

'same transaction.'" In re Denby, 86 B.R. at 782 (quoting Westinghouse Elec. Corp. v. Fidelity & Deposit Co., 63 B.R. 18, 21 (E.D.Pa. 1986)) (emphasis added). Furthermore, courts are required to strictly construe the doctrine of recoupment because it is in conflict with the goal of providing equal treatment under the Code.

17. In its simplest form there exist here two distinct obligations based upon two distinct agreements. The unearned premiums due to the Debtor arise out of the policy; the unsecured claim of WAL arises out of the financing agreement which was established through the agency agreement. These obligations do not arise from a single contract and are therefore not subject to recoupment. Based upon the foregoing, there exists no right of recoupment. See In re H. Wolfe Iron & Metal Co., 64 B.R. at 757.

18. WAL's actions in demanding payment of the prepetition insurance premiums constitute a violation of the automatic stay. The demand that the unearned premium be delivered to it was an act to obtain possession of property of the estate in violation of § 362(a)(3) of the Code. WAL's actions constitute a willful violation of the automatic stay which threatened to put Debtor out of business, but the effort failed. Debtor has failed to establish actual damages. See Lovett v. Honeywell, Inc., 930 F.2d 625, 629 (8th Cir. 1991). The conduct of WAL does not rise to the level of egregiousness to justify an award of punitive damages. Id. at 628-29.

ORDER FOR JUDGMENT

1. Debtor is entitled to the funds held pursuant to this Court's order dated July 28, 1994, together with interest earned thereon. The clerk shall deliver the funds to the Debtor upon request;

2. Debtor's request for damages under § 362(h) of the Code is DENIED; and

3. The claims made by WAL are DISMISSED with prejudice on the merits.

LET JUDGMENT BE ENTERED ACCORDINGLY.

Nancy C. Dreher
United States Bankruptcy Judge