



ENTERED

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The following constitutes the order of the Court.

Signed August 31, 2004.

United States Bankruptcy Judge

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION

IN RE:	§	
	§	
GPR HOLDINGS, L.L.C.,	§	CASE NO. 01-36736-SAF-11
DEBTOR(S).	§	
	§	
<hr/>	§	
MICHAEL R. BUCHANAN, TRUSTEE	§	
FOR THE GPR HOLDINGS LIQUIDAT-	§	
ING TRUST,	§	
PLAINTIFF,	§	
	§	
VS.	§	ADVERSARY NO. 03-3622
	§	
KERR-McGEE ENERGY SERVICES	§	
CORP.,	§	
DEFENDANT.	§	

MEMORANDUM OPINION AND ORDER

On August 12, 2003, Plaintiff GPR Holdings Liquidating Trust filed this adversary proceeding against Defendant Kerr-McGee Energy Services Corp. In its complaint, the trust, as successor

to the debtor, GPR Holdings, L.L.C.,¹ pursuant to a confirmed plan of reorganization, seeks to recover a money judgment of \$2,575,253.41 for the principal and interest allegedly due for the purchase of natural gas by Kerr-McGee, which formerly conducted business as HS Energy Services, Inc.

Kerr-McGee asserts several affirmative defenses in response to GPR's complaint, and contends that it paid for the natural gas by offsetting the amount it owed GPR with obligations owed to it by Aurora Natural Gas LLC and Western Natural Gas LLC, both affiliates of GPR. Beginning in 1997, Kerr-McGee's predecessor, HS, began buying and selling natural gas to and from both Aurora and Western. In May 2000, GPR executed two Corporate Guaranties, which stated that GPR would guarantee the debts owed to HS by its affiliates Aurora and Western. In December 2000, HS entered into a Net Settlement Agreement with Aurora and Western, allowing the three parties to set off amounts which became due as a result of sales and purchases between them. The Net Settlement Agreement, however, did not apply to the financial obligations of any affiliates of the parties to the transaction, including GPR. In January 2001, HS entered into a contract with GPR to purchase natural gas between June 2001 and August 2001. The contract between HS and GPR did not include a right to setoff debt

¹The court refers to both the plaintiff trust and the debtor as GPR for ease of reference throughout this opinion.

obligations between them.

Kerr-McGee argues that the two Corporate Guaranties executed by GPR which guarantee the obligations of Aurora and Western affords Kerr-McGee the right to a setoff against GPR. GPR argues that Kerr-McGee does not have the right to setoff its obligations to GPR because (1) the setoff provision in the Net Settlement Agreements between HS, Aurora, and Western do not apply to GPR as a corporate affiliate; (2) the Corporate Guaranties guarantee only debt liabilities and neither provides for the assumption of debts nor includes any right to a setoff; and (3) the combination of the contract to purchase natural gas between HS and GPR, the Corporate Guaranties, and the Net Settlement Agreements demonstrate an intention to disallow the right to setoff between Kerr-McGee and GPR. Both parties move for summary judgment. The court conducted a hearing on the motions on June 23, 2004.

Summary judgment is proper if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, and other matters presented to the court show that there is no genuine issue of material fact and that the moving party is entitled to a judgment as a matter of law.

Celotex Corp. v. Catrett, 477 U.S. 317, 322-23 (1986); Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 250 (1986); Washington v. Armstrong World Indus., Inc., 839 F.2d 1121, 1122 (5th Cir. 1988). On a summary judgment motion the inferences to be drawn

from the underlying facts must be viewed in the light most favorable to the party opposing the motion. Anderson, 477 U.S. at 255. A factual dispute bars summary judgment only when the disputed fact is determinative under governing law. Id. at 250.

The movant bears the initial burden of articulating the basis for its motion and identifying evidence which shows that there is no genuine issue of material fact. Celotex, 477 U.S. at 322. The respondent may not rest on the mere allegations or denials in its pleadings but must set forth specific facts showing that there is a genuine issue for trial. Matsushita Elec. Indus. Co., Ltd. v. Zenith Radio Corp., 475 U.S. 574, 586-87 (1986). The court applies the same standards to the cross-motion for summary judgment.

In its first affirmative defense, Kerr-McGee asserts that the complaint must be dismissed for lack of subject matter jurisdiction. This court has subject matter jurisdiction. 28 U.S.C. § 1334(b). GPR asserts a breach of contract claim premised on a pre-bankruptcy petition sale of natural gas. The claim became property of the bankruptcy estate as of the filing of the bankruptcy petition on August 14, 2001. 11 U.S.C. § 541(a). The United States District Court for the Northern District of Texas has jurisdiction over all property of the bankruptcy estate. 28 U.S.C. § 1334(e). The proceeding has been referred by the district court to the bankruptcy court. 28

U.S.C. § 157(a); Misc Order. No. 33. The liquidation of a claim belonging to the bankruptcy estate can have a conceivable effect on the bankruptcy estate. In re L.D. Brinkman Holdings, Inc., 310 B.R. 686, 688 (Bankr. N.D. Tex. 2004). As a result, this proceeding is "related to" a case under the Bankruptcy Code. 28 U.S.C. § 1334(b). Therefore, the bankruptcy court has subject matter jurisdiction. The liquidation of a pre-petition breach of contract claim owned by the debtor raises a non-core matter. That does not affect the bankruptcy court's subject matter jurisdiction. 28 U.S.C. § 157(c).

Kerr-McGee's second affirmative defense asserts that the complaint must be dismissed for improper venue. As discussed above, this proceeding is related to the GPR bankruptcy case. The underlying bankruptcy case was properly filed in this district. 28 U.S.C. § 1408. This adversary proceeding is properly filed in this district. 28 U.S.C. § 1409(a).

As its third affirmative defense, Kerr-McGee contends that GPR's complaint fails to state a claim upon which relief may be granted. The complaint alleges that GPR sold natural gas to Kerr-McGee pursuant to a contract and that Kerr-McGee failed to pay for the natural gas, thereby giving rise to a claim for breach of contract. The complaint obviously states a claim for relief. Kerr-McGee argues, however, that any recovery by GPR will only benefit its secured creditor. The distribution of the

assets of a bankruptcy estate to the creditors of the estate, based on the priorities recognized by the Bankruptcy Code, has no bearing on jurisdiction, venue, the existence of a claim for relief, or the standing of the representative of the bankruptcy estate to liquidate property of the estate.

Having resolved those affirmative defenses, the court turns to the essence of the parties' dispute. Kerr-McGee and its predecessor HS purchased natural gas from GPR pre-petition. Kerr-McGee did not pay for the natural gas by transferring money to GPR. Instead, Kerr-McGee asserts that it paid for the natural gas by offsetting amounts owed to Kerr-McGee by GPR's affiliates Aurora and Western. GPR contends that Kerr-McGee lacked authority to offset the debt making Kerr-McGee's actions ineffective to pay the debt. GPR seeks a money judgment to collect the debt. Kerr-McGee requests that the complaint be dismissed under the doctrines of setoff and recoupment.

Kerr-McGee did not argue the doctrine of recoupment on its motion for summary judgment and the court considers that affirmative defense abandoned.

With regard to the doctrine of setoff, the Bankruptcy Code "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 [bankruptcy] case . . . against a claim of such creditor against the debtor that arose before the

commencement of the case." 11 U.S.C. § 553(a). The parties agree that Oklahoma law governs the transaction. Oklahoma law therefore determines whether Kerr-McGee had a right to offset.

Oklahoma recognizes the power of courts to offset debts under common law, especially in circumstances of insolvency. Caldwell v. Stevens, 167 P. 610, 612 (Okla. 1917); Southern Surety Co. v. Maney, 121 P.2d 295, 298 (Okla. 1941). GPR transferred gas in the months of March through July 2001. Under the parties' contract, a significant portion of the amount due under the contract would have been within ninety days of GPR's bankruptcy case. GPR filed its bankruptcy petition on August 14, 2001. Under the Bankruptcy Code, GPR is presumed to have been insolvent during that period. 11 U.S.C. § 553(c). Under the Oklahoma case law, offset does not occur by operation of law. The parties agree that Oklahoma law also allows parties to contract for offset of mutual debts.

Pursuant to 11 U.S.C. § 553 and Oklahoma law, Kerr-McGee must establish three elements to have been entitled to setoff: (1) a pre-petition debt owed by Kerr-McGee to GPR; (2) a pre-petition claim of Kerr-McGee against GPR; and (3) the debt and the claim must be mutual obligations. See Braniff Airways, Inc. v. Exxon Co., USA, 814 F.2d 1030, 1034 (5th Cir.1987).

There is no genuine issue of material fact concerning the following:

Beginning in 1997, HS entered several contracts for the sale and purchase of natural gas with Aurora and Western. HS sold natural gas to, and purchased natural gas from, Aurora and Western.

On May 2, 2000, GPR executed two Corporate Guaranties. GPR guaranteed to HS the indebtedness owed to HS by Aurora and Western. The two Corporate Guaranty agreements provide that GPR: "Will fully and promptly pay, perform and discharge when due all liabilities and obligations . . . arising out of or relating to Obligor's various gas purchase agreements . . . Guarantor further agrees . . . to pay Obligee *on demand*, all sums due from Obligor . . ." (emphasis added). The Corporate Guaranties do not provide for the offset of obligations, nor do they assume any of the liabilities of Aurora or Western. The guaranty by GPR under both Corporate Guaranties are only to the liabilities which come due on demand. The guaranty agreements were never revoked by GPR. HS and GPR had not yet entered a natural gas purchase contract.

On December 28, 2000, HS entered into Net Settlement Agreements with Aurora and Western providing for setoff of amounts due as a result of natural gas sales among them. GPR was not a party to those agreements. The agreements expressly do not apply to obligations of affiliated persons who were not parties to the agreements. Therefore, the Net Settlement Agreements do not provide contractual authority for Kerr-McGee to offset Aurora

or Western obligations against Kerr-McGee's obligations to GPR.

On January 1, 2001, HS entered a natural gas contract with GPR. On August 1, 2001, Kerr-McGee acquired HS. Kerr-McGee purchased natural gas from GPR between April and August 2001 in the amount of \$2,109,778.00. The natural gas contract between HS and GPR does not provide for the setoff of obligations involving HS transactions with Aurora and Western.

Kerr-McGee has presented summary judgment evidence regarding setoff as follows:

For the transfers of gas during March 2001, gas bought from GPR was netted against amounts owed by Western and Aurora, with a net balance due to Kerr-McGee paid by wire transfer received from GPR. For the transfers of gas during April 2001, gas bought from GPR was netted against amounts owed by Western and Aurora, with a net balance owed by Kerr-McGee paid by wire transfer to Aurora. For the transfers of gas during May 2001, June 2001 and July 2001, gas bought from GPR was netted against amounts owed to HS by Western and Aurora. There is no summary judgment evidence that Kerr-McGee ever made a demand on GPR to pay the obligations of Aurora or Western under the guaranty agreements. Kerr-McGee's summary judgment evidence indicates that, without applying the setoff, Kerr-McGee would owe the principal amount of \$2,109,778.00 for natural gas delivered by GPR from April through July 2001. GPR accepts this number.

On this record, Kerr-McGee owed a pre-petition debt to GPR. Kerr-McGee had a pre-petition claim against GPR based on GPR's guaranty of the debts of Aurora and Western for the natural gas purchased by Aurora and Western from Kerr-McGee. The Bankruptcy Code defines a "claim" as a right to payment however contingent. 11 U.S.C. § 105(5). The guaranty agreements fit within this definition.

GPR asserts that Kerr-McGee has not presented summary judgment evidence establishing that it actually applied the setoff pre-petition. If it did not, then the setoff would be stayed pursuant to 11 U.S.C. § 362(a)(7). For purposes of analyzing the mutuality of the obligation, the court assumes that Kerr-McGee applied the setoff pre-petition.

Mutuality is satisfied when the offsetting obligations are held by the same parties in the same capacity (that is, as obligor and obligee) and are valid and enforceable, and (if the issue arises in bankruptcy) both offsetting obligations arise either pre-petition or post-petition, even if they arose at different times out of different transactions. In re Doctors Hosp. of Hyde Park, Inc., 337 F.3d 951, 955 (7th Cir. 2003); In re Davidovich, 901 F.2d 1533, 1537 (10th Cir. 1990); see, e.g., In re Bevill, Bresler & Schulman Asset Management, 896 F.2d 54, 59 (3d Cir. 1990); In re Bay State York Co., 140 B.R. 608, 613-15 (Bankr. D.Mass. 1992); In re Thurston, 139 B.R. 14, 15 (Bankr.

W.D.Mo. 1992). At the time of each offset, the contingent nature of the guaranty had not been removed. Kerr-McGee made no demand on GPR to pay under the guaranty agreements after Aurora or Western failed to pay Kerr-McGee. GPR, Aurora, and Western were all separate legal entities. Kerr-McGee bought natural gas from GPR. Kerr-McGee bought and sold natural gas from and to both Western and Aurora. Their guaranty agreements do not provide for GPR's assumption of either Aurora's or Western's debt to Kerr-McGee. There is no mutuality of the obligations of Kerr-McGee and GPR with Kerr-McGee and Western or Kerr-McGee and Aurora. Without a demand or an assumption, the guaranty agreements do not make the debt and claim mutual obligations.

Kerr-McGee contends that Oklahoma case law allows setoff of guaranteed obligations, citing Jones v. England, 782 P.2d 119 (Okla. 1989). GPR responds that the Oklahoma Supreme Court limited its holding in Jones to financial institutions and insurance companies, citing Crawford v. Guardian Life Insurance Co., 954 P.2d 1235 (Okla. 1998), and other cases. This court disagrees with both parties' reading of Jones. The case requires "mutual obligations." In Jones, an insolvent plaintiff brought suit on a guaranty. The defendant sought to setoff payments made to the plaintiff. Kerr-McGee has not made a demand on the guaranty. Kerr-McGee did not file suit on the guaranty after Western and Aurora failed to pay and GPR failed to respond to a

demand on the guaranty. Jones does not stand for the proposition that amounts owed to Kerr-McGee from third parties may be offset against amounts Kerr-McGee owes GPR, simply because GPR guaranteed the third parties obligations. Jones also does not stand for the proposition that the mere existence of the guaranty creates a mutual obligation under these circumstances. As previously explained, the guaranty agreements do not assume the debts of Western and Aurora to Kerr-McGee. The guaranty agreements do not provide for setoff of the debts of Western and Aurora.

On this record, there is no basis under Oklahoma case law or common law or under the parties' contracts to find the obligations mutual at the time of Kerr-McGee's actions to apply its debt to GPR against amounts owed to it by Western and Aurora.

Accordingly, GPR shall be granted a partial summary judgment declaring that Kerr-McGee could not setoff the amounts owing to Kerr-McGee by Aurora and Western against the amounts Kerr-McGee owed GPR, making the Kerr-McGee debt to GPR under their contract due and owing.²

²The court does not address whether setoff may be ripe in this litigation. Aurora and Western have both filed their own bankruptcy cases. Kerr-McGee may have claims in those cases, as a result of this decision, if not otherwise holding claims. If the claims are not paid, the court may have to address a Kerr-McGee claim on the guaranty in the GPR case. The court has no basis on this summary judgment record to opine on how the post-petition events and the treatment of creditors in each bankruptcy case may affect setoff rights in the GPR case. Depending on developments in the several cases, Kerr-McGee may seek relief from this court to make demand on its guaranty. If Kerr-

Kerr-McGee argues that GPR never objected to the pre-petition setoff or to the course of conduct of the parties as demonstrated by its summary judgment evidence concerning net payments and wire transfers in the March through July 2001 time period. In essence, in its summary judgment motion, Kerr-McGee argues that GPR has waived any objection to the setoff based on the parties' prior business dealings. Kerr-McGee filed a separate motion for leave to file an amended answer to add the affirmative defenses of waiver and estoppel based on the parties' prior business dealings which allegedly established a course of conduct.

GPR objects to the motion for leave to file an amended answer. GPR contends that the motion is untimely and will unduly prejudice GPR. Kerr-McGee filed its original answer on September 12, 2003. Kerr-McGee filed its motion for leave to file an amended answer on May 17, 2004. Kerr-McGee does not have an adequate explanation for the delay.

Nevertheless, leave to file an amended pleading should be liberally granted. Fed. R. Civ. P. 15(a), made applicable by Bankruptcy Rule 7015. The affirmative defenses of waiver and

McGee effectively receives that relief, the court will then have to consider how a post-petition demand will play against a post-petition judgment on a breach of contract claim. While mutuality must exist pre-petition, the court must consider equity in the fashioning of a post-petition judgment. The court assumes that, as a result, the parties will engage in good faith settlement discussions.

estoppel are implicit in the summary judgment evidence presented by Kerr-McGee. As both parties recognize, under Oklahoma law, setoff does not occur by operation of law. Rather, courts apply setoff as an equitable consideration. Unless the GPR bankruptcy case will pay claims in full, in equity, Kerr-McGee's waiver and estoppel defenses should be determined on their merits at trial.

This is not a situation where a party seeks to add a claim or a defense when it is about to lose on the merits of the claim or defense presented. See Matter of Southmark Corp., 88 F.3d 311 (5th Cir. 1996). Rather, this is a situation where the defense is implicit in the defendant's approach to the case. Consequently, the court should only deny the motion if the amended pleading would work an undue hardship on GPR.

The mere fact of additional discovery does not amount to undue prejudice. Given the summary judgment evidence, GPR should only need limited additional discovery. The court will modify the scheduling order to accommodate the needed discovery and assure that the remaining issues be promptly set for trial.

GPR argues that the activities in the relatively short period of time before the bankruptcy petition cannot give rise to a course of conduct upon which to premise waiver or estoppel. Indeed, the summary judgment evidence demonstrates a genuine issue concerning the parties' intentions and understanding of their conduct. The court will not entertain a motion for summary

judgment on the waiver, estoppel or course of conduct defenses.

Based on the foregoing,

IT IS ORDERED that Kerr-McGee Energy Services Corporation's motion for leave to file an amended answer is **GRANTED**.

IT IS FURTHER ORDERED that GPR Holdings Liquidating Trust's motion for summary judgment is **GRANTED** without prejudice to Kerr-McGee's affirmative defenses of waiver and estoppel based on the parties' prior business dealings.

IT IS FURTHER ORDERED that Kerr-McGee's motion for summary judgment is **DENIED**.

IT IS FURTHER ORDERED that the parties may conduct limited discovery on the waiver, estoppel and business dealings affirmative defenses, to be completed by September 30, 2004.

IT IS FURTHER ORDERED that the trial docket call is continued to October 12, 2004, at 1:30 p.m.

###END OF ORDER###