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United States Bankruptcy Court
Eastern District Of Washington

In Re:)
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DAVID WALLACE BAYS,) Main Case 01-05127
) Number:
)
)
)

Debtor(s).)
LINDA BAYS; KELLY CASE ,) Adversary A03-00237
) Number:
)
)
)

Plaintiff(s))
)
vs.)
DAVID BAYS; DOUG LAMBARTH)
and JANE DOE LAMBARTH;)
JOE ESPOSITO and JANE DOE)
ESPOSITO; GARY STENZEL)
and JANE DOE STENZEL;)
PAUL BASTINE and JANE DOE)
BASTINE; JOE WITTSTOCK)
and JANE DOE WITTSTOCK;)
DAVID HARDY and JANE DOE)
HARDY; SPOKANE COUNTY)
COURT,)

Defendant(s))

DECISION RE: LINDA BAYS' AND KELLY
CASE'S CLAIMS FOR SETOFF AGAINST
DAVID BAYS, JOSEPH ESPOSITO,
INDIVIDUALLY AND HIS MARITAL
COMMUNITY AND AS TRUSTEE OF THE
BANKRUPTCY ESTATE OF DAVID BAYS,
AND DOUGLAS LAMBARTH, INDIVIDUALLY
AND HIS MARITAL COMMUNITY

FILED

SEP 17 2008

U.S. BANKRUPTCY COURT
EASTERN DISTRICT OF WASHINGTON

The plaintiffs Linda Bays and Kelly Case are suing the defendants
Bays, Esposito and Lambarth for recovery of a setoff. This matter

1 comes before the court upon motions for summary judgment relating to
2 the right of setoff filed by Linda Bays [AP #557], Kelly Case [AP
3 #570], Joseph Esposito individually, his marital community, and as
4 trustee of the bankruptcy estate of David Bays [AP #544], and Douglas
5 Lambarth, individually and his marital community. [AP #539].

6
7 **PROCEDURAL HISTORY**

8
9 David Bays, Joseph Esposito and Douglas Lambarth were original
10 defendants named in Linda Bays' "Complaint for Damages and for
11 Injunctive Relief" filed in Stevens County Superior Court. [AP #1,
12 pg 7-20]. Ms. Bays complained about alleged misconduct of David
13 Bays during their marriage, dissolution and David's bankruptcy, of
14 Douglas Lambarth's conduct as David's attorney and of Mr.
15 Esposito's conduct as David's bankruptcy trustee. Her state court
16 lawsuit was removed by Mr. Esposito to bankruptcy court and it
17 became this adversary proceeding. [AP #1].

18 Linda Bays filed an amended complaint in this adversary
19 proceeding. [AP #104]. This amended complaint added Kelly Case as
20 a plaintiff.

21 The new complaint included a claim that the plaintiffs were
22 entitled to a setoff; specifically it stated:

23 7.2 Joe Esposito failed to setoff claims of the debtor
24 concerning interest in the creditor, Linjerick
25 Society's property with full knowledge that debtor
26 owed Linjerick's society more money than debtor
27 claimed plaintiffs owed on alleged real estate
28 contract.

27 7.3 The bankruptcy laws provide for a setoff, but Joe
28 Esposito's acts were intentional to allow the

1 debtor, David Bays and his attorney, Doug Lambarth
2 get away [sic] with their bad acts and to be able to
3 keep all of the debtors non-exempt property, while
4 taking property belonging to a creditor.

5 [AP #104].

6 Following the filing of the amended complaint, David Bays,
7 Joseph and Jane Doe Esposito, the Spokane County Superior Court,
8 Joseph and Jane Doe Wittstock, David and Jane Doe Hardy, Paul and
9 Jane Doe Bastine, Douglas Lambarth and Jane Doe Lambarth, and Gary
10 and Jane Doe Stenzel all moved to dismiss the lawsuit for failure
11 to state a claim upon which relief could be granted. [AP #158 (Mr.
12 Bays), AP #144 (Esposito), AP #153 (Spokane County Superior Court,
13 Wittstock, Hardy and Bastine), AP #187 (Lambarth), AP #149
14 (Stenzel)].

15 This court entered several orders in response to the Rule
16 12(b) motions filed by Mr. Bays, Esposito, and other defendants on
17 November 8, 2004. All claims brought by the Linjericks Society
18 were dismissed without prejudice. [AP #s 192-199]. The court held
19 Linjericks Society may not appear before it without counsel. [AP
20 #189]. The court also dismissed with prejudice the setoff claims
21 brought by Linda Bays and Kelly Case against the Spokane County
22 Superior Court [AP #192], Joseph and Jane Doe Wittstock [AP #193],
23 David and Jane Doe Hardy [AP #194], and Paul and Jane Doe Bastine
24 [AP #195].

25 Following the orders entered on November 8, 2004, setoff
26 claims remained against David Bays, Joseph and Jane Doe Esposito,
27 Gary and Jane Doe Stenzel, and Douglas and Jane Doe Lambarth.

28 During a subsequent telephonic hearing on May 29, 2008, Kelly
Case dismissed, by oral motion, his setoff claims against Gary and

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1 Jane Doe Stenzel.¹ [AP #628]. This court granted Case's motion by
2 entering an order May 30, 2008. [AP #630].

3 Linda Bays dismissed, also by oral motion during the same
4 telephonic hearing, her setoff claims against Douglas Lambarth and
5 Gary and Jane Doe Stenzel. [AP #628]. This court granted Ms. Bays'
6 motion, entering an order on May 30, 2008. [AP #633].

7 As a result of this procedural history, Linda Bays currently
8 has pending setoff claims against David Bays and Joseph Esposito.
9 Kelly Case currently has setoff claims against David Bays, Joseph
10 Esposito and Douglas Lambarth. It is these remaining claims that
11 are before the court for summary judgment.

12 Since the argument of this motion Joseph Esposito has passed
13 away. A motion has been filed to substitute his probate estate as
14 a party in this adversary proceeding. [AP #689]. The United States
15 Trustee's Office has appointed Anthony Grabicki to act as the
16 successor trustee of the David Bays bankruptcy estate. [DB Ct
17 #106].

18 This matter comes before the court upon motions for summary
19 judgment relating to the setoff claims by Linda Bays [AP #557],
20 Kelly Case [AP #570], Espositos [AP #544] and Lambarths [AP #539].
21
22

23
24 ¹As discussed in this Court's recent decision on the Plaintiff's
25 outrage cause of action [AP #681], during the May 29, 2008 hearing the
26 court also heard oral motions and subsequently entered orders
27 dismissing setoff claims as to Joe and Jane Doe Wittstock, David and
28 Jane Doe Hardy, and Paul and Jane Doe Bastine. These orders are
redundant as to these defendants; setoff claims as to these defendants
have been previously dismissed with prejudice via 12(b) motion. [AP
#193 (Wittstock), AP #194 (Hardy), AP #195 (Bastine)].

FACTSI. LINDA BAYS- SETOFF CLAIMSA. The Payoff of the Kettle Falls Property

Linda Bays has maintained in the dissolution court, on appeal, and in Bankruptcy Court that she had a contract with David Bays. She alleges that she and David agreed that if she would clean up his Ione property he would pay off the real estate contract on her Kettle Falls property. It is her position that she cleaned up the property and in exchange David paid off her contract with the Fergusons. [AP #610 pg. 24-25].

David Bays maintains that there was no contract to clean up the Ione property, that he loaned Linda the money to pay off the Ferguson contract and took an assignment of the vendors interest in that real estate contract to secure his loan. [AP #612 pg 2]. David Bays' version of the facts prevailed before the dissolution court. Linda Bays was not represented at the trial. She filed post trial motions and appealed the result to no avail. The decision in the dissolution court became a final judgment.

Linda Bays seeks to assert a setoff in this court based on her contract to clean up the Ione property in exchange for a pay off on her Kettle Falls residence.

B. Storage Claim

David Bays had a substantial amount of personal property. This property was kept at the Kettle Falls residence. After the parties separated, David's personal property remained at the Kettle

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1 Falls property during the dissolution and part of the bankruptcy.
2 Joseph Esposito, the trustee of David Bays' bankruptcy estate
3 sought to abandon this property from the estate. [DB #71]. The
4 court granted the trustee's motion on August 11, 2003. [DB #75].
5 On May 23, 2005, Linda Bays filed a motion requesting an order that
6 David Bays remove his personal property and awarding her rent for
7 storage. [DB #81]. After a hearing on August 16, 2005 the court
8 entered an order directing the trustee and the debtor to remove the
9 personal property. [DB #90]. The court did not rule on the rent
10 issue at that time. [AP #503 pg 17 ¶87]. Ms. Bays relies on this
11 claim for rent as part of her off set claim.

12 C. Other Off Set Claims- Linda Bays

13 Linda Bays may be asserting other offset claims either against
14 David Bays or the bankruptcy estate but given the extensive
15 pleadings and allegations in this case the basis of these claims
16 are not obvious to the court.

17
18 II. KELLY CASE- SETOFF CLAIMS

19
20 A part of Kelly Case's offset claim is based on a challenge of
21 the amount of the equitable lien granted David Bays on the Kettle
22 Falls real property. [AP #571 pgs 2-3; AP #608 pgs 9-10]. He also
23 asserts that he provided labor on the Kettle Falls property and
24 presumably seeks credit for that work against David Bays and/or his
25 bankruptcy estate. [AP #571 pg 3]. His setoff claim also evidently
26 includes claims for bills he paid off for his mother and which he
27 was to hold a deed on the property as security for his advances to

1 his mother.

2

3

DISCUSSION

4

5 I. ELEMENTS OF Setoff

6 Section 553(a) of the Bankruptcy Code provides that
7 bankruptcy

8 "does not affect any right of a creditor to offset a
9 mutual debt owing by such a creditor to the debtor that
10 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 this case..."

11 Collier on Bankruptcy 15th ed. ¶ 553.01 [1] explains the concept of
12 setoff as follows:

13 Setoff is a right of equitable origin designed to
14 facilitate the adjustment of mutual obligations. Its
15 central premise is an ancient one well-grounded in a
16 practical logic: If A is indebted to B, and B is likewise
indebted to A, it makes sense simply to apply one debt in
satisfaction of the other rather than require A and B to
satisfy their mutual liabilities separately.

17

....

18

19 In general, section 553(a) recognizes and preserves
rights of setoff where four conditions exist:

- 20 (1) The creditor holds a "claim" against the debtor
21 that arose before the commencement of the case;
- 22 (2) The creditor owes a "debt" to the debtor that
also arose before the commencement of the case;
- 23 (3) The claim and debt are "mutual"; and
- 24 (4) The claim and debt are each valid and
25 enforceable.

26 Ibid, ¶ 553.01[1].

27 The debtor in this case is David Bays. In order to avail

1 themselves of the doctrine of setoff, Linda Bays and Kelly Case
2 must show that they are creditors of David Bays and that their debt
3 arose before David Bays filed bankruptcy. They must show that the
4 debts are mutual, i.e. in their individual capacity, not in any
5 other capacity. The debt to be setoff must be valid and
6 enforceable.

7
8 II. Setoff CLAIMS AGAINST ESPOSITO

9
10 The concept of setoff is inapplicable to any claims Ms. Bays
11 and Kelly Case have against the Espositos, individually and their
12 marital community. In order for setoff to apply each party must
13 owe the other party money. There is no claim that Ms. Bays or
14 Kelly Case owe anything to the Espositos individually or their
15 marital community. Therefore there is nothing to setoff between
16 them.

17 All of the actions taken in this matter by Joseph Esposito
18 were taken in his capacity and within the scope of his authority as
19 trustee of the bankruptcy estate of David Bays. He and his marital
20 community are entitled to immunity for these actions. [AP #659 pg
21 9]. Any of the plaintiffs' rights to setoff which prove viable can
22 only be asserted against the bankruptcy estate.

23
24 III. LINDA BAYS-SETOFF VS DAVID BAYS & HIS BANKRUPTCY ESTATE

25
26 A. Ione Clean Up/Kettle Falls Pay Off

27 This court has ruled that Linda Bays is bound by the decision

1 of the dissolution court. [AP #s 429, 515, 673, and 681]. The
2 dissolution court's findings, conclusions, and decree determined
3 the rights and obligations between Linda Bays and David Bays.
4 Those decisions are final and binding on Linda Bays. They preclude
5 her claim to the contrary, even if she didn't raise it at the
6 dissolution trial or appellate level. David Bays' bankruptcy
7 estate stands in the same status as David Bays individually on this
8 point. Linda Bays has no right to setoff based on the Ione clean
9 up against either David Bays or his bankruptcy estate.

10 B. Storage Claim

11 No court has specifically ruled on Linda Bays' claim for
12 storage/rent against David Bays individually or against his
13 bankruptcy estate. If any of Ms. Bays' storage/rent claim is pre
14 dissolution decree, that portion of the claim would be precluded.
15 It appears however that a substantial portion of that storage/rent
16 claim is post decree and is not the victim of either claim or issue
17 preclusion.

18 The factual materials provided by the parties are insufficient
19 for the court to decide on the merits of the post decree
20 storage/rent claims. It is premature to consider and decide this
21 claim at this time.

22 C. Linda Bays Other Setoff Claims

23 The allegations in the amended complaint's ¶ 7.2² refers to
24 setoff claims of the Linjerick Society. The Linjerick Society has
25 been dismissed as a party to this adversary proceeding. [AP #s 189,
26

27 ²See pgs. 2-3 of this decision.

1 192-199]. Linda Bays can not assert any claim on the Linjerick
2 Society's behalf.

3 There may be other setoff claims which Linda Bays may be
4 asserting in this case but which are insufficiently developed in
5 this record by either Ms. Bays, David Bays or the bankruptcy
6 estate. It is premature to consider and decide these claims at
7 this time.

8

9 IV. KELLY CASE-SETOFF

10

11 A. vs. David Bays and His Bankruptcy Estate

12 There are no allegations that Kelly Case owes anything to
13 David Bays or his bankruptcy estate. Therefore the concept of
14 setoff generally would not apply.

15 Kelly Case is asserting rights in property which David Bays
16 and his bankruptcy estate claims an interest. These competing
17 claims are the subject of litigation in this court. It is
18 premature to consider application of setoff until those rights have
19 been adjudicated.

20 B. vs. Lambarth

21 There are no allegations that Kelly Case owes anything to
22 Douglas Lambarth. Therefore the concept of setoff would not
23 generally apply.

24 Kelly Case is asserting rights in property which David Bays
25 claims an interest. Those competing claims are the subject of
26 litigation in this court. Kelly Case appears to base his setoff
27 assertions against Mr. Lambarth on the possibility that if David

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1 Bays should prevail in that litigation Douglas Lambarth, as David
2 Bays' attorney, might acquire an interest in the property. This
3 prospect appears remote at this time, since David Bays' bankruptcy
4 estate appears to have priority over David Bays' personal claims in
5 the property. Accordingly Kelly Case's claim for setoff against
6 Douglas Lambarth should be dismissed without prejudice.

8 CONCLUSION

9
10 Linda Bays claims for setoff against David Bays individually
11 and his bankruptcy estate, as those claims relate to the Ione Clean
12 Up/Kettle Falls Pay Off should be dismissed. Summary judgment
13 should be entered in favor of the bankruptcy estate of David Bays
14 and David Bays individually and against Linda Bays on the Ione
15 Clean Up/Kettle Falls Pay Off element of her setoff claim.

16 Linda Bays claims for setoff against David Bays individually
17 and his bankruptcy estate, as those claims relate to the post
18 dissolution decree storage claims and such other setoff claims she
19 may have are not ripe for determination at this time. Summary
20 judgment on the motions of Linda Bays, David Bays and the
21 bankruptcy estate as they relate to the storage claim and the
22 remaining other setoff claim are denied at this time.

23 Linda Bays' and Kelly Case's claims for setoff against Joseph
24 Esposito, individually and his marital community should be
25 dismissed. Summary judgment should be entered in favor of Joseph
26 Esposito individually, his marital community and his successor in
27 interest and against Linda Bays and Kelly Case on all these setoff

28 SETOFF DECISION

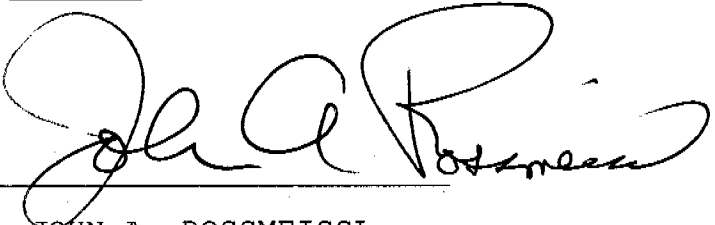
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1 claims.

2 The motions for summary judgment filed by Kelly Case, David
3 Bays, and his bankruptcy estate on the issue of Kelly Case's setoff
4 are denied as being premature.

5 The motions for summary judgment filed by Douglas Lambarth on
6 the issue of setoff as it relates to Kelly Case should be granted.
7 Kelly Case's claim for setoff against Douglas Lambarth should be
8 dismissed without prejudice.

9
10 Done this 17 day of September, 2008

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14 JOHN A. ROSSMEISSL
15 BANKRUPTCY JUDGE