350 B.R. 182
In re Bonnie S. CALDWELL, Delotar.
Bonnie J. Caldwell, Plaintiff,
v.
Continental American Insurance Co. f/k/a United States Life Insurance Co., and Disability Reinsurance Management Services, Inc., Defendants.
United States Bankruptcy Court, E.D. Pennsylvania.
September 26, 2006.
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Ronald H. Beifeld, Esquire, Plymouth Meeting, PA, for Plaintiff.

Amy E. Vulpio, Esquire, White & Williams, George M. Conway, III, Esquire, Office of the United States Trustee, Philadelphia, PA, for Defendants.

OPINION

STEPHEN RASLAVICH, Bankruptcy Judge.

I. *Introduction*

Debtor Bonnie J. Caldwell (the "Debtor" or the "Plaintiff') filed this Adversary Proceeding against Defendants Continental American Insurance Co. f/k/a United States Life Insurance Co. ("U.S.Life") and Disability Reinsurance Management Services, Inc. ("DBMS") (collectively, the "Defendants") alleging breach of contract, seeking monetary and equitable relief, and asking the Court to reinstate certain long-term disability benefits. The Defendants oppose the relief requested and have filed three Counterclaims against the Plaintiff seeking declaratory and monetary relief. The Court presided over a trial on this matter on May 31, 2006, following the submission of all post-trial briefs, the Court took the matter under advisement. For the reasons discussed below, the Court enters judgment in the favor of the Defendants and against the Plaintiff.

II. *Background*

The Plaintiff is a former U.S. Airways employee who claims she suffers from Lyme Disease and that her illness entitles her to long-term disability benefits under her former company's disability policy. In 1992, the Plaintiff began working for U.S. Airways as a part-time fleet servicer, a position in which she loaded baggage onto aircraft. In 1998, the Plaintiff became a full-time fleet servicer with U.S. Airways. As a full-time employee, she became eligible for long-term disability, and she enrolled in the company's plan.

The Policy

The company's long-term disability program is governed by a group disability policy (the "Policy") that defined "Total Disability" or "Totally Disabled" to mean:

(1) during the first twenty-four (24) months of a period of disability, an injury or sickness required the employee to be under the regular care and attendance of a physician, and prevented her from performing the material duties of her *regular occupation;* and

(2) after the first twenty-four (24) months of total disability, an injury or sickness prevented her from performing the material duties of any *occupation* for which her education, training and experience qualified her.

See Ex. D-2 at 5 (emphasis added).

Plaintiff's Disability Claim

On or about February 3, 2003, the Plaintiff submitted a claim for disability benefits under the Policy, asserting that she was

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disabled as a result of Lyme Disease. On the authenticated claim form, the Plaintiff specified March 18, 2001 as the "Date of Accident or Date Symptoms First Appeared." *See* Ex. P-1 § 7. The claim form also questioned whether she had ever had the same or similar condition in the past. The Plaintiff responded in the negative. The Plaintiff later testified at trial, however, that she had been first diagnosed with Lyme Disease in 1993[1] and tested positive for Lyme Disease in October 2000.[2]

At the time the Plaintiff submitted her disability claim form, her job responsibilities as a fleet servicer included physically demanding work, such as loading and unloading airplanes, driving airport equipment, and lifting bags and other cargo into aircraft bins. The Defendants initially granted the claim and began paying benefits to the Plaintiff in April 2003 in the amount of $1,785.000 per month. (N.T. 5/31/06 at 19; 103)

Income From Other Sources

On August 1, 2003, the Plaintiff executed an Agreement Concerning Benefits ("Agreement") for the Defendant U.S. Life. (N.T. 5/31/06 at 20). The Agreement provided that the benefits would be reduced by any income that the Plaintiff received from other sources, including social security. The Policy likewise provided in a section addressing other income benefits that "[t]he scheduled amount [of other income benefits] will be reduced by the sum of any income or benefit you receive or for which you are eligible ... from .. . the Federal Social Security Act." *See* Ex. D-2 at 8-9. The Policy further provided that "[i]f you are totally disabled beyond 6 months you must provide proof of application for Social Security Disability Income benefits within 8 months of date of disability in order for your benefits under the Plan to continue so long as total disability continues." *See id.*

In the Agreement, the Plaintiff elected to receive her monthly long-term disability benefit with no estimated reduction in benefits received from the Social Security Administration ("SSA") but specifically acknowledged that "I understand that this may result in an overpayment on my Long Term Disability claim and agree to repay any overpayment in full immediately following receipt of award for said benefits." *See* Ex. P-2. The Policy also provided in pertinent part for the adjustment of benefits in the event of an under or overpayment as follows: "We may reduce your benefit or stop paying benefits until the overpayment is recovered." *See id.* at 9. The Plaintiff testified that she understood these provisions to mean that U.S. Life would want to recoup any monthly social

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security amounts that she received. (N.T. 5/31/06 at 21)

Social Security Payments and Allegations of Overpayment

The Plaintiff applied for social security benefits in July 2003 and received a lump sum award on May 1, 2004 of $7,458.00. (N.T. 5/31/06 at 21; 29). At that time, she also received a lump sum award of $5,473.00 from the SSA payable to her as the custodian for her minor daughter. (N.T. 5/31/06 at 45). In addition, the Plaintiff received two monthly payments of $1,007.00 each for both April and May 2004 and a monthly payment of $503.00 for May 2004 on behalf of her daughter. The Plaintiff testified that she notified U.S. Life about the award by contacting them via telephone and speaking to a customer service agent. (N.T. 5/31/06 at 30).

The Defendants dispute that the Plaintiff notified them of the social security payments and claim that they did not discover that the Plaintiff had received an award from the SSA until June 2004 when they were informed by the

agency. (N.T. 5/31/06 at 106) Furnished with this information, the Defendants adjusted the Plaintiffs monthly disability benefits accordingly. The Defendants also notified the Plaintiff by letter that an overpayment of $17,617.30 (later adjusted downward) was immediately due. The Plaintiff refused to reimburse the Defendants for the overpayment, disputing the claimed amount and claiming that, at most, she owed $9,094.00 as a result of an overpayment. (N.T. 5/31/06 at 36; 45-46) Because the Plaintiff failed to repay the overpayment, the Defendants suspended her benefits in June 2004. They subsequently terminated benefits effective April 2005, claiming that the Plaintiff no longer met the definition of "total disability" under the Policy.

Part of the dispute over the amount of overpayment owed stems from amounts that were received from social security for Ms. Caldwell's minor daughter. The Policy provided how receipt of other income benefits, including social security, would affect the amount of benefits due under the Policy as follows: "Benefits provided to your dependants by reason of your disability or retirement will be considered to be provided to you." *See* Ex. D-2 at 8-9. The Plaintiff claims that the portion attributable to her daughter should not be counted as part of any overpayment because her daughter was living with and being cared for by her father for at least a portion of the time that she was receiving social security payments. (N.T. 5/31/06 at 32) The Defendants, on the other hand, claim that any benefits provided to the Plaintiffs daughter are deemed to be other income benefits resulting from the Plaintiffs disability that reduce the long-term disability payment payable to the Plaintiff. (N.T. 5/31/06 at 120)

The Defendants have since adjusted downward their claimed amount of overpayment due to their erroneous inclusion in the initial amount of approximately $2,400.00 in attorneys' fees paid to the Plaintiffs disability attorney. (N.T. 5/31/06 at 108) Because the Defendants were also able to recoup part of the overpayment before the time that they determined that the Plaintiff was no longer eligible for benefits, they now claim that the true amount of overpayment at issue is $12,251.30. (N.T. 5/31/06 at 112)

Vocational Assessment and Questionnaire

As discussed above, the Policy provides that following expiration of the first 24-month period — i.e., as of April 2005 — the Plaintiff had to be disabled from any occupation, not just her own occupation, to continue receiving disability benefits. Accordingly, in January 2005, the Defendants informed the Plaintiff that her insurance

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claim would be cancelled in its entirety effective April 1, 2005 unless she completed a vocational assessment showing that an injury or sickness prevented her from performing the material duties of any occupation for which her education, training and experience qualified her. The Plaintiff refused to complete a vocational assessment but did complete and return an activities-level questionnaire in April 2005. (N.T. 5/31/06 at 104) In the questionnaire, the Plaintiff acknowledged that she was able to use a computer, do laundry, and prepare her own meals. She subsequently testified, however, that she can only do laundry and cook some of the time and that her partner has responsibility for all of the housework and maintaining of the household. (N.T. 5/31/06 at 46-47) By her own admission, the Plaintiff has made no attempt to find a job since filing her disability claim in 2003. The Defendants determined that the Plaintiff had at least sedentary work capacity, (N.T. 5/31/06 at 105), and that, as a result, she did not satisfy the criteria for "total disability" beyond the initial 24-month period. Accordingly, the Defendants terminated benefits effective April 2005.

Bankruptcy Filing

On October 4, 2004, the Plaintiff filed a Voluntary Petition for relief under Chapter 13 of the United States Bankruptcy Code in an effort to stave off a foreclosure sale of her home

following a delinquency in her mortgage payments. On April 14, 2005, the Plaintiff's case was converted to Chapter 7. On February 11, 2005, the Plaintiff filed an Adversary Complaint against the Defendants alleging breach of contract, seeking monetary and equitable relief, and asking the Court to reinstate her long-term disability benefits.

The Defendants filed an Answer, Affirmative Defenses, and Counterclaims to Plaintiff's Adversary Complaint on April 7, 2005. In three Counterclaims, the Defendants seek an order declaring that DBMS properly exercised its right of recoupment of the overpayment received by the Plaintiff from the SSA by suspending benefits, and that such recoupment did not violate the automatic stay provided by 11 U.S.C. § 362. In addition, the Defendants seek an order declaring that the overpayment is nondischargeable under either of two theories: (1) that the Plaintiff obtained the overpayment by false pretenses, false representation, or actual fraud by misrepresenting her date of initial diagnosis of Lyme Disease, and/or that the Plaintiffs actions were willful and malicious, making her obligation to repay the overpayments nondischargeable under 11 U.S.C. § 523(a)(2)(A), 11 U.S.C. § 523(a)(2)(B), and/or 11 U.S.C. § 523(a)(6),[3] or (2) because the Plaintiff never had the right in the first place to retain the overpayment, because the funds are not property of the estate.

To assess these issues, the Court first must determine whether the Plaintiff is "totally disabled" under the company's long-term disability policy and therefore entitled to continued long-term disability benefits beyond the initial 24-month period. Second, the Court must determine whether the Defendants properly exercised their right of recoupment to the overpayment that the Plaintiff received from social security by suspending her benefits as of June 2004. This second issue further requires the Court to consider the predicate questions of whether the Defendants' exercise of recoupment violated the automatic stay; and whether any

overpayment debt is nondischargeable in bankruptcy. The Court shall address each of these issues in turn below.

III. *Discussion*

A. *Plaintiff Has Failed To Prove That She Is "Totalling Disabled" And That Defendants reached heir Contractual Obligation To Pay Benefits*

In her Complaint, the Plaintiff seeks a determination that: (1) the Defendants breached the Policy by wrongfully terminating her disability benefits, and (2) such benefits should be reinstated at the rate of $799.00 per month retroactive to July 2004.[4] As a threshold matter, the Court must determine whether the Plaintiff is or was "totally disabled" under the Policy, which in turn will determine whether the Defendants were required to continue to pay disability benefits beyond the initial 24-month period. In considering that question, the Court notes that the Plaintiff bears the burden of proving that she was totally disabled and that the Defendants breached their obligation to pay benefits. *See, e.g., Doe v. Provident Life and Accident Ins. Co.*, 1997 WL 214796, at *1 (E.D.Pa. April 22, 1997) ("It is beyond cavil that, in an action asserting breach of contract to provide disability benefits, the burden rests with plaintiff to prove that [s]he was totally disabled within the meaning of the policy and to prove that defendant breached its obligation to pay benefits.").

There are two periods of time relevant to the Plaintiffs claims. The first is the initial 24-month period of disability when the Defendants found that the Plaintiffs injury prevented her from performing her duties as a fleet servicer.[5] This period extended from April 2003 through April 2005 but was interrupted after the Defendants learned that the Plaintiff had also been receiving other income benefits from the SSA, resulting in an overpayment. In an effort to recoup the overpayment, the Defendants suspended the Plaintiffs benefits beginning in

June 2004 and continued to suspend them until the initial period of disability expired in April 2005. The Court will address the propriety of the Defendants' exercise of recoupment and related issues in Section III.B. of this Opinion below.

The second period is the period following the initial 24-month disability period, from April 2005 onward. To be eligible for benefits in this second time frame, the Plaintiffs injury or sickness must have prevented her from performing the material duties of any occupation for which her education, training and experience qualify

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her. The Court will address in this Section whether the Plaintiff has met the definition of "total disability" *as* of April 2005.

The Plaintiff maintains that the Defendants wrongfully terminated her disability benefits and that she remains disabled by Lyme Disease to an extent that prevents her from performing the material duties of any occupation for which her education, training and experience qualify her. The Defendants, on the other hand, contend that the Plaintiff has not met her burden of proving that she suffers from Lyme Disease or any other condition that prevents her from performing the material duties of any occupation for which she is qualified. For those reasons, the Defendants maintain that they properly terminated the Plaintiffs coverage.

1. *No Reliable Evidence of Lyme Disease*

Both parties presented expert testimony regarding the proper testing for Lyme Disease and the diagnosis of the Plaintiff. In general, the experts agree that the Plaintiff claims to suffer from various symptoms including, *inter alia,* chronic fatigue, pain and sleep problems and that she has undergone various testing for Lyme Disease. The experts, however, dispute the efficacy of the tests for Lyme Disease and the ultimate diagnosis of the Plaintiff.

To date, the Plaintiff has undergone two known tests for Lyme Disease: (1) the PCR test; and (2) a blood test from the Center for Disease Control ("CDC") known as the Western Blot. The Plaintiff has undergone the PCR test 17 times, resulting in four positive tests and thirteen negative tests for Lyme Disease. In addition, the Plaintiff has undergone the Western Blot test nine times, resulting in one positive test in October 2000 (N.T. 5/31/06 at 76) and eight negative tests for Lyme Disease.

The parties' respective experts dispute the value and proper administration of the tests. For example, the Defendants note that the PCR test has not been approved for testing of Lyme Disease, nor any other disease, and is considered experimental. (N.T. 5/31/06 at 75) The Defendants argue that the PCR test is not generally accepted in the mainstream medical community and that it notoriously generates inconsistent and false positive results. As a result, the Defendants maintain that the PCR tests lack the requisite degree of reliability necessary to satisfy the standard enunciated in *Daubert v. Merrell Dow Pharmaceuticals, Inc.,* 509 U.S. 579, 113 S.Ct. 2786, 125 L.Ed.2d 469 (1993).

The Plaintiff's expert, Dr. Peter Fabulian, opined that the Plaintiff suffers from Lyme Disease. He bases his opinion primarily on the one positive Western Blot test from October 2000 and his own treatment of the Plaintiff since June 2003. Although board certified in family medicine, Dr. Fabulian was proffered as an expert in infectious diseases. (N.T. 5/31/06 at 52) His claimed expertise stems from his treatment of approximately three to four hundred Lyme Disease patients per month. (N.T. 5/31/06 at 52-53; 59; 73) By all accounts, Dr. Fabulian is a zealous advocate for patients he believes the "mainstream" medical community has failed to properly diagnose with Lyme Disease. He contends that Lyme Disease is a much larger problem than mainstream doctors are willing to recognize. According to Dr. Fabulian, many of his patients came to him after becoming dissatisfied with their regular doctors and find reassurance in Dr. Fabulian's diagnosis of Lyme Disease.

Dr. Fabulian began treating the Plaintiff as a patient in June 2003 when she came to him complaining of achiness and joint pain.

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(N.T. 5/31/06 at 57-58). Based on her symptoms and the one positive Western Blot test taken nearly three years earlier in October 2000, Dr. Fabulian diagnosed the Plaintiff with Lyme Disease, a position he echoes in his expert opinion in this matter. It is less clear whether Dr. Fabulian also relies on the PCR tests in reaching his conclusion. In his report, he claims that "positive urine and blood PCR's are used extensively by the `mainstream Lyme and infectious disease experts' so it certainly is recognized." *See* Ex. 9-22 at ¶¶ 1, 9. He also testified that he trusts the PCR test because it finds a bacteria and it is acceptable to insurance companies as being indicative of disease. On cross-examination, however, Dr. Fabulian appeared to distance himself from PCR testing, stating that the test "has not been approved for anything, it's experimental" and that he does not use the test because it has not been recognized by the CDC. (N.T. 5/31/06 at 75)

Dr. Thomas A. Reeder. M.D. testified for the defense. He is board certified in internal medicine and is employed as a medical consultant by DRMS. (N.T. 5/31/06 at 84) Dr. Reeder disputes that the Plaintiff is currently afflicted with Lyme Disease and believes that there has been no evidence by history, clinical examination, or laboratory testing that the Plaintiff ever suffered from Lyme Disease. The Defendants further dispute that injury or sickness prevents the Plaintiff from performing the material duties of any occupation for which her education, training and experience qualify her. Dr. Reeder never examined the Plaintiff but rather based his opinions and conclusions solely on his examination of the Plaintiffs medical records.[6] (N.T. 5/31/06 at 85; 93-94) Based on a review of those records, Dr. Reeder concluded that the Plaintiff does not suffer from Lyme Disease although there is evidence that she suffered from fibromyalgia, premenstrual dysphoric disorder, depression, and a benign thyroid nodule that did not impair thyroid function. (N.T. 5/31/06 at 86)

In addition, Dr. Reeder disputes both Dr. Fabulian's methodology and his diagnosis of the Plaintiff. Dr. Reeder challenges Dr. Fabulian's methodology on three grounds. First, he criticizes Dr. Fabulian's reliance on the October 2000 Western Blot test that was not administered in accordance with the CDC's recommended testing sequence. The CDC recommends that an initial antibody screen be performed and, only if the screen is positive, for the patient then to undergo a Western Blot test. (N.T. 5/31/06 at 87). If the antibody screen is negative, the CDC does not recommend the Western Blot test. This procedure was not followed in the October 2000 test of the Plaintiff, but rather the Western Blot test was administered alone. (N.T. 5/31/06 at 86-87).

Second, Dr. Reeder argues that the Plaintiff did not have the clinical picture consistent with Lyme Disease. (N.T. 5/31/06 at 87) According to Dr. Reeder, although the Plaintiff lives in Eastern Pennsylvania, an area where Lyme Disease is present, she did not exhibit any

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other clinical reasons to suspect Lyme Disease, such as involvement in activities that would have exposed her to ticks that transmit Lyme Disease, such as working out in the woods or in the fields, as well as flulike symptoms, muscle aches, joint pains, fatigues, a low-grade fever (perhaps), and a rash called erythema migrans. (N.T. 5/31/06 at 87) Based on Dr. Reeder's review of the medical records, although symptoms were reported, none that were consistent with an acute Lyme infection were present. (N.T. 5/31/06 at 88)

Third, Dr. Reeder argues that the testing of the Plaintiffs IgM bands in 2000 was faulty. Testing under the IgM portion of the Western Blot test would only be appropriate when the test is performed within a narrow, one-month window after the Plaintiff had been infected. There has been no evidence that the Plaintiff

was infected by a tick bite within a month of the October 2000 test and, in fact, the Plaintiff claims that she was infected with Lyme Disease *as far* back as 1993. The CDC specifically recommends against using the Western Blot in individuals who have chronic or late stage Lyme Disease because the incidence of false positivity of IgM bands is high and one would not expect the persistence of IgM antibodies beyond a few weeks after the initial Lyme infection; by that time, IgG bands should be present.[7] (N.T. 5/31/06 at 88) An IgG test was performed at the same time which came back negative. (N.T. 5/31/06 at 88)

Before comparing the experts' diverging views, the Court must make a preliminary finding that each expert's opinion meets the requirements of Fed.R.Evid. 702. Rule 702 allows a witness to testify as an expert if scientific, technical or other specialized knowledge will assist the trier of fact. The witness must be qualified as an expert by knowledge, skill, experience, training, or education, and the witness may testify in the form of an opinion or otherwise "if (1) the testimony is based on sufficient facts or data, (2) the testimony is the product of reliable principles and methods, and (3) the witness has applied the principles and methods reliably to the facts of the case." Fed.R.Evid. 702.

In applying Rule 702, the Third Circuit Court of Appeals has developed a three part analysis. *See Crisomia v. Parkway Mortgage, Inc. (In re Crisomia),* 286 B.R. 604, 608 (Bankr.E.D.Pa.2002) (citing *Paoli R.R. Yard PCB Litigation,* 35 F.3d 717, 741-43 (3d Cir.1994)) (identifying the three requirements as "qualifications," "reliability," and "fit"). First, the witness must be an expert. *Crisomia,* 286 B.R. at 608. The Third Circuit has interpreted this requirement liberally, holding "[t]hat a broad range of knowledge, skills, and training qualify an expert as such." *Id.* (citations omitted) The third determination requires that an expert's opinion be relevant. *Id.* at 610.

The second requirement, referred to as the reliability test, requires the Court to perform a general gatekeeping function to determine if an expert's opinions are reliable. *Id.* (citing *Daubert,* 509 U.S. 579, 113 S.Ct. 2786, 125 L.Ed.2d 469). The following factors, enunciated first in *Daubert,* and later expanded by the Third Circuit, have been found probative of reliability: (1) whether a method consists of a testable hypothesis; (2) whether the method has been subject to peer review; (3) the known or potential rate of error; (4) the existence and maintenance of standards

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controlling the technique's operation; (5) whether the method is generally accepted; (6) the relationship of the technique to methods which have been established to be reliable; (6) the qualifications of the expert witness testifying based on the methodology; and (8) the non-judicial uses to which the method has been put. *Id.* (citing *Paoli,* 35 F.3d at 724 n. 8)

The factors relevant to determining reliability should be applied to the principles and methodologies rather than to the expert's opinions. *Crisomia,* 286 B.R. at 608 (citing *Daubert,* 509 U.S. at 595, 113 S.Ct. 2786, 125 L.Ed.2d 469). "For an opinion to be reliable, the opinion must be grounded in principles and methodology of the relevant discipline, no matter how impressive the expert's credentials may be." *Crisomia,* 286 B.R. at 608 (citations omitted). The mere fact that an expert states that a methodology is valid does not require the Court to admit opinion evidence based on methodology. *Id.; see also General Electric Co. v. Joiner,* 522 U.S. 136, 146, 118 S.Ct. 512, 139 L.Ed.2d 508 (1997) (stating that "nothing in either *Daubert* or the Federal Rules of Evidence requires a district court to admit opinion evidence that is connected to existing data only by the *ipse dixit* of the expert."); *Soldo v. Sandoz Pharmaceuticals Corp.,* 244 F.Supp.2d 434, 527 (W.D.Pa.2003) (citations omitted) ("When an expert's testimony `relies in part on his own *ipse dixit,* rather than on something more readily verifiable ... it is open to attack.'..." "[S]omething doesn't become `scientific knowledge' just because it is uttered by a

scientist; nor can an expert's self-serving assertion that his conclusions were `derived by the scientific method' be deemed conclusive."). Hence, an opinion, albeit based on training and experience, without more, is unreliable because it is not based on applicable principles and methodologies. *Crisomia,* 286 B.R. at 609 (citations omitted).

In this case, it is clear that Dr. Reeder's opinion meets the reliability factors set out in *Daubert* and *Crisomia,* and the Court need not address them in detail.[8] More problematic, however, is the opinion of Dr. Fabulian. Dr. Fabulian's reliance on the October 2000 Western Blot test is flawed. The Defendants' expert, Dr. Reeder, does an effective job highlighting the areas of fault with Dr. Fabulian's methodology. First, as detailed above, the Western Blot that Dr. Fabulian relies on failed to follow the appropriate testing sequence recommended by the CDC.[9] (N.T. 5/31/06 at 86-87). Second, to the extent that Dr. Fabulian is relying on positive PCR tests of the Plaintiff, the Court finds that the PCR tests lack the requisite degree of reliability necessary under *Daubert.* Similarly, Dr. Fabulian's shortcomings with respect to the clinical picture and the IgM testing cast significant doubt on the reliability of his opinion because it is based, in part, on those principles and methodology. Regardless of whether any one of these issues would prevent the elements of *Daubert* from being met, the Court finds that collectively they render Dr. Fabulian's opinion unreliable.

In sum, therefore, the Court agrees with Dr. Reeder's conclusions that Dr. Fabulian's reliance on the Western Blot test

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testing sequence; the IgM results were most consistent with false positive tests; and the absence of IgG bands, coupled with a clinical picture not consistent with acute Lyme Disease, makes Dr. Fabulian's methodology unreliable and inconsistent with evidence of chronic Lyme infection. (N.T. 5/31/06 at 89). Moreover, this Court will not adopt Dr. Fabulian's diagnosis of Lyme Disease based on sheer *ipse dixit* or his adamant belief that the Plaintiff suffers from Lyme Disease. Absent reliable methodology behind his conclusions, the Court will not adopt his opinions.[10] Consequently, the Court finds that the Plaintiff has failed to meet her burden of proving with reliable evidence that she suffers from Lyme Disease.

2. *Regardless of Whether Plaintiff Suffers from Lyme Disease, the Evidence Fails to Support a Finding that Plaintiff Is Totally Disabled*

Even if the Court were to find sufficient evidence to support the conclusion that the Plaintiff suffers from Lyme Disease, the Plaintiff still has failed to establish that her condition prevents her from performing the material duties of *any* occupation for which she is qualified. For example, the Plaintiff completed an activities-level questionnaire in April 2005 acknowledging that she could perform household activities consistent with work including laundry, meal preparation, housekeeping, grocery shopping, driving and yard care as well as use of a computer. (See Ex. D-1; N.T. 5/31/06 at 91; 46) These activities suggest to the Court that the Plaintiff could potentially perform the responsibilities of more sedentary work. Moreover, the Court finds these questionnaire answers more credible than the Plaintiffs later, self-serving testimony to the contrary.

In addition, the Court emphasizes that the Plaintiff refused to undergo a vocational assessment offered by her employer that would have determined the types of job duties she could or could not perform. The Plaintiffs refusal to learn what duties she might be able to do should not inure to her benefit now that he claims she can do none. Based on the above, the Court finds that the Plaintiff has failed to meet her burden of establishing that she is totally disabled for the period after April 2005.[11] Consequently, the Defendants did

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not breach any agreement to provide benefits for that period.

B. *Defendants Properly Exercised Their Right To Recoup The Overpagment; Defendants ad Net Act In Violation Of The Automatic Stay Provided By 11 § 362; tut The Debt Is Dischargeable*

The Defendants argue that they properly suspended the Plaintiff's benefits beginning in June 2003 to recoup the social security overpayment received by the Plaintiff. They now seek a determination from this Court that (1) they had a valid right of recoupment against the Plaintiff that was not subject to the automatic stay, and (2) the remaining overpayment indebtedness owed by the Plaintiff is nondischargeable in bankruptcy.

1. *Valid Right of Recoupment Not Subject to Automatic Stay*

The Court finds that the Defendants properly exercised their right of recoupment against the Plaintiff. The common law doctrine of recoupment "is the setting up of a demand arising from the same transaction as the plaintiffs claim or cause of action, strictly for the purpose of abatement or reduction of such claim." 4 COLLIER ON BANKRUPTCY § 553.03, at 553-15-17. Recoupment "does not require a mutuality of obligation, but rather countervailing claims or demands arising out of the same transaction under which the initial claim was asserted." *See Long Term Disability Plan of Hoffman-LaRoche, Inc. v. Hiler (In re Hiler),* 99 B.R. 238, 241 (Bankr.D.N.J. 1989) The distinction between setoff (a doctrine limited by the Bankruptcy Code) and recoupment is whether the claim arises out of the same or different transactions. *Id.* So long as the creditor's claim arises out of the same transaction as the debtor's, that claim may be offset against the debt owed to the debtor without concern for the limitations the Bankruptcy Code places on the setoff doctrine. *See In re Davidovich,* 901 F.2d 1533, 1537 (10th Cir.1990). Here, the Defendants argue that their recoupment of the overpayment resulting from payments that the Plaintiff received from the SSA arises out of the same contracts (the Policy and Agreement) under which the Plaintiff is asserting her claim for continuation of benefits. The Defendants point to *In re Hiler* for support. The Court finds *Hiler* persuasive and will apply its reasoning to the instant case.

In *Hiler,* a long-term disability plan sought a determination that the plan had a valid right to recoupment against a debtor who received an overpayment of social security benefits, that Such recoupment was not subject to the automatic stay, and that the indebtedness of the debtor to the plan was nondischargeable. *Hiler,* 99 B.R. at 239. The debtor in *Hiler* was declared totally disabled under a disability plan that provided for a reduction in the payment of benefits by contributions received from outside sources such as social security. As in the instant case, the debtor in *Hiler* signed reimbursement agreements agreeing to repay the plan any and all benefits received from social security and to inform the plan of any social security determinations. *Id.* at 240. The debtor received social security benefits, but failed to notify the plan, resulting in an overpayment. *Id.* at 240-241. After the plan learned on its own of the social security award, it began to recoup the overpayment balance due out of the debtor's monthly benefit amount. *Id.* at 241. The debtor subsequently filed for bankruptcy protection.

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The *Hiler* court found that the plan had a valid right to recoupment against the debtor because the plan's claim for reimbursement of the overpayment stemmed from the same contract under which the debtor was seeking benefits. *Id.* at 244. The court found that the debtor must accept the burdens of the contract if he wants to continue to receive the benefits of it.[12] *Id.* ("... in the case where overpayments are made under a contract which provides for recoupment prior to the filing of a bankruptcy petition, the debtor should not be allowed to avoid the burden of reimbursement of such sums by having them discharged in bankruptcy while he continues to receive the benefits under the

same contract. A debtor simply may not assume part of the agreement and reject another.").

As in *Hiler*, the Court finds here that the Defendants' claim for reimbursement for overpayment stems from the same contracts under which the Plaintiff is now asserting her claim for disability benefits (i.e., the Policy and Agreement Concerning Benefits). The contracts provided for recoupment in the event of overpayment. *See* Ex. D-2 at 9 (Policy) and Ex P-2 (Agreement). Indeed, the Debtor expressly agreed under the Agreement to repay in full any overpayment immediately resulting from her receipt of social security benefits, and agreed to notify the Defendants of any social security determinations. *See* Ex. P-2. Moreover, the Plaintiff testified at trial that she understood the provisions meant that the Defendants could recoup form her any overpayment that resulted from her receipt of social security benefits. (N.T. 5/31/06 at 21) The Court sees no reason why the Plaintiff should be able to seek the contract's benefit of continuation of disability benefits without also bearing its burden of reimbursement of an overpayment from other income sources.

The Plaintiff attempts to distinguish *Hiler* by arguing that the instant case is more similar to the facts of *Lee v. Schweiker*, 739 F.2d 870 (3d Cir.1984) and *University Medical Center v. Sullivan (In re University Medical Center)*, 973 F.2d 1065 (3d Cir.1992).[13] The Court finds those cases readily distinguishable.

In *Lee*, the debtor challenged the SSA's withholding of amounts of an alleged overpayment both prior to and after the filing of the bankruptcy petition. The court held that the SSA was not entitled to recoup the overpayments post-petition and that its continued deduction of benefits after the filing violated the automatic stay. In so holding, however, the court specifically

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distinguished cases involving recoupment by insurers post-petition of overpayments under a *contract* providing for such recoupment benefits from cases involving government benefits under a social welfare statute. The Court reasoned that social welfare payments, like social security, are statutory "entitlements" rather than contractual rights. *Id.* at 876. Thus, the court held that once a bankruptcy petition is filed, the income provided by social security benefits should be protected by the automatic stay, and the SSA had no right to recoup previous overpayments made to the debtor. *Id.* at 876. Likewise, the Plaintiff's case is governed not by a social welfare statute but by a *contract* between the parties. As a result, Lee does not apply.

In *University Medical Center*, the Department of Health and Human Services (HITS) sought to recover 1985 pre-petition Medicare provider reimbursement overpayments by withholding payments for 1988 Medicare services rendered post-petition without violating the automatic stay. The governing regulations stated that each provider cost year was subject to an annual audit that followed the submission of a separate cost report for each fiscal year. *Id.* at 1081. The court had to determine whether the 1985 overpayments were part of the same transaction as UMC's claims for 1988 reimbursement. *Id.* at 1081. The court found that the reimbursement payments made for any one year arise from transactions wholly distinct from reimbursement payments made for subsequent years, therefore holding that the claims were not part of a "single integrated transaction so that it would be inequitable for the debtor to enjoy the benefits of that transaction without also meeting its obligations." *Id.* at 1081. As a result, the court held that recoupment violated the automatic stay. *Id.* at 1082. In the instant case, by contrast, there is no such micro-contract situation. Rather, the evidence supports that there was a single, integrated transaction between the parties.[14] Hence, the Court finds the facts of *University Medical Center* also distinguishable from the facts at bar. Consequently, the Court holds that the Defendants had a valid right of recoupment against the Debtor and that such right was not subject to the automatic stay..

2. *Amount of Overpayment*

Finding that the Defendants had a valid right of recoupment, the Court must next determine the amount of overpayment due. The Defendants claim that they are entitled to recoup an overpayment in the amount of $12,251.00. The Plaintiff, on the other hand, claims that no more than $8,947.30 (*see* Joint Pretrial Statement) is owed.[15] The Defendants base their calculation on an estimated

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monthly benefit amount of $306.00,[16] approximately $2,880.00 of which they claim to have already recouped.

The evidence concerning social security payments is as follows. The Plaintiff initially received a lump sum from the SSA of $12,931.00, comprised of $7,458.00 payable to her and $5,473.00 for her minor daughter. (*See* N.T. 5/31/06 at 21, 29, 45). The SSA also paid Plaintiff two monthly payments of $1,007.00 each and one monthly payment of $503.00 to her daughter. Thus, before the Defendants adjusted the Plaintiffs benefits in June 2004 to account for her social security income, the SSA had already paid out to the Plaintiff a total of $15,448.00, consisting of $9,472.00 directly on the Plaintiffs behalf and $5,976.00 on her daughter's behalf. The Plaintiff contends that she ceased receiving a dependant award from the SSA on her daughter's behalf in September 2004.

The Plaintiff argues that the social security benefit payments made for the benefit of her child should not be included in the overpayment amount because her child was living with and being cared for by her father for at least some of the relevant time period. The Policy provides that "[b]enefits provided to your dependents by reason of your disability or retirement will be considered to be provided to you." *See* Ex. D-2 at 8-9. The Plaintiff argues that, because the word "dependent" is not defined in the Policy, the ambiguity must be construed against the Defendants as the drafter of the Policy and in favor of the Plaintiff as the insured.

The pertinent facts are as follows. The Plaintiff admits that she" has had legal custody of her daughter since she was a minor and that there has never been any formal change to that earlier custody order. (N.T. 5/31/06 at 32-34). Still, the Plaintiff testified that at the time she received the social security award, her daughter had been living with her father for approximately nine months. The Plaintiff further testified that she turned over some or all of the first lump sum social security allotted for her child to the father. (N.T. 5/31/06 at 33-35) The Plaintiff testified that, after the initial lump sum payment, the payments for her daughter were sent directly to the father. (N.T. 5/31 /06 at 35). Although legal custody does not appear in dispute, the Plaintiffs testimony concerning her daughter's physical custody with her father as well as other factors such as who was providing financial support to the minor at the time in question raise some ambiguities as to whether the child was the Plaintiffs dependent at the time she received the social security payments. Dependency is not necessarily defined as legal custody, and the Court will not construe it as such where the Policy here is silent on the definition of "dependent." Because the Court finds the term ambiguous, the Court will construe it against the Defendants, as the drafters of the Policy, and in favor of the Plaintiff. *See, e.g., Madison Constr. Co. v. Harleysville Mut. Ins. Co.,* 557 Pa. 595, 735 A.2d 100, 106 (1999) ("Where a provision of a policy is ambiguous, the policy provision is to be construed in favor of the insured and against the insurer, the drafter of the agreement.") As a result, the Court will exclude the amounts paid directly to or on behalf of the Plaintiffs daughter for purposes of calculating the

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overpayment owed by the Plaintiff in this case.

Turning to the calculation, the Court finds that the Plaintiff owes an overpayment of 228.00 to the Defendants. The Court has calculated that

figure as follows. The Plaintiff received initial lump sum payments from the SSA of $7,458.00 payable to her and $5,473.00 for her daughter. Of the $5,473.00 allocated for her daughter, the Plaintiff acknowledges that she owes Defendants $1,636.00 of that lump sum to compensate for a short period of time that her daughter was living with the Plaintiff following her receipt of the benefits before the daughter moved in with her father in September 2003. Hence, the Plaintiff owes the $7,458.00 paid to her *as* well as $1,636,00 allotted for the child, which totals $9,094.00. Due to the ambiguity in the contract, the Court will disallow the remaining $3,837.00 paid on the child's behalf because it is not clear whether the child should be considered a dependent under the Policy once she went to live with her father. To the $9,094.00, the Court adds the two $1,007.00 payments made to Plaintiff by the SSA, for a new total of $11,108.00. Again, the Court will exclude the $503.00 payment made to or on behalf of the child. Out of, the $11,108.00 figure, however, the Court must deduct the $2,880.00 that the Defendants have already recouped by suspending the Plaintiff's benefits from June 2004 through April 2005.[17] That leaves an overpayment of $8,228.00.

3. *Dischargeability*

Finally, the Court must determine whether the overpayment debt is nondischargeable. The Defendants argue that the Plaintiff's overpayment debt is nondischargeable because (1) it was incurred as a result of false pretenses, false representations and/or actual fraud, or, alternatively, (2) because it is not property of the estate. The Court finds that the Defendants have not met their burden under either theory.

As to the first theory, the Defendants argue that the Plaintiffs obligation to return the overpayment is nondischargeable under 11 § 523(a)(2)(A) because it was obtained by false pretenses, false representation, or actual fraud. Specifically, Defendants claim that the Plaintiff engaged in misrepresentation and fraudulent conduct by indicating on the claim form submitted to the Defendants that her symptoms first appeared on March 18, 2001 and not answering truthfully that she had been tested for Lyme Disease in October 2000 and had first been diagnosed with the disease in 1993.

A creditor seeking to except debt from discharge under section 523(a)(2)(A) bears the burden of proving that the debt should not be discharged by a preponderance of the evidence. *See Bank One Columbus, NA v. McDonald*, 177 B.R. 212 (Bankr.E.D.Pa.1994). That burden can be met by proving each of the following elements: (1) that the debtor made representations; (2) that at the time she knew were false; (3) that she made them with the intention and purpose of deceiving the creditor; (4) that the creditor relied on such representations; and (5) that the creditor sustained the alleged loss and damages as a proximate result of the representations having been made. *See In re Weiler*, 244 B.R. 305, 307-308 (Bankr. E.D.Pa.2000). It is well established that the provisions of Section 523 are to be strictly construed against creditors and liberally

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construed in favor of debtors, because of the Bankruptcy purpose of granting debtors a fresh start. *In re Cohn* 54 F.3d 1108 (3d Cir.1995) Here, the Defendants admittedly only "speculate" that the Plaintiff misrepresented the above facts in order to get around the Policy's provision regarding pre-existing conditions. (*See* Defendants' brief, at 23) This is understandable, as an alternative reasonable inference that might be drawn is that the Plaintiff believed that her symptoms at the time she completed the questionnaire were the result of a new infection and not a preexisting condition. As the evidence on this point is thin, and highly inconclusive, the Court concludes that it is insufficient to establish the element of intent which is critical to the Defendants' cause of action. Thus, the Court concludes that the Defendants have failed to meet their burden of persuasion and the overpayment will not be declared non-dischargeable under 11 U.S.C. § 523(a)(2)(A).[18]

As to their second theory, the Defendants argue that the overpayment was never rightfully

the Debtor's property and therefore she has no right to retain it. (*See* Defendants' Brief, at 22). The Defendants again base their argument on *Hiler*. The *Hiler* court held that "in the case where overpayments are made under a contract which provides for recoupment prior to the filing of a bankruptcy petition, the debtor should not be allowed to avoid the reimbursement of such claims by having them discharged in bankruptcy while he continues to receive the benefits under the same contract." *Hiler,* 99 B.R. at 241-42. The *Hiler* court went on to reason:

To allow the [d]ebtor to side-step the [disability plan's] right would unjustly enrich [the debtor's] estate as well as provide a windfall to all the other creditors at the expense of the [p]lan. Discharge in bankruptcy is intended to provide a debtor with a fresh start, not a head start. If [the debtor] were permitted to have the overpayments made to him by the [p]lan discharged in bankruptcy, he would be retaining property that was never his, and in effect be getting a head start. To avoid such a result, [the debtor's] claim to future benefits as property of the estate is subject to the [p]lan's valid right of recoupment. Thus, to the extent that the [p]lan's right to recoupment is not property of the estate, the dollar value of that right is non-dischargeable.

Hiler, 99 B.R. at 244-245.

The Defendants suggest that the above reasoning makes the Debtor's overpayment debt nondischargeable — regardless of whether she has a valid claim to continued benefits under the Policy. A critical aspect of the *Hiler* court's ruling, however, was that a debtor could not have his overpayment obligations discharged *while he continues to receive the benefits under the same contract*. Doing so, said the Court, would give a debtor a "head start." In the instant case, by contrast, this Court has found that the Debtor is not entitled to

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any benefits under the Policy going forward. There being no claim to future benefits, the Defendants have no property in which the Debtor has an interest and from which they can continue to recoup the overpayment.

The debt that remains therefore becomes nondischargeable only if the criteria of § 523(a) have been met. As discussed above, the Defendants have failed to meet their burden under that provision. Consequently, the Court holds that the $,228.00 balance of the overpayment is dischargeable.

An appropriate Order follows.

ORDER

And Now, after trial of this adversary proceeding and for the reasons set forth in the attached Opinion, it is

Ordered, that judgment on the Plaintiffs complaint is granted in favor of the Defendants, and against the Plaintiff. The Defendants' termination of benefits was justified, they have no obligation to provide further benefits to the Plaintiff, and their recoupment of the overpayment of benefits to the Plaintiff was permitted and not in violation of the automatic stay; and it is further:

Ordered, that judgment on the Defendants' counterclaims is granted in favor of the Plaintiff and against the Defendants. The outstanding balance of the benefits overpayment is determined to be $8,228.00, however, it is a general unsecured claim, and the Defendants' request that it be declared non-dischargeable is Denied.

Notes:

1. The Plaintiff testified that she was diagnosed positive for Lyme Disease in June 1993. The Plaintiff testified that, at that time, she became very ill, had what appeared to be a bull's eye rash on the back of her shoulder, and that her symptoms caused her to miss work for two weeks. Following a visit to her family doctor and two weeks of treatment with medication, the Plaintiff returned to work, believing that the disease had been cured.

2. The Plaintiff testified that in October 2000, she began noticing weakness and pain in her wrist. She saw the same family doctor who had earlier diagnosed her with Lyme Disease. Her doctor did blood work and told the Plaintiff that her pains were job-related. The Plaintiff then went on light duty at work and engaged in physical therapy with the company doctor for approximately three months. Her pain continued to get worse until the point that she claims she was not able to lift anything with her right hand and arm. She also complained of chronic fatigue. She returned to her family doctor in March 2001, at which time she was told that she had tested positive for Lyme Disease the previous October but he had failed to inform her. She then began a course of antibiotics to treat her symptoms.

3. Although the Defendants cite to all three of the above provisions in their Counterclaims, their argument is limited to 11 U.S.C. § 523(a)(2)(A). Accordingly, the Court will limit its analysis to that provision as well.

4. The testimony indicates that the Defendants in fact began suspending Plaintiff's benefits in June — not July — of 2004. The Plaintiff calculates the $799.00 figure by deducting the $986.00 social security payment paid to the Plaintiff (excluding payments to her daughter) from the $1,785.00 monthly disability amount that she was receiving from the Defendants.

5. Although the Defendants initially granted the Plaintiff's claim, they continued to investigate the specifics of her claim. Included in that investigation were a number of medical examinations to determine whether the Plaintiff did in fact suffer from Lyme Disease or some other "special condition" such as fibromyalgia or depression, conditions for which the Policy provided limited coverage (up to a maximum disability period of 12 months) (*see* Ex. D-2 at 6). The evidence presented is inconclusive as to whether fibromyalgia or any other special condition was the cause of the Plaintiff's symptoms. Consequently, the Court will refrain from disturbing the Defendants' initial finding that the Plaintiff suffered from a disability covered under the Policy during the initial 24 month period, and will limit its analysis to whether Plaintiff has proven a disability in the period following the initial 24 months.

6. The Plaintiff argues that because Dr. Reeder did not personally examine her, his testimony is inherently less credible than that of Dr. Fabulian who did examine her. The Court disagrees. Not only is a personal examination not required by Fed.R.Evid. 703, *see In re Paoli R.R. Yard PCB Litigation*, 35 F.3d 717, 762 (3d Cir.1994) ("evaluation of the patient's medical records, like the performance of a physical examination, is a reliable method of concluding that a patient is ill even in the absence of a physical evaluation.")., the Court finds that Dr. Reeder was able to effectively evaluate the Plaintiff's medical condition absent a physical exam.

7. Dr. Fabulian disagrees with the CDC literature stating a positive IgM response without a positive IgG response is generally of limited diagnostic value if the specimen was obtained more than one month after the disease onset, and testified that what he has seen in his practice does not conform to that conclusion. (N.T. 5/31/06 at 77-78)

8. The Court finds that the first and third *Crisomia* factors have been satisfied; i.e., both Dr. Fabulian and Dr. Reeder qualify as experts and both have proffered relevant opinions. Thus, the Court limits its discussion here to the second factor requiring reliability.

9. Moreover, even if Dr. Fabulian had followed the proper testing sequence, a positive Western Blot test taken in October 2000 does not compel the conclusion that the Plaintiff is still positive or that she is disabled by the disease now six years later.

10. Dr. Reeder further opined that it is more probable that the Plaintiff's symptoms (such as chronic pain, joint pain, fatigue and poor sleep) are caused by depression or fibromyalgia than by Lyme disease. (N.T. 5/31/06 at 90). Again, the Court finds that the evidence before it is insufficient for it to rule on whether Plaintiff's symptoms are caused by fibromyalgia or any other "special condition" under the Policy. Suffice it to say, however, that the Plaintiff has not met her burden of proving that she was totally disabled by any ailment that she may be suffering from.

11. The Court further notes that it need not adopt the collateral determination by the SSA awarding benefits as reliable evidence that the Plaintiff is "totally disabled" under the Policy. Although the Third Circuit has held that a determination by another government agency that a claimant is disabled is entitled to substantial weight before the Secretary of Health and Human Services, *see Somenski v. Barnhart*, 2006 WL 494997, at *9 (E.D.Pa. Feb.28, 2006) (citing *Kane v. Heckler*, 776 F.2d 1130, 1135 (3d Cir.1985)), that holding is not binding on the issue before this Court, particularly considering that

the Policy at issue and the SSA operate under different standards. *See, e.g., Zimbalist v. Richardson,* 334 F.Supp. 1350, 1355 (E.D.N.Y.1971). *Compare Lewis v. Califano,* 616 F.2d 73 (3d Cir. 1980) (holding in a case where the court was reviewing a disability determination by the Secretary of Health, Education and Welfare that the agency finding must be accepted as conclusive if supported by substantial evidence). Rather, the Court must evaluate the facts and evidence before it. Based on those, the Court finds that the Plaintiff has failed to prove total disability.

12. The *Hiler* court observed that a majority of bankruptcy courts have allowed creditors to recoup amounts owed by the debtor for prepetition debts from payments to debtor for post-petition earnings under one of two theories. *Hiler,* 99 B.R. at 243. The first is an application of the concept of executory contracts in bankruptcy which determines that a debtor cannot accept the benefits of a contract without also accepting its intrinsic burdens. *Id.* Under the second theory, courts have found that the interest of a creditor asserting a valid right of recoupment is not property of the debtor's estate. *Id.*

13. The Plaintiff also claims that *Hiler* is distinguishable because the Defendants in the instant case breached the underlying contract by making small miscalculations of the overpayment such as erroneously including attorney's fees in the overpayment amount, and therefore the contract lacked mutuality. The Court finds this argument entirely unpersuasive for a number of reasons. One, even assuming arguendo that a breach defeated mutuality, the Defendants' breaches were non-material. Two, the Defendants subsequently cured all of their miscalculations. And, three, to the extent that there was a material breach, the Plaintiff was the offender, as she breached the Agreement by failing to repay the overpayment as agreed despite acknowledging that certain amounts were due.

14. The Court also finds misplaced the Plaintiff's reliance on a series of 9th Circuit decisions — which rely on a more liberal "logical relationship" standard to determine whether claims arise out of the same transaction, a standard that has been explicitly rejected by the Third Circuit — as well as others addressing the issue of whether separate transactions were involved. *See, e.g., In re TLC Hospitals, Inc.,* 224 F.3d 1008 (9th Cir.2000); *In re Madigan,* 270 B.R. 749 (9th Cir. BAP 2001); *In re B & L Oil Co.,* 782 F.2d 155 (10th Cir.1986). Indisputably, what is present here is a single contract for disability benefits; thus, the same transaction requirement for recoupment has been satisfied.

15. At a minimum, Plaintiff admits that this amount is owed. By failing to repay the amount, as contractually provided for, the Plaintiff breached the Agreement. Moreover, to the extent that the Plaintiff failed to promptly notify the Defendants of her receipt of social security benefits, the Court finds that she additionally breached her obligations under the Agreement.

16. The Defendants calculate the $306.00 amount by deducting the $986.00 social security payment to the Plaintiff, as well as the $493.00 payment to the Plaintiff's daughter, from the $1,785.00 disability benefit amount. The Plaintiff's calculation of $799.00, by contrast, are based on only a deduction of her social security amount and exclude her daughter's payments.

17. These figures already take into account the deduction of legal fees that the Defendants erroneously included in their initial estimate.

18. Notably, it is at a minimum, inconsistent for the Defendants to argue that the Plaintiff fraudulently failed to disclose a pre-existing condition (i.e., lyme disease) when they insist that the plaintiff does not suffer from lyme disease in the first place. The Court notes also that in their counterclaim the Defendants also assert that the overpayment is non-dischargeable under 11 U.S.C. § 523(a)(2)(B). They do not address this issue in their post-trial submission, but their pleading indicates that their position is based on the Plaintiff's alleged failure to disclose her receipt of social security benefits. The Defendants' pleading fails to recite what "writing" was involved with the alleged non-disclosure such as might implicate the provisions of 11 U.S.C. § 523(a)(2)(B) and there does not seem to be any. This cause of action appears to fail on that basis alone.

In re: JOSEPH WARREN TERRY, Debtor.
JOSEPH WARREN TERRY, Plaintiff,
v.
STANDARD INSURANCE COMPANY, Defendant.
Case No. 08-43123
No. 09-3031

United States Bankruptcy Court For The
Western District Of Missouri
Southwest Division
July 21, 2010

MEMORANDUM OPINION

HONORABLE JERRY W. VENTERS, JUDGE

The pending issue in this adversary proceeding is whether Standard Insurance Company may exercise the equitable right of recoupment to recover $45,316.54 in alleged benefit "overpayments" from the Debtor's future disability benefits.

One week before Joseph Terry filed a Chapter 7 bankruptcy petition, the Defendant, Standard Insurance Company ("Standard"), recovered from Terry $45,316.54 in "overpayments" that had been made to Terry under a long term disability insurance policy. The Chapter 7 trustee ("Trustee") asserted that the payment to Standard was a preference under 11 U.S.C. § 547 and demanded that Standard turn the money over to him. Standard did so and then initiated steps to recoup that amount from the Debtor's post-bankruptcy disability benefits.

The Debtor then filed this adversary proceeding to: 1) obtain turnover of the money obtained by the Trustee from Standard, which money the Debtor claimed as exempt; and 2) obtain a declaratory judgment that Standard is not entitled to reduce Terry's future benefit payments to recoup the $45,316.54. On March 23, 2010, the Court ruled in the main case that the Debtor could not claim as exempt the money that he had paid to Standard, rendering the first issue in the adversary complaint moot. The sole remaining issue is whether Standard may exercise the equitable right of recoupment post-bankruptcy to recover the money that it turned over to the Trustee.

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For the reasons stated below, the Court holds that Standard may not recoup the $45,316.54 from Terry's future disability payments and that Standard is limited to filing a general unsecured claim under 11 U.S.C. § 502(h) against the Debtor's bankruptcy estate.

BACKGROUND

The Debtor became disabled and unable to work on or about December 5, 2005. Shortly thereafter, he filed a claim under a long term disability insurance policy ("Policy") issued by Standard Insurance Company.[1] He began receiving benefits under the Policy in August 2006.

Germanely, the Policy provides that benefits payable to a disabled employee will be reduced on a dollar-for-dollar basis by any benefits a disabled employee receives under the Social Security Act. The Policy requires disabled employees to actively pursue the recovery of all available Social Security benefits, and in connection with his claim for benefits under the Policy, the Debtor authorized Standard (through an agent) to automatically withdraw from his bank account any retroactive Social Security disability benefits received by the Debtor. The amount withdrawn would be used to satisfy the resulting "overpayment" obligation.

On July 17, 2008, the Debtor received a $45,316.54 lump-sum award of Social Security disability benefits retroactive to June 1, 2006. Consistent with his obligations under the Policy, Standard withdrew that amount from the Debtor's bank account on July 24, 2008.[2] Terry filed a Chapter 7 bankruptcy petition one week later, on July 31, 2008.

On April 20, 2009, the Trustee sent a letter to Standard demanding that it turn over the $45,316.54 received from the Debtor on the basis that it was a preferential payment pursuant to 11 U.S.C. § 547. Standard complied, with apparently no resistance, and then began reducing its monthly payment obligations to Debtor under the Policy to recover the funds lost to the Trustee's § 547 demand. Standard ceased these reductions pending resolution of the parties' dispute and repaid to the Debtor all amounts previously withheld, when the Court commented that such reductions might be in violation of the automatic stay.

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This adversary proceeding ensued.

DISCUSSION

The parties frame this dispute in terms of whether Standard has met the common law requirements for exercising its equitable right of recoupment to decrease future payments owed to the Debtor under the Policy. Recoupment is an equitable doctrine that operates similarly to set-off, permitting a defendant to reduce or extinguish a plaintiff's claim by reason of a claim the defendant has against the plaintiff. Recoupment differs from set-off, though, in that recoupment requires that the offsetting claims must have arisen out of the same transaction.[3] And, as is pertinent to its application in bankruptcy, recoupment does not require mutuality with respect to the petition date. In other words, a pre-petition obligation can be "recouped" from a post-petition obligation; the doctrine of set-off requires that both obligations arise either pre-petition or post-petition.

As Standard points out, recoupment is routinely asserted in bankruptcy cases by insurance providers as a defense against an insured's claim for post-petition insurance payments where the insured-debtor owes the insurance provider for pre-petition overpayments under the insurance contract.[4] This case, Standard argues, is no different from those cases, and therefore, it should be permitted to exercise its right of recoupment with regard to future payments due the Debtor under the Policy. The Debtor argues, somewhat obliquely, that the Court should not permit Standard to exercise its equitable right of recoupment because the equities weigh against Standard. Specifically, the Debtor contends that Standard breached its (alleged) fiduciary duty to the Debtor by not more vigorously defending against the Trustee's preference demand. Both of these arguments, however, fail to appreciate the impact the Trustee's avoidance of the Debtor's payment to Standard has on the recoupment analysis here.

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Standard's claim in this case is unlike the claims asserted in moust insurance recoupment cases. In most cases, and possibly all such cases, based on the Court's research, the insurance company has not recovered the overpayments from the debtor pre-petition, nor has it paid over any recovered overpayments to the Trustee; rather, it is simply attempting to recover the overpayments from the debtor's future benefit payments. In contrast, here, Standard's claim against the Debtor for the overpayments was satisfied when Terry repaid the $45,316.54 one week before he filed his bankruptcy petition. Accordingly, Standard's claim against the Debtor in this case exists only through the operation of11 U.S.C. § 502(h)-the Bankruptcy Code section that gives the transferee of an avoided preference a claim against the estate, *not against the Debtor*. Therefore, the dispositive question before the Court is whether a claim under § 502(h) can be asserted against a debtor and satisfied through the doctrine of recoupment.

Section 502(h) provides:

> "A claim arising... under section... 550... *shall be determined, and shall be allowed under subsection (a), (b), or (c) ofthis section... the same as ifsuch claim had arisen before the date of the filing of the petition."*[5]

Standard contends that § 502(h) permits a claim for recoupment because, as several courts have opined, a § 502(h) claim "takes on the characteristics of the original claim [paid by the preferential payment]."[6] The cases Standard cites for this proposition, however, do not involve claims for recoupment. And, more important, permitting a claim for recoupment under § 502(h) conflicts with the plain language of the statute, which on its face precludes a claim for recoupment, inasmuch as the statute states that a claim resulting from a trustee's avoidance of a transfer "shall

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be determined, and shall be allowed under [§ 502] (a), (b), or (c)."[7] A claim for recoupment is not "allowed" under § 502; rather, it exists outside the Bankruptcy Code by operation of common law.[8]

This interpretation of § 502(h) is confirmed, and likely mandated, by *U.S. Postal Service v. Dewey Freight System., Inc.*, [9] wherein the Eighth Circuit Court of Appeals held that 11 U.S.C. § 502(g)(1), which contains the same operative language as § 502(h), precludes a claim for recoupment.[10] Section 502(g)(1) states: "A claim arising from the rejection, under section 365 of this title... of an executory contract... *shall be determined, and shall be allowed under subsection (a), (b), or (c) of this section... the same as if such claim had arisen before the date of the filing of the petition."*[11]

In *U.S. Postal Service*, the U.S. Postal Service sought to reduce post-petition payments owed to the debtor-in-possession, Dewey Freight System, Inc., by the amount of damages incurred by the U.S. Postal Service for Dewey's post-petition non-performance and ultimate rejection of the contract under 11 U.S.C. § 365. In other words, the U.S. Postal Service sought to "recoup" the damages caused by the debtor-in-possession's actions taken under § 365 by reducing its future payment obligations under the contract. The Eighth Circuit prohibited this, holding that under § 502(g)(1), the U.S. Postal Service's claim "must be administered through bankruptcy and receive a general unsecured creditor's priority."[12]

Although the context under which the claim arose in *U.S. Postal Service* -contract rejection under § 365-and this case-preferential transfer avoidance and recovery under § 547 and § 550-differ, the circumstances are analogous, and more important, the language of the Code sections

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addressing the allowance of those claims is identical. Therefore, the Court finds that the Eighth Circuit's prohibition of recoupment under § 502(g)(1) applies equally to prohibit the recoupment of claims arising under § 502(h).

Finally, the Court notes that this interpretation of § 502(h) is consistent with the Eighth Circuit's general hesitancy to apply recoupment in bankruptcy cases. "A fundamental tenet of bankruptcy law is that a petition for bankruptcy operates as a 'cleavage' in time. Once a petition is filed, debts that arose before the petition may not be satisfied through post-petition transactions.... Any recoupment exception to this general principle should be narrowly construed."[13] And it squares with the purpose of the avoidance provisions in the Bankruptcy Code. The avoidance of a preferential payment advances the goal of equal distribution to creditors, [14] so it would be inimical to that purpose to interpret § 502(h) in such a way that would permit that creditor to

once again obtain preference over other creditors by use of the doctrine of recoupment.

CONCLUSION

For the reasons stated above, the Court holds that Standard Insurance Company may not recoup the $45,316.54 from the Debtor's future disability payments and that it is limited to filing a general unsecured claim under 11 U.S.C. § 502(h) against the Debtor's bankruptcy estate. The Debtor's request for a declaratory judgment will, therefore, be granted.

A separate judgment will be entered contemporaneously with this memorandum opinion.

ENTERED this 21st day of July, 2010.

HONORABLE JERRY W. VENTERS, UNITED STATES BANKRUPTCY JUDGE

A copy of the foregoing was mailed conventionally or electronically to: Norman E. Rouse Seth Albin Kevin Checkett

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Notes:

[1.] The policy was a benefit of the Debtor's employment with the State of Missouri.

[2.] Although the withdrawal was automatic, pursuant to a pre-authorization the Debtor executed at the time he made a claim under the Policy, the Court has held that the transfer was voluntary.

[3.] *See U.S. Postal Serv. v. Dewey Freight Sys., Inc.*, 31 F.3d 620, 623 (8th Cir. 1994) *(citing In re Univ. Med. Ctr.*, 973 F.2d 1065, 1081 (3rd Cir. 1992) ("[B]oth debts must arise out of a single integrated transaction so that it would be inequitable for the debtor to enjoy the benefits of that transaction without also meeting its obligations.")).

[4.] *See, e.g., In re Caldwell*, 350 B.R. 182, 195-197 (Bankr. E.D. Pa. 2006); *In re Powell*, 284 B.R. 573 (Bankr. D. Md. 2002); *In re Lord*, 284 B.R. 179 (Bankr. D. Mass. 2002).

[5.] 11 U.S.C. § 502(h) (emphasis added).

[6.] Defendant's Reply Brief (Doc. # 30), at p. 4 citing: *Busseto Foods, Inc. v. Charles Laizure (Matter of Charles Laizure)*, 548 F.3d 693, 697 (9th Cir. 2008) (holding that claim arising under § 502(h) as a result of creditor's disgorgement of a preferential payment made on a nondischargeable debt is likewise nondischargeable); *The Official Committee of Unsecured Creditors of Enron Corp. v. Martin (In re Enron Creditors Recovery Corp.)*, 376 B.R. 442, 465 (Bankr. S.D. N.Y. 2007) (involving general unsecured claim); and *Fleet National Bank v. Gray (In re Bankvest Capital Corp.)*, 375 F.3d 51, 67 (1st Cir. 2004) (involving secured claim). *See also, In re Hackney*, 93 B.R. 213, 217-218 (Bankr. N.D. Cal. 1988)("[T]he claim arising from the avoidance of a transfer under 11 U.S.C § 502(h) is a claim against the debtor, not just a claim against the estate.").

[7.] 11 U.S.C. § 502(h).

[8.] *See U.S. Postal Serv.*, 31 F.3d at 624 (8th Cir. 1994). *See also Matter of Gaither*, 200 B.R. 847, 850 (Bankr. S.D. Ohio. 1996)("Because recoupment only reduces a debt, rather than constituting an independent basis for a debt, it is not a claim in bankruptcy.").

[9.] *U.S. Postal Serv.*, 31 F.3d at 624.

[10.] *Id.* at 623-25.

[11.] 11 U.S.C. § 502(g)(1) (emphasis added).

[12.] Id. at 625.

[13.] *Idat* 623 (citing *In re B & L Oil Co.*, 782 F.2d 155, 158 (10th Cir. 1986)).

[14.] *In re Smith*, 966 F.2d 1527, 1535 (7th Cir. 1992)("[T]he avoidance power promotes the 'prime bankruptcy policy of equality of distribution among creditors' by ensuring that all creditors of the same class will receive the same pro rata share of the debtor's estate")(quoting H.R.Rep. No. 595, 95th Cong., 2d Sess. 177-78 (1978)).

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359 B.R. 859
In re Dale/Brenda IRBY, Debtors.
Brenda Irby, Plaintiff,
v.
Preferred Credit, Defendant.
No. 06-3536.
United States Bankruptcy Court, N.D. Ohio.
January 30, 2007.

Donald R. Harris, Sandusky, OH, for plaintiff.

Curtis L. Tuggle, Thompson Hine LLP, Cleveland, OH, for defendant.

DECISION AND ORDER

RICHARD L. SPEER, Bankruptcy Judge.

This cause is before the Court on the Motion of the Defendant/Creditor, Preferred

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Credit, to Dismiss; and the Plaintiffs Memorandum in Opposition thereto. Having now had the opportunity to review the arguments of the Parties, the Court, for the reasons now explained, finds that the Defendant's Motion should be Granted.

DISCUSSION

The instant proceeding was commenced when the Plaintiff filed a Complaint in this Court for "Injunctive Relief and Monetary Damages and Punitive Damages." (Doc. No. 1). As the basis for her Complaint, the Plaintiff stated:

Defendant has continued to report to credit reporting agencies or has failed to update its listing with the credit reporting agencies for Plaintiffs past due payments not withstanding [sic] an order of discharge being granted by the United States Bankruptcy Court on July 25, 2002. Defendant was properly notified of the discharge. This action or failure to act was willful and malicious and continues to the present time.

(Doc. No. 1, at pg. 2). Based on these allegations, the Plaintiff, in her Complaint, maintains that the Defendant violated § 524 (the discharge injunction) and § 727 (discharge) of the Bankruptcy Code. *Id.* at pg. 4. In response, the Defendant filed the instant Motion to Dismiss in accordance with FED.R.BANK.P. 7012(b) for failure to state a claim upon which relief may be granted. (Doc. No. 4).

Under FED.R.CIV.P. 12(b)(6), made applicable to this proceeding by Bankruptcy Rule 7012(b), a Motion to Dismiss for failure to state a claim can only be entered when it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief. *Hartford Fire Ins. Co. v. California,* 509 U.S. 764, 811, 113 S.Ct. 2891, 2917, 125 L.Ed.2d 612 (1993). For this standard, all factual allegations must be accepted as true, and where an allegation is capable of more than one inference, it must be construed in the plaintiffs favor. *Pilc-Coal Co. v. Big Rivers Elec. Corp.,* 200 F.3d 884, 886 fn. 2 (6th Cir.2000). However, while the standard for a Rule 12(b)(6) motion is to be read quite liberally in favor of the plaintiff, the plaintiff is not permitted to rest on bare assertions of unsupported legal conclusions. *Scheid v. Fanny Farmer Candy Shops, Inc.,* 859 F.2d 434, 436 (6th Cir.1988).

In support of its burden, the Defendant cites to this Court's recent decision in *Irby v. Fashion Bug (In re Irby),* 337 B.R. 293 (Bankr.N.D.Ohio 2005). In *Fashion Bug,* which involved this very same Plaintiff, this Court held that allegations regarding a creditor's failure to take affirmative steps to ensure that a prepetition discharged debt was removed from the debtor's credit report does

not, alone, support a violation of the discharge injunction of § 524. Instead, this Court found that, with respect to the issue of credit reporting, in order to maintain a complaint for a violation of the discharge injunction, the reporting of the debt must be coupled with other overt acts by the creditor to collect on the debt.

As compared to the *Fashion Bug* matter, the issue of law and factual circumstances presented in this proceeding are, for all practicable purposes, indistinguishable. Not only is the same Plaintiff involved, but both this case and the *Fashion Bug* matter set forth the same cause of action: an alleged violation of the discharge injunction of § 524. But of particular importance, the allegations made by the Plaintiff in her complaint in the *Fashion Bug* matter read almost verbatim to those made in this particular case. Specifically, it is observed that in the *Fashion Bug* matter, the Plaintiff stated as the basis for her complaint:

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Defendants have continued to report that there is a balance owed on the debt that was discharged by this Court on July 25, 2002. This action is willful and malicious and continues to the present time.

(Case No. 04-3430, Doc. No. 1, at pg. 2). Based then upon this nearly exact identity in the applicable facts and law between this case and that of *Fashion Bug*, the doctrine of *stare decisis* prescribes that the Plaintiff come forth with a viable reason as to why the Defendant's Motion to Dismiss lacks merit.

The doctrine of *stare decisis* holds that a court, in the absence of any intervening change in the law, is to abide by a principle of law laid down in a past decision to a present case having substantially the same facts. *In re Vargas*, 342 B.R. 762, 764 (Bankr.N.D.Ohio 2006). The doctrine of *stare decisis*, however, is not absolute, allowing courts the flexibility to reexamine their past decisions. Yet, deviation from a legal holding set forth in a prior decision is always the strong exception, not the norm, given the doctrine's strong policy underpinnings: it promotes evenhandedness and predictability, thereby contributing to the actual and perceived integrity of the judicial process. *Id.* at 764-65, *citing Payne v. Tennessee*, 501 U.S. 808, 827-28, 111 S.Ct. 2597, 115 L.Ed.2d 720 (1991). In this way, the Supreme Court has stated that before a court should part from a rule of law set down in a past decision, a "special justification" is needed. *Patterson v. McLean Credit Union*, 491 U.S. 164, 109 S.Ct. 2363, 105 L.Ed.2d 132 (1989). Common examples of the type of "special justification" that will warrant a court departing from its past precedent include, the governing decision is unworkable or badly reasoned, or new and very persuasive arguments are presented that were not previously considered. *In re Vargas*, 342 B.R. at 765.

For such a justification, the Plaintiffs arguments fall around the "fresh-start" policy of the Bankruptcy Code, and how the continued reporting of a discharged debt would frustrate this important bankruptcy policy. In the words of Plaintiffs counsel:

Credit reporting has become a crucial aspect of the business life. It has been used as a `powerful' collection tool of creditors for many years. The nature of the report and whether or not a balance is owed on the account is a valid aspect of the collection process. Merely listing the account on a credit report is not harmful. What is harmful, and is the effective nature of the credit report is listing a balance and listing the fact that the account remains unpaid.

(Doc. No. 6, at pg. 2).

At its most basic level, the Court cannot disagree with the Plaintiffs position; the continued reporting of a discharged obligation on a debtor's credit report carries with it the significant potential to negatively affect a debtor's ability to obtain future credit. Yet, to the extent that this may be construed as interfering with a debtor's fresh-start, such a negative consequence does not necessarily couple with the outcome desired by the Plaintiff. To begin with, the Bankruptcy Code is replete with

situations in which a debtor's need for a fresh-start is subordinated to other policy concerns. *See, e.g.*, § 362(c) (relief from the automatic stay); § 523(a) (nondischargeable debts); § 727(a) (denial of discharge).

Similarly, the fresh-start policy inherent in the Bankruptcy Code was never meant to eliminate all the negative consequences that may flow from a debtor's prior financial difficulties. In fact, it is assumed that a debtor's creditworthiness

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will suffer as a result of bankruptcy. In this way, the Code's fresh-start policy looks primarily to the direct burden surrounding the debtor's financial obligations, as opposed to the peripheral consequences attendant with a bankruptcy filing, with the Supreme Court of the United States having described bankruptcy's fresh-start as "a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of preexisting debt." *Brown v. Felsen*, 442 U.S. 127, 128, 99 S.Ct. 2205, 60 L.Ed.2d 767 (1979). Thus, trying to form a close fit between credit reporting and the Code's fresh-start policy seems somewhat ostentatious as it would appear to rest on the improper foundation that bankruptcy comes without any lasting stigma. *See Caldwell v. Continental American Ins. Co. (In re Caldwell)*, 350 B.R. 182, 200 (Bankr.E.D.Pa.2006) (the Code's fresh-start policy does not entail a head start).

Even these concerns aside, the Plaintiffs equitable argument does not address the substance giving rise to this Court's holding in *Fashion Bug*: The application of the statutory text of § 524, against which the Debtor's equitable argument regarding the fresh-start policy of the Bankruptcy Code cannot take precedence. As has been often said in one form or another: the general grant of equitable power to the bankruptcy courts, as contained in § 105(a), cannot trump specific provisions of the Bankruptcy Code, and must be exercised within the parameters of the Code itself. *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 206, 108 S.Ct. 963, 99 L.Ed.2d 169 (1988) ("Whatever equitable powers remain in the bankruptcy courts must and can only be exercised within the confines of the Bankruptcy Code."); *ATD Corp. v. Advantage Packaging, Inc. (In re ATD Corp.)*, 352 F.3d 1062, 1066 (6th Cir.2003) (the bankruptcy court's broad equitable powers are constrained to actions or determinations that are not inconsistent with the Bankruptcy Code).

Therefore, for all these reasons, the Court is not persuaded that the decision reached in *Irby v. Fashion Bug (In re Irby)* was improperly decided. Consequently, with the facts and circumstances of this case closely aligning with those in *Fashion Bug*, the Court's decision therein, finding no violation of the discharge injunction of § 524 when a discharged debt remains on a debtor's credit report, is equally applicable in this matter. As such, the Court holds that, for purposes of FED. R.BANK.P. 7012, the Plaintiff has failed to state a claim upon which relief can be granted.

In reaching the conclusions found herein, the Court has considered all of the evidence, exhibits and arguments of counsel, regardless of whether or not they are specifically referred to in this Decision.

Accordingly, it is

ORDERED that the Motion of the Defendant, Preferred Credit, to Dismiss, be, and is hereby, GRANTED.

IT IS FURTHER ORDERED that this adversary proceeding is hereby DISMISSED.

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300 B.R. 669
In the Matter of Francisco Jose DELICRUZ and Vicki Lynn Delicruz, Debtors.
No. 01-52173-PJS.
United States Bankruptcy Court, E.D. Michigan, Southern Division.
October 31, 2003.
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Mark E. Bredow, Warren, MI, M. Jill Weinger, Royal Oak, MI, for Debtors.

Sheila Solomon, Royal Oak, MI, trustee.

OPINION GRANTING DEBTORS' MOTION TO REOPEN ESTATE TO ADD OMITTED CREDITOR

PHILLIP J. SHEFFERLY, Bankruptcy Judge.

I. Introduction

DaimlerChrysler is Mr. Delicruz's employer. Mr. Delicruz was on extended sick leave from November, 1993 to August, 2001. During this time, he received sickness and accident benefits and extended disability benefits. He also received Social Security benefits, which overlapped the extended disability benefits. The collective bargaining agreement contained a Life, Disability and Health Care Benefits Program ("Plan"). According to the Plan, the sickness and accident and extended disability benefits were to be reduced by any

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benefits paid under Social Security. Mr. Delicruz was cleared by his doctor to return to work in August, 2000. However, DaimlerChrysler did not immediately reinstate Mr. Delicruz. After Mr. Delicruz filed a grievance, the parties reached a negotiated disposition, and Mr. Delicruz returned to work on August 27, 2001.

Meanwhile, Mr. and Mrs. Delicruz filed a chapter 7 petition for relief on June 21, 2001. The Debtors neither scheduled a debt to DaimlerChrysler nor listed DaimlerChrysler on the matrix. The order of discharge was entered September 20, 2001. The trustee submitted a report of no assets, and the case was closed on October 15, 2001.

After Mr. Delicruz returned to work, DaimlerChrysler began withholding funds from his paycheck to recover an alleged overpayment of disability benefits because Mr. Delicruz's Social Security benefits had overlapped his benefits under the Plan. The Debtors filed a motion to reopen their bankruptcy case to add DaimlerChrysler as an omitted creditor. The Debtors argue that the matter was "settled" as part of the disposition of the grievance for Mr. Delicruz's reinstatement. Alternatively, the Debtors contend that any overpayment has since been recovered in full by DaimlerChrysler, and if not, they seek to reopen the case to have the debt declared discharged. DaimlerChrysler objects to the motion, asserting that the overpayment was not included in the grievance settlement, the overpaid benefits have not been repaid in full, and, further, that the balance owing is not a "debt" under 11 U.S.C. § 101(12), and thus was not subject to the order of discharge under § 524(a). The parties tried to reach an agreement on the amount of the overpayment, as well as the amount withheld, but could agree on neither. The Court held an evidentiary hearing on this matter. This Court has jurisdiction pursuant to 28 U.S.C. §§ 1334(a) and 157(a). This is a core proceeding under 28 U.S.C. § 157(b)(2)(A), (I), and (O). For the reasons set forth below, the Court grants the motion.

II. The Evidentiary Hearing

Oral argument on the Debtors' motion was originally set for May 2, 2003. The parties reported that they anticipated resolving the matter, and asked for a two-month adjournment, which the Court granted. The Debtors also requested additional time to file a reply to a recently filed brief by DaimlerChrysler that argued the overpayment was not a "debt" under the Bankruptcy Code. In addition, the Debtors noted that DaimlerChrysler continued to take deductions from Mr. Delicruz's paycheck. The Debtors asked for a stipulation that the deductions would stop, pending the Court's decision on the motion to reopen. DaimlerChrysler agreed to suspend the ongoing deductions, although that was never set forth in an order of the Court.

The adjourned hearing was held July 9, 2003. At that time, the Debtors reported on the record that the parties had made significant progress in resolving the matter. Both parties expected that the matter would be settled, and thus did not anticipate the need for an evidentiary hearing. The Debtors noted that DaimlerChrysler continued to withhold funds from Mr. Delicruz's paycheck and, if the matter was not resolved, reserved the right to bring a contempt motion. DaimlerChrysler's counsel was unaware of the continued withholding, which he explained was an oversight, and not deliberate. He assured the Court and the Debtors that it would cease forthwith. The Court set a second adjourned date for August 6, 2003, in the event the matter did not settle.

On August 6, the parties initially reported that they were still in negotiations.

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After a short recess, they stated that they had reached an impasse and the hearing needed to go forward. Three witnesses testified at the evidentiary hearing: Mr. and Mrs. Delicruz, and Ms. Eulene Burnside, an employee of Esis, which is the Plan administrator.

Although she did not work for Esis or its predecessor during the time that Mr. Delicruz was disabled and thus did not deal with the Debtors directly, Ms. Burnside gave helpful background information about how disability benefits are awarded, and how Social Security benefits are offset against those benefits under the Plan. According to her testimony, sickness and accident benefits are short term benefits, which are awarded in the first year of a disability. On the other hand, an employee is eligible to receive extended disability benefits only after one year of being disabled. Employees are directed to apply for Social Security benefits while they are receiving sickness and accident benefits. Social Security benefits are not awarded until the fifth month of disability. Employees may appeal an initial denial of Social Security benefits and, if successful, are entitled to a retroactive award.

According to Ms. Burnside, the letter of award from the Social Security Administration is critical to determining the amount of benefits an employee and their dependents are entitled to receive, including the amount of any retroactive award. The letter contains the most accurate and comprehensive information. However, she explained that Esis never received a copy of Mr. Delicruz's award letter despite having requested it. Therefore, Esis could not verify the exact amount of benefits that Mr. Delicruz was entitled to receive from Social Security.

Portions of the Plan were introduced into evidence as Exhibit 1. The Plan details the process for employees to apply for Social Security benefits, including challenging an initial disallowance. (Creditor's Ex. 1 at 234.) In the event an award is made, Ms. Burnside testified that Esis relies on the following general provision to obtain repayment of any duplicate payments that were made under the Plan:

Upon receipt of a notice of award of [Social Security disability insurance benefits], any overpayment of Sickness and Accident (or Extended Disability) benefits that results from a retroactive award of [Social Security disability insurance benefits] shall be repaid. The amount of the overpayment will be based on the actual amount of such award for the coinciding period

of Sickness and Accident (or Extended Disability) benefit payments.

(*Id.* at 235.)

If any overpayment is not repaid, the Plan permits DaimlerChrysler to recover the overpayment by offsetting disability benefits. Ms. Burnside explained that the following paragraph authorizes the offsetting of short term disability benefits:

Reduction of Benefit. Weekly benefits will be reduced by ... the weekly equivalent of any Disability Insurance benefits ... to which the employee is entitled for the same period under the Federal Social Security Act or any future legislation providing similar benefits, ... and for purposes of such reduction, the weekly equivalent of benefits paid on a monthly basis is computed by dividing the monthly benefit rate by 4.33.

(*Id.* at 88-89.) For authority to recover the overpayment against long term benefits, Ms. Burnside pointed to the following provision:

The Insurance Company may require each applicant or recipient of extended disability benefits to certify or furnish

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verification of the amount of his income from sources listed in B. above, and the amount of any extended disability benefit payments in excess of the amount that should have been paid, after reduction for such other benefits, may be deducted from future extended disability benefits.

(*Id.* at 94.)

Ms. Burnside also stated that these same provisions were outlined in a letter dated September 27, 1999 from DaimlerChrysler to the Union. (Creditor's Ex. 2.) In addition, the letter states that employees must submit "a signed authorization for release of [Social Security disability insurance benefit] information to" Esis, and "copies of all Social Security determinations and decisions regarding the [Social Security disability insurance benefit] claim." (*Id.* at 1.) The letter warns employees

that failure to submit the required documents or any subsequent authorization request will result in the deduction from any [sickness and accident] (or [extended disability benefits]) of an amount equal to the assumed [Social Security disability insurance benefit].

(*Id.*)

Near the end of the hearing, the Court questioned Ms. Burnside generally about DaimlerChrysler's ability to use payroll deductions from wages as a mechanism to recover an overpayment. On re-direct examination, Ms. Burnside stated that the right to implement a payroll deduction was separate from the provisions allowing offset against future disability benefits. However, she could not remember exactly what provision of the Plan authorizes the payroll deduction. Counsel for DaimlerChrysler handed her a copy of the entire Plan, and Ms. Burnside then identified a provision on page 140 of the Plan as authorizing payroll deductions. Counsel for the Debtors then noted that page 140 permits DaimlerChrysler to make "appropriate deductions," and asked Ms. Burnside whether she had received any guidance as to what an "appropriate" amount would be. Ms. Burnside responded that Esis' standard was to deduct the entire amount of disability benefits, but only 25% of wages. She stated that the 25% limit on deductions against wages was in the Plan, but could not point out specifically where.

Applying the Plan provisions to Mr. Delicruz's case, Ms. Burnside testified that DaimlerChrysler became aware in 1995 that Mr. Delicruz had been awarded Social Security disability benefits. Mr. Delicruz had very little recollection of the Social Security benefits awarded or the application process. He testified that his disability was such that he was heavily medicated and essentially incapacitated. His wife was appointed as his conservator. When asked whether he knew if there was an award

letter, he stated that he did not and that his wife "took care of everything." The checks were not issued to him directly, but instead went to his "payee." Mr. Delicruz did not know the amount of benefits he received. Mrs. Delicruz testified that her husband received a lump sum payment of $16,385 from Social Security and that another $10,000 was paid to her husband's minor children. Mrs. Delicruz also testified that her husband received a subsequent monthly amount of $1,088, but her testimony was unclear as to how many such payments he received.

Having been notified that Mr. Delicruz had received Social Security benefits, Esis proceeded to determine the amount of the award and any resulting overpayment. Ms. Burnside testified that Esis still did not have a copy of the award letter. Her file indicated that two letters were sent to Mr. Delicruz in 1995 asking for a copy of the award letter. The file contained one

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letter in response from Mr. Delicruz, stating that he had "gone to court" and was awaiting a decision. As an alternative method of ascertaining the amount of a Social Security award, where the employee fails to provide the award letter, Ms. Burnside explained that Esis uses a form Authorization to Secure Award or Denial Information, which authorizes the Social Security Administration to release information concerning Social Security benefits awarded. According to Ms. Burnside, Esis cannot contact the Social Security Administration for information without the employee's approval, and any request must be in writing. This form is first sent to the employee for their signature, and then forwarded to the Social Security Administration for completion of any award information. Exhibit 3 is the authorization form used for Mr. Delicruz.

During his testimony, Mr. Delicruz identified the undated signature in the middle of Exhibit 3 as his, but did not remember signing the form. The form "authorize[d] the Social Security Administration to either send a copy of the award or denial notice or furnish the information requested in Item 2 below ...." (Creditor's Ex. 3.) The form contains an "Item 1" and an "Item 2." The former states that the employee "[h]as authorized us to send you a copy of his or her award or denial notice which is enclosed." (*Id.*) The latter states that the employee "[h]as authorized us to furnish you the following information regarding his or her claim." (*Id.*) There is a box before both items, but neither is checked on Mr. Delicruz's form. However, there is detailed information about the award to Mr. Delicruz set forth on the form below Item 2.

The form contains a box to check if the type of claim is for disability benefits and a box to check if the type of claim is for retirement benefits. Here, the box for disability was checked and it then shows that Mr. Delicruz filed his claim in November, 1992, and became eligible to receive benefits in May, 1993. It further indicates that he received his first payment that month in the amount of $1,075, and the current monthly benefit was $1,134.10. The "Remarks" section of the form reads "5/93 — 1075.00 12/93 — 1103.00 12/94 — 1134.00 4/95 — 1134.10." Ms. Burnside explained that the amounts and dates did not necessarily reflect what Mr. Delicruz *actually* received during those months, but instead showed what he was *entitled* to receive during the months indicated. Item 2 bears a signature, presumably from the Social Security Administration, dated October 18, 1995. The form also has two "received" date stamps. Ms. Burnside testified that the January 5, 1994 "received" date on the bottom of the form indicated the date DaimlerChrysler received the form from Mr. Delicruz. The second stamp, in the middle of the form, has the date October 20, 1995, which she said is the date DaimlerChrysler received the completed form from the Social Security Administration.

Using this information, Ms. Burnside explained how Esis calculated Mr. Delicruz's Social Security benefit and, ultimately, the overpayment amount. Mr. Delicruz received sickness and accident (short term) benefits through December 2, 1993, and long term disability benefits after that. Adding the monthly

amounts in the Item 2 "Remarks" section, the total is $32,101. This calculation is detailed on page 2 of Creditor's Exhibit 4. However, the permitted offset is not dollar-for-dollar. According to Ms. Burnside, Esis does not include an annual cost of living increase for long term disability. Therefore, the monthly benefit rate used by Esis was set at $1,103 from December, 1993 forward. In addition, the Plan requires that the monthly benefit be recalculated as a weekly

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amount, using a multiplier. With those adjustments, Esis determined that Mr. Delicruz was entitled to receive $7,596.16 in short term disability benefits, and $24,194.84 in long term benefits, for a total of $31,791. Ms. Burnside again emphasized that Esis used Exhibit 3 to compute the amounts that Mr. Delicruz was entitled to receive from Social Security, not what he actually received. She also acknowledged that a certain amount of speculation was involved because Esis never received a copy of the award letter from Mr. Delicruz.

The Debtors admit that Mr. Delicruz received an award from Social Security. However, they do not agree with Ms. Burnside's calculation of the amount received. There were two areas where the Debtors argued that Esis should have adjusted its calculation of Mr. Delicruz's Social Security award. The first relates to Medicare insurance payments. Mrs. Delicruz testified that Medicare insurance premiums were deducted from the Social Security benefits Mr. Delicruz received. However, Esis did not adjust its figure downward because Ms. Burnside said Esis needed more information in order to take those premium payments into account, and that the information would have been contained in the award letter that the Debtors failed to provide. Even if that information had been provided, she testified that the Medicare insurance premiums would not necessarily result in a reduction in the overpayment amount, but instead would have been reimbursed "off to the side."

The second area of contention regarding the Social Security award amount was whether some portion of it should not be treated as an overpayment because it was actually not made to Mr. Delicruz but instead was a separate award made by the Social Security Administration to Mr. Delicruz's four minor children: April, Summer, September, and Amber Gawronski. Mrs. Delicruz testified that the children live with their mother, and that they received $10,000 from Social Security, with the checks having been sent directly to their home. In support of this contention, the Debtors introduced into evidence Exhibits A through E, which are computer printouts entitled "RSDI PAYMENT HISTORY," one each for Mr. Delicruz and his four children. Although the Debtors relied on these exhibits to prove payments were made to the children, no witness was able to interpret the forms or to explain the details of the information on them.

On the other hand, Ms. Burnside testified that the award letter itself would have indicated any adjustments for the children. She said the Social Security Administration will typically send a separate award letter stating that a dependent is eligible for a certain dollar amount per month. If an award to a dependent is clearly separate from the benefits awarded to an employee, Esis does not offset those amounts. Absent any evidence to show that payments to a dependent are because of the entitlement of the dependent, and not for the employee, Esis would treat any payment made to a dependent as part of the overpayment to the employee and would still offset to recover it. In this case, Esis did not receive any award letter, for either Mr. Delicruz or his children. Ms. Burnside concluded that there was nothing on which Esis could base a determination that any benefits paid to the children were separate from benefits paid to Mr. Delicruz, and thus should not be offset. Therefore, Esis had no information other than the detail set forth under Item 2 of Exhibit 3. Although that authorization form has a section labeled "Dependent Award(s)", in this case, this section was left blank.

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Although Mr. Delicruz was awarded Social Security disability benefits through September, 1995, he was not cleared to return to work until August, 2000. DaimlerChrysler refused to allow him to return to work at that time. Mr. Delicruz testified that, after thirty days, he filed a grievance for failure to reinstate. He explained that it is a four-step process, and the grievance went to the appeal board. During this time, the overpayment was an active issue. Exhibit F is a letter dated October 10, 2000, from Ms. Burnside's file. The letter is from Mr. Delicruz, and states: "I Francisco Delicruz, ... [d]o not agree with decision regarding $15,056.20 overpayment. Please send me hard copy documents to review this claim." (Debtors' Ex. F.) No explanation was provided by the Debtors of the figure used in this letter. According to Mr. Delicruz, another issue in the grievance was the amount of back pay due upon his reinstatement. He testified that he agreed to a lesser amount of back pay in exchange for a disposition that included a settlement of the overpayment issue. In his words, he "wanted to be made whole." It made no sense to him to receive back pay, only to have it taken away a few months later in satisfaction of the overpayment. Thus, he testified that he agreed to reinstatement with no back pay or benefits.

Both Mr. and Mrs. Delicruz took part in the negotiations that led to the disposition of the grievance. Mrs. Delicruz testified that they had almost daily discussions with their union representative. She stated that they wrote letters, but did not have copies in Court. She believed that the overpayment was an issue in the grievance process. Mr. Delicruz testified that the grievance was pending before the appeal board when the matter was settled and the disposition entered. Mrs. Delicruz stated that there were multiple dispositions of the grievance, although only one was offered and admitted into evidence, which was Exhibit 5. That Exhibit, entitled "Disposition," is dated August 22, 2001, and states:

In full and final settlement of this case the Corporation agrees to reinstate Mr. Delicruz from sick leave in accordance with his seniority without back pay or benefits for the time he was away from the plant, provided he can meet normal requirements. Upon his return to work, his employment status will be amended to a layoff for the period of time from January 18, 2001 to the reinstatement date of August 27, 2001.

(Creditor's Ex. 5.) The Disposition also addressed payment of "SUB benefits," indicating that Mr. Delicruz would be paid an "equivalent" amount "[i]n the event it is determined that SUB benefits are not payable ...." (*Id.*) Mr. Delicruz explained that SUB benefits are partial pay during a lay off.

When questioned about Exhibit 5, Mr. Delicruz stated that his understanding of the "case" was that it encompassed not only his reinstatement, but also back pay, benefits, pension, and the overpayment. Mrs. Delicruz echoed her husband's understanding that the Disposition somehow included the overpayment issue, although each of them acknowledged that the Disposition said nothing on its face about the overpayment. At the time the Disposition was rendered, the chapter 7 petition had already been filed. Mr. Delicruz stated that they were in the process of filing for bankruptcy when the negotiations were completed. Mrs. Delicruz testified that, at the time they filed their petition, she thought the matter was resolved. Ms. Burnside could offer no information about the settlement of the grievance because Esis was not involved in that process.

Mr. Delicruz testified that, some months after he was reinstated, DaimlerChrysler

began taking deductions from his paycheck. In addition, he later took separate sick leaves for two operations and pneumonia. During that time, DaimlerChrysler withheld his entire sickness benefit checks. DaimlerChrysler calculated that it had recovered a total of $23,608.25 as of July 30, 2003. Exhibit 4 contains a summary and detailed accounting of the amounts and dates of those deductions, but it

does not show how much was deducted from Mr. Delicruz's paychecks and how much was offset against sick pay or disability benefits. The calculations in Exhibit 4 were confirmed by the testimony of Ms. Burnside. Although the Debtors alleged in their post-hearing brief that DaimlerChrysler recommenced the deductions from Mr. Delicruz's paycheck post-hearing, despite an agreement on the record to suspend deductions pending this Court's decision, (Debtors' Closing Arguments at 7, n. 1.), the Debtors introduced no evidence to refute DaimlerChrysler's evidence that it has recovered a total of $23,608.25 as of July 30, 2003.

Using the recovery figure of $23,608.25 and the adjusted Social Security assumed award of $31,791, Ms. Burnside calculated that Mr. Delicruz was still overpaid by $8,182.75. (Creditor's Ex. 4 at 1.) On the other hand, the Debtors argue that Mr. Delicruz received only $16,385 in Social Security benefits and any amounts paid to his children were not received by him. Thus, according to the Debtors, even without deducting Medicare insurance premiums or adding any amounts withheld since July 30, 2003, the $23,608.25 that DaimlerChrysler acknowledges it has withheld more than compensates it for the overpayment.

The parties submitted written briefs in lieu of closing argument. The Debtors presented three alternative arguments: (1) the overpayment issue was resolved in the Disposition, which settled the failure to reinstate grievance; (2) any overpayment was paid in full, and indeed DaimlerChrysler has received more than full recovery; and (3) any amount of the overpayment still owing is a debt that was discharged by the bankruptcy. Therefore, the Debtors conclude that reopening the bankruptcy case would afford them relief by having an order entered declaring the debt to be discharged.

DaimlerChrysler counters that: (1) the grievance Disposition was clear on its face and did not resolve the overpayment issue; (2) based on the amount of benefits awarded by Social Security and the right to offset under the Plan, DaimlerChrysler has still not recovered the full amount of the overpayment; and (3) the amount of the overpayment still owing is not a "debt" under the Bankruptcy Code and thus not subject to the discharge.[1] DaimlerChrysler thus reasoned that it would be pointless to reopen the case. In addition, DaimlerChrysler raised a jurisdictional issue in that its right to recover any overpayment, or Mr. Delicruz's right to recover any over-reimbursement, should be adjudicated through the administrative procedures and remedies available under the Plan. Because Mr. Delicruz has not exhausted these procedures, DaimlerChrysler contends

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that this Court has no jurisdiction over this matter.

III. Discussion

A. The Jurisdictional Argument

DaimlerChrysler bases its jurisdictional argument on the assumption that the Debtors have agreed that any amount still owing is not a debt subject to the bankruptcy discharge. However, the Debtors never conceded this point. Therefore, the questions of whether any amount still owing is a debt and, if so, whether it was subject to the order of discharge, remain open issues. These are core matters under 28 U.S.C. § 157(b)(2)(A), (I) and (O).

Nevertheless, DaimlerChrysler argues that this "Court should decline to exercise jurisdiction." Although DaimlerChrysler acknowledges that ERISA does not require that the Debtors exhaust their administrative remedies, DaimlerChrysler urges this Court to require them to do so. DaimlerChrysler did not cite any statutory authority for its request that this Court decline to entertain the Debtors' motion. The questions of the amount of benefits Mr. Delicruz received, the amount that the Plan authorized to be offset, and whether or not adjustments for insurance premiums and payments to dependents should be subtracted, could be decided through administrative means. However, whether the overpayment constitutes a

debt and whether it is subject to the discharge are core matters, and DaimlerChrysler has not explained the jurisdictional basis for these matters to be decided through the administrative process. Thus DaimlerChrysler's proposal would leave the Debtors without a forum to decide these core issues. Therefore, the Court rejects DaimlerChrysler's suggestion that it decline to exercise its jurisdiction.

B. Determining "Cause" for Reopening the Case

Section 350(b) of the Bankruptcy Code provides for the reopening of a case "to administer assets, to accord relief to the debtor, or for other cause." 11 U.S.C. § 350(b). "The burden of establishing cause is on the movant." Barry Russell, *Bankruptcy Evidence Manual* § 301.45 (West 2003) (citations omitted). The Debtors ask that the case be reopened so that they may amend Schedule F to add DaimlerChrysler as a general unsecured creditor. DaimlerChrysler did not allege, nor is there anything in the record to suggest, that the omission of DaimlerChrysler from the original schedules was anything other than the result of the Debtors' belief that the matter was resolved through the Disposition of the failure to reinstate grievance. The Court notes that adding an omitted creditor in a no asset case where dischargeability is not challenged "is for all practical purposes a useless gesture." *Zirnhelt v. Madaj (In re Madaj),* 149 F.3d 467, 468, 471 n. 4 (6th Cir.1998) (internal quotation marks and citation omitted). Such is not the case if dischargeability is at issue. *See generally In re Walker,* 195 B.R. 187, 199-203 (Bankr.D.N.H.1996) (outlining three methods of litigating dischargeability after a case is closed, and concluding that "clear[ing] the waters" as to dischargeability, relieving the parties from litigating this "rather arcane area of law" in state forums, allowing debtors to file accurate and complete schedules as required by law, and ensuring that a creditor will receive future notice if assets are later administered, all constitute "cause" for reopening a case). The issue of dischargeability is central to this case. The parties disagree whether the amount of the overpayment, assuming that there is a balance due, is a debt and, if so, whether or not it is discharged. Therefore, reopening

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the case will afford relief to the Debtors.

C. Whether the Grievance Disposition Encompassed the Overpayment

Both the Debtors testified credibly that they believed the grievance settlement reflected in the Disposition (Creditor's Ex. 5) included any overpayment issue. Mr. Delicruz contended that he gave up a claim for back pay in exchange for settling the benefits overpayment matter, and it would have made no sense to receive back pay only to have the overpaid benefits then deducted from his paycheck. That would have entailed receiving money from DaimlerChrysler only to pay it back. This is supported by his reinstatement being "without back pay or benefits". (Creditor's Ex. 5.) However, Mr. Delicruz's reasoning assumes that he was likely to have received back pay upon reinstatement. There is nothing in the record to enable the Court to make such a finding. It may have been that, under the circumstances, he was not entitled to receive back pay and thus the matter was not even a negotiating point. Mrs. Delicruz testified that the Debtors had written several letters, and there were multiple grievance dispositions. However, the Debtors produced none of those letters or any written disposition that supports this testimony. Mrs. Delicruz also stated that they had almost daily discussions with Mr. Delicruz's union representative, yet there was no testimony from a corroborating witness. The Court may draw an adverse inference from the Debtors' failure to produce supporting documentary or testimonial evidence. *See Beil v. Lakewood Engineering and Manufacturing Co.,* 15 F.3d 546, 552-53 (6th Cir.1994); *Gafford v. Trans-Texas Airways,* 299 F.2d 60, 63 (6th Cir.1962).

The only documentary evidence adduced by the Debtors on this issue is Exhibit 5, which makes no mention of the benefit overpayment

being a part of the Disposition. It simply refers to "this case." In examining Exhibit 5, it includes a case number, and is captioned "Failure to Reinstate Delicruz, Francisco." It purports to be a "full and final settlement of this case ...." It expressly addresses back pay and benefits, Mr. Delicruz's seniority, his status being amended to layoff, and the amount of SUB benefits he was to receive. According to the Debtors' testimony, these were matters that were a part of the negotiation process. If a claim for overpayment of benefits was part of "*this case*," then one would expect to see it recited on the face of the Disposition. It is not. There is no reason to question the sincerity of the Debtors' *belief* that the reinstatement case included the overpayment issue. However, there is simply no evidence to show that it *in fact* was included in the settlement, given the stated issues that were explicitly addressed in the Disposition. Therefore, the Court concludes that the Debtors have not met their burden of proving that the Disposition included the overpayment issue.

D. Whether the Overpayment is a "Debt": Recoupment vs. Setoff

A discharge under 11 U.S.C. § 727 "operates as an injunction against the commencement or continuation of an action, ... or an act, to collect, recover or offset any such debt as a personal liability of the debtor ...." 11 U.S.C. § 524(a)(1). The term "debt" is defined under the Bankruptcy Code as "liability on a claim." § 101(12). "Claim" in turn is defined as a "right to payment ...." § 101(5)(A). All parties concede that Mr. Delicruz received an overpayment of benefits. The basis for DaimlerChrysler's argument that the overpayment does not constitute a debt is the premise that its deductions are a recoupment of the overpayment of benefits. Recoupment

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should be distinguished from setoff. The latter "reduc[es] or extinguish[es] a mutual debt arising from different transactions", and is subject to the automatic stay. *Aetna Life Insurance Co. v. Bram (In re Bram)*, 179 B.R. 824, 826 (Bankr.E.D.Tex.1995) (citation omitted). On the other hand, recoupment "reduc [es] or extinguish[es] a debt arising from the same transaction", and is not stayed by the bankruptcy. *Id.* (citation omitted); *see also Lee v. Schweiker*, 739 F.2d 870, 875 (3d Cir.1984) (describing recoupment as "essentially a defense to the debtor's claim against the creditor rather than a mutual obligation").

[Recoupment] is applied when there are countervailing claims arising from the same transaction strictly for the purpose of abatement or reduction ... [and] provides for the adjudication of the just apportionment of liability relative to a dispute regarding a singular transaction.

Because recoupment only reduces a debt as opposed to constituting an independent basis for a debt, it is not a claim in bankruptcy, and is therefore unaffected by the debtor's discharge.

Oregon v. Harmon (In re Harmon), 188 B.R. 421, 425 (9th Cir. BAP 1995) (internal quotation marks and citation omitted). "The principle of recoupment presents an affirmative defense ... The burden of proof on matters raised in the use of recoupment is on the [party] who raises them." Russell, *Bankruptcy Evidence Manual* § 301.73 (citation omitted). Therefore, DaimlerChrysler has the burden of proving the applicability of the doctrine of recoupment by a preponderance of the evidence. *See Grogan v. Garner*, 498 U.S. 279, 286, 111 S.Ct. 654, 112 L.Ed.2d 755 (1991) ("presum[ing] that [preponderance of the evidence] standard is applicable in civil actions between private litigants unless particularly important individual interests or rights are at stake" and applying the standard to a non-dischargeability action) (internal quotation marks and citations omitted).

Several courts have found that recovering an overpayment of disability benefits from future benefits falls within the scope of recoupment. For example, in *Aetna Life Insurance Co. v. Bram (In re Bram)*, 179 B.R. 824 (Bankr.E.D.Tex.1995), the debtor was covered by the employer's long term disability

plan, which was administered by the plaintiff. 179 B.R. at 825. The debtor became totally and permanently disabled, and thus eligible to receive disability benefits. However, the plan provided that, if the beneficiary received social security benefits, the plan benefits would be reduced proportionately. The plan also provided that, in the event of an overpayment due to a retroactive award of social security, the plaintiff was entitled to temporarily suspend payments until the overpayment was recovered. The debtor had executed an agreement in which he agreed to reimburse the plaintiff in the event of an overpayment. *Id.* Upon discovering that the debtor had in fact been receiving social security benefits, the plaintiff demanded reimbursement, and suspended payment of benefits. *Id.* at 825-26. The debtor then filed a chapter 7 petition. The plaintiff argued that the overpayment was not a "debt." *Id.* at 826.

After noting the distinction between setoff and recoupment, the *Bram* court found that "[t]he key issue is whether or not the prepetition overpayments and the postpetition [long term disability plan] benefit payments arise from the same transaction." *Id.* at 826. Because both the pre-petition overpayments and the post-petition disability payments from which the plaintiff sought to recover the overpayments arose from the disability benefit plan, the court

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concluded that recoupment applied. *Id.* at 826-27. The court found the recovery of overpaid benefits was in the nature of recoupment, and concluded, because "the right to recoupment gives no right to actual payment, it is not a claim. If it is neither a claim nor a debt, then it is also not dischargeable under the Code." *Id.* at 827; *see also Brown v. General Motors Corp.*, 152 B.R. 935 (W.D.Wis.1993) (finding duplicate social security benefits under similar plan provisions to give the employer a right to recoupment but not a right to payment); *Oregon v. Harmon (In re Harmon)*, 188 B.R. 421, 425-26 (9th Cir. BAP 1995) (finding awards of temporary and permanent disability benefits to be related to the same injury and thus arose out of the same transaction). *Compare Baker v. United States*, 100 B.R. 80, 82-83 (M.D.Fla.1989) (finding an obligation to repay federal disability benefits was a debt because the government had a right to direct collection as well as the right to offset against future benefits); *Thompson v. Board of Trustees of the Fairfax County Police Officers' Retirement System (In re Thompson)*, 182 B.R. 140, 145, 149 (Bankr.E.D.Va.1995) (finding disability benefits could not be recouped against retirement benefits even though both were provided for under a single employee contract because they arose from separate transactions).

The Debtors agreed at the hearing with the general proposition that any overpayment could be recovered against future disability benefits, but contended that DaimlerChrysler had failed to prove it had a valid right of recoupment. The Plan provides that short term "[w]eekly benefits will be reduced by ... the weekly equivalent of any" Social Security benefits. (Creditor's Ex. 1 at 88-89.) In addition, "any extended disability benefit payments in excess of the amount that should have been paid ... may be deducted from future extended disability benefits." (*Id.* at 94.) Therefore, the Court concludes that DaimlerChrysler's ability to recover overpaid disability benefits from future disability benefits is a right of recoupment. Because a right to recoupment does not give rise to a right to payment, there is no liability on a claim and thus no "debt" as defined by the Bankruptcy Code. Therefore, the right of recoupment is not subject to the discharge. This leaves the issue of DaimlerChrysler's right to recover the overpayment against Mr. Delicruz's wages.

According to the testimony of Ms. Burnside, the Plan also allows DaimlerChrysler to recover an overpayment through payroll deductions, including withholding up to 25% of wages. Ms. Burnside testified that page 140 of the Plan provided this authority. She was asked on cross examination to clarify that provision, but only as to the calculation of the permissible amount of deductions, not DaimlerChrysler's authority to make such deductions. As noted, DaimlerChrysler has the burden of proving its

affirmative defense by a preponderance of the evidence. Ms. Burnside was a credible witness. The Debtors have offered nothing to counter her testimony. Therefore, the Court concludes that DaimlerChrysler did have the authority under the Plan to recover the overpayment against Mr. Delicruz's wages.[2]

However, even though the Court has found that the Plan authorizes DaimlerChrysler to recover overpaid disability benefits from wages, the Court concludes that this is not a true right of recoupment. As noted, recoupment is a defense to a

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claim, and acts to reduce a debt arising from the same transaction. *Lee v. Schweiker*, 739 F.2d at 875. Applied to this case, if Mr. Delicruz has a claim for future benefits, DaimlerChrysler may defend against that claim by reducing those benefits on account of a previous overpayment of benefits. Under DaimlerChrysler's reading, in addition to recouping against the payment of future disability benefits, if Mr. Delicruz also has a claim for wages for hours worked, DaimlerChrysler can defend against that claim by reducing those wages in order to recoup the overpaid disability benefits. This is not recoupment. Disability benefits are not the same as wages. They do not arise out of the same transaction. The former are awarded upon a determination that a disability has left someone unable to work, and the latter are earned for hours worked. They are not "countervailing claims arising from the same transaction strictly for the purpose of abatement or reduction ...." *In re Harmon*, 188 B.R. at 425 (internal quotation marks and citation omitted). Nor is DaimlerChrysler's offsetting against wages an "adjudication of the just apportionment of liability relative to a dispute regarding a singular transaction." *Id.* Instead, the recovery of disability benefits against wages creates "an independent basis for a debt," *id.*, and a "right to actual payment," *In re Bram*, 179 B.R. at 827.

The Court's conclusion is supported by cases that address recoupment in the context of retirement benefits. In *Mullen v. United States*, 696 F.2d 470 (6th Cir.1983), the debtor was released from service in the Air Force when forces were reduced. *Id.* at 471. He received a $15,000 "readjustment allowance" at that time, and was informed that if he returned to service, upon later retirement, "he would not be receiving any retirement pay unless and until he repaid 75% of this readjustment allowance." *Id.* (internal quotation marks and citation omitted). The debtor did reenlist, and soon after retiring, he filed for bankruptcy without having repaid the readjustment allowance. The Air Force continued to withhold his retirement benefits. The debtor sought to hold the Air Force in contempt for a violation of the stay. *Id.* The Air Force argued that it only had a right of recoupment and no right to payment. *Id.* at 472.

In analyzing whether this situation gave rise to a right to payment, the *Mullen* court looked to a discussion of the definitions of "debt" and "claim" in the legislative history, which used the situation of a loan against an insurance policy as an example of what would not qualify as a debt:

Under that kind of transaction, the debtor is not liable to the insurance company for repayment; the amount owed is merely available to the company for setoff against any benefits that become payable under the policy. As such, the loan will not be a claim (it is not a right to payment) that the company can assert against the estate; nor will the debtor's obligation be a debt (a liability on a claim) that will be discharged ....

Id. at 472 (internal quotation marks and citation omitted). The *Mullen* court found that the

readjustment allowance appears to be nothing more than a type of prepaid retirement benefit. Like the terms of a loan on an insurance policy, the [Air Force] has a right to setoff benefits that have already been paid against benefits that become payable. No interest accrued on the amount owed nor did the [Air Force] have the right to recoup the readjustment allowance from any other source.

Id. Therefore the court concluded that the "transaction gave rise to no creditor-debtor

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relationship between the [Air Force] and [the debtor]." *Id.* The *Mullen* court cited with approval *New York City Employees' Retirement System v. Villarie (In re Villarie)*, 648 F.2d 810 (2d Cir.1981), in finding "[t]his is the precise transaction contemplated by the legislative history of subsection 101(11)." *Mullen* 696 F.2d at 472.

In *Villarie*, the debtor participated in the New York City Employees' Retirement System ("NYCERS"). 648 F.2d at 811. Contributions to retirement accounts were made through payroll deduction from weekly paychecks. NYCERS allowed members to borrow against their accounts, which were, "[i]n effect, ... an advance against the member's future retirement benefits." *Id.* Members were required "to repay the loan, with interest, through payroll deductions in excess of the member's ordinary contribution." *Id.* Upon retirement or separation of service, any outstanding loan balance was repaid through a reduction in retirement benefits. The debtor had an outstanding loan when he filed for bankruptcy. NYCERS initiated an adversary proceeding, asking that the advance be declared not a "debt" and that the retirement system be allowed to continue weekly payroll deductions. The bankruptcy court's finding that the advance was a debt and subject to the discharge was reversed on appeal. *Id.* at 811-12. The Second Circuit found that NYCERS' only recourse was to "offset the amount borrowed against his future benefits", and did "not give NYCERS the right to sue a member for the amount of the advance." *Id.* at 812; *see also In re Esquivel*, 239 B.R. 146-47, 151 (Bankr.E.D.Mich.1999) (J. Spector) (addressing whether a loan against an ERISA-qualified pension plan created a claim and concluding because the pension plan "could not sue the debtor for the unpaid loan because its remedy is to deduct the unpaid portion of the amount advanced from any benefits the debtor was to receive in the future", that there was no right to repayment); *In re Thompson*, 182 B.R. at 145, 149 (finding disability benefits could not be recouped against retirement benefits even though both were provided for under a single employee contract because they arose from separate transactions).

The lack of a right to recover "from any other source" was significant in the *Mullen* decision in determining whether the doctrine of recoupment applied. 696 F.2d at 472. If a right to recover from a single source supports a finding of recoupment, then it stands to reason that a right to recover from multiple sources means the transaction is outside the scope of recoupment. In the case before this Court, DaimlerChrysler claims the right to recover the overpaid disability benefits not only against future disability benefits, but against wages as well. These are different sources. Under the reasoning in *Mullen*, this means that the doctrine of recoupment does not apply. To paraphrase, only apples can be recouped against apples, not apples against oranges. Apples may be *set off* against oranges, but this takes the matter out of the nature of recoupment by affording a right to payment instead of simply a right to reduce a debt. Disability benefits are not prepaid wages, *Mullen*, 696 F.2d at 472, nor are they an advance against wages, *Villarie*, 648 F.2d at 811. *See also Baker v. United States*, 100 B.R. 80, 81-82 (M.D.Fla.1989) (finding that, because the Department of Labor had a choice between recoupment or direct collection, there was a right to payment through the alternate remedy of direct collection, which created a claim, and the liability on the claim was a debt).

Therefore, the Court concludes that the Plan gives DaimlerChrysler both a right to setoff and a right to recoupment, the former

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against wages and the latter against future disability benefits. The right to setoff was subject to the automatic stay under § 362(a)(7) and is covered by the discharge injunction under § 524(a). The right to setoff against wages also means that DaimlerChrysler's post-petition garnishment of Mr. Delicruz's wages was a

violation of the stay and the discharge injunction, regardless of DaimlerChrysler's knowledge or notice of the case, or lack thereof. *See* 3 *Collier on Bankruptcy* ¶ 362.11 (15th ed. rev.2003) ("Because the stay is imposed automatically, and often without notice to parties who may be stayed, a party may violate the stay without realizing that it has taken effect."). Any amounts deducted from those wages post-petition must be refunded to Mr. Delicruz. The right to setoff against wages also means that DaimlerChrysler had a claim against the bankruptcy estate. However, this is a no asset case and DaimlerChrysler did not allege any basis for non-dischargeability under § 523. Therefore, that claim was discharged. *In re Madaj,* 149 F.3d at 472. On the other hand, DaimlerChrysler's right of recoupment against future benefits does not give rise to a right to payment, so there is no liability on a claim and no debt that is subject to the discharge injunction.

E. The Amount Subject to Recoupment

Having reached a conclusion as to the core matters, the Court must decide the amount of the overpayment, which in turn requires determining the amount of the award of Social Security benefits. Mr. Delicruz was required to complete the Authorization to Secure Award or Denial Information form, which authorized the Social Security Administration to release information on the award to Esis. (Creditor's Ex. 2 at 1.) In addition, he was required to provide "copies of all Social Security determinations and decisions regarding the [Social Security disability insurance benefit] claim." (*Id.*) Although Mr. Delicruz completed the release form, he did not provide a copy of the award letter. The consequence of his failure to provide documentation is "the deduction from any [sickness and accident] (or [extended disability benefits]) of an amount equal to the assumed [Social Security disability insurance benefit]." (*Id.*) Ms. Burnside testified that the "assumed" award of Social Security benefits was $32,101, and explained the calculation, based on the release form. (Ex. 3, Ex. 4 at 2.) Ms. Burnside also explained that Esis adjusted that total assumed award and determined the overpayment amount to be recovered was $31,791. The Court finds her testimony persuasive. Therefore, the Court finds that the total amount that DaimlerChrysler was entitled to recover from Mr. Delicruz for overpaid benefits was $31,791.

As to any adjustments to that amount, Mrs. Delicruz testified that Medicare insurance premiums were deducted from the benefits Mr. Delicruz received. Although she testified that the amount of $46.10 was deducted from the monthly Social Security payments, she never clearly stated how many monthly payments were made after the initial lump sum payment. Her later testimony differed from her initial testimony when she stated her husband only received the initial lump sum payment. On the other hand, Ms. Burnside testified that whether or not Medicare insurance premiums would be deducted from an award would have been contained in the award letter, which the Debtors failed to provide. Moreover, even if that information had been provided, Ms. Burnside testified that Esis would not have reduced the overpayment amount, but instead would have reimbursed Mr. Delicruz directly. Without knowing whether the insurance premiums

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should reduce the overpayment amount, or even the amount of those premiums, the Court is unable to make a finding that the overpayment amount should be decreased by the amount of Medicare insurance premiums.

Mrs. Delicruz also stated that Mr. Delicruz's children received $10,000 directly from Social Security and that this was a separate award to them, and should not be treated as part of the Social Security award to Mr. Delicruz. As supporting documentary evidence, the Debtors relied on Exhibits A-E, the computer printouts for "RSDI PAYMENT HISTORY". Mrs. Delicruz was questioned about these Exhibits, but her testimony was vague and it was evident that she had little personal knowledge of the forms or the information on the forms. Ms. Burnside stated that she was familiar with

similar information being provided on different forms by the Social Security Administration, but with more detail. She had not seen that particular form or format. Although the Debtors offered these exhibits to prove that deductions were made for Medicare insurance and payments were made to the children, no witness was able to interpret the forms or to explain the details of the information on them. Exhibits A-E are virtually indecipherable to the Court. There was no foundation established even as to their source. Nor could any witness testify authoritatively as to their content. Therefore, the Court gives them little evidentiary weight. The Court does find probative, and therefore gives greater weight, to the Authorization to Secure Award or Denial Information form, which under Item 2 has a section labeled "Dependent Award(s)". (Ex. 3.) This section is blank, indicating that the Social Security Administration made no award to any dependent, and the entire Social Security benefit award of $32,101 was made to Mr. Delicruz.

In weighing all of the evidence, the Court concludes that the Debtors have not met their burden of proving that there should be any adjustments to the assumed award of $32,101 in Social Security benefits, or to Esis' calculation of the overpaid benefit amount of $31,791. Therefore, the Court finds that DaimlerChrysler was authorized to recover $31,791. The Court accepts DaimlerChrysler's calculation that it had recovered $23,608.25 as of July 30, 2003, leaving a shortfall of $8,182.75. (Ex. 4 at 1.) It is unknown how much of the $23,608.25 came from Mr. Delicruz's wages, which the Court has held must be returned to Mr. Delicruz. However, any amounts so reimbursed to Mr. Delicruz can be added to the shortfall, the recoupment of which out of future sickness and accident benefits, and extended disability benefits, survives the discharge.

IV. Conclusion

In summary, (1) this Court has core jurisdiction to determine the existence of a debt and whether such debt is subject to the discharge injunction; (2) cause exists to reopen the case for entry of an order memorializing the Court's findings; (3) the Debtors did not meet their burden of proving that the Disposition of the return to work grievance resolved the overpayment issue; (4) DaimlerChrysler is authorized to recover $31,791 of the $32,101 assumed award of Social Security benefits; (5) Daimler/Chrysler has both a right to recoup against future disability benefits and a right to setoff against wages under the Plan; (6) DaimlerChrysler's right to setoff against wages created a right to payment and thus liability on a claim, and a debt which was discharged; and (7) DaimlerChrysler's right to recoup against future benefits did not create a right to payment, thus it did not create liability on a debt and is not dischargeable under the Code.

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Accordingly, the motion to reopen is GRANTED. The Court will enter an order consistent with this opinion.

ORDER GRANTING DEBTORS' MOTION TO REOPEN ESTATE TO ADD OMITTED CREDITOR

This matter came before the Court upon Debtors' Motion to Reopen Estate to Add Omitted Creditor. An evidentiary hearing was held on August 6, 2003 and the parties thereafter submitted closing arguments in writing. For the reasons set forth in this Court's Opinion Granting Debtors' Motion to Reopen Estate to Add Omitted Creditor,

IT IS HEREBY ORDERED that the Debtors' Motion to Reopen Estate to Add Omitted Creditor is granted.

IT IS FURTHER ORDERED that the Debtors shall add DaimlerChrysler to their schedules of assets and liabilities as a creditor in this Chapter 7 case.

IT IS FURTHER ORDERED that the overpayment of benefits made by DaimlerChrysler to Francisco Jose Delicruz is adjudged to be $31,791.00 ("Overpayment").

IT IS FURTHER ORDERED that the amount of the Overpayment recovered by DaimlerChrysler as of July 30, 2003 is adjudged to be $23,608.25, leaving an unrecovered balance of the Overpayment in the amount of $8,182.75.

IT IS FURTHER ORDERED that DaimlerChrysler is determined to have a right to recoup the Overpayment out of sickness and accident and extended disability benefits owing or to become owing by DaimlerChrysler to Francisco Jose Delicruz.

IT IS FURTHER ORDERED that DaimlerChrysler does not have a right to recoup any of the Overpayment from the wages earned or to be earned by Francisco Jose Delicruz for services rendered by him for DaimlerChrysler. To the extent that DaimlerChrysler has deducted any of the Overpayment from the wages earned by Francisco Jose Delicruz for the performance of services by him for DaimlerChrysler, DaimlerChrysler is hereby ordered to immediately refund such amount to Francisco Jose Delicruz. Any amount so refunded by DaimlerChrysler shall be added to the sum of $8,182.75 which represents the remaining balance of the unrecovered Overpayment of benefits which DaimlerChrysler may recoup from sickness and accident or extended disability benefits owing or to become owing by it to Franciso Jose Delicruz.

IT IS FURTHER ORDERED that any debt owing to DaimlerChrysler by Francisco Jose Delicruz was discharged by the discharge order entered in this case on September 20, 2001.

IT IS FURTHER ORDERED that the discharge order entered by the Bankruptcy Court on September 20, 2001 and this order do not impair DaimlerChrysler's right of recoupment of the Overpayment of benefits from sickness and accident and extended disability benefits owing by DaimlerChrysler to Francisco Jose Delicruz.

IT IS FURTHER ORDERED that this bankruptcy case is reopened for the limited purpose of entering this order and allowing the Debtors to file amended schedules, and shall thereafter be closed.

Notes:

1. The Debtors conceded that, *if* the return of the overpayment is not a "debt" under the Code, it was not subject to the discharge injunction. However, DaimlerChrysler misinterpreted this concession and repeatedly stated both at the evidentiary hearing and in its post-hearing brief, that the Debtors somehow admitted that the return of the overpayment was in fact not a "debt" and thus not subject to the discharge. The Court has carefully reviewed the written submissions, the testimony, and oral argument. There was no such admission by the Debtors or by their counsel. In fact, the Debtors continued to argue in the alternative that the return of the overpayment was a debt that was discharged.

2. The Debtors also argued that DaimlerChrysler's withholding of 25% of Mr. Delicruz's paycheck violated Michigan labor laws. However, the Debtors failed to cite a statute or any authority for this assertion. Therefore, the Court will not address this argument.

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367 B.R. 529
In re Robert E. MEWBORN, Debtor.
No. 00-17206 (GMB).
United States Bankruptcy Court, D. New Jersey.
March 29, 2006.
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Joseph J. Rogers, Esquire, Turnersville, NJ, Attorney for Debtor.

Janet Greenberg Cohen, Esquire, Office of the Attorney General of New Jersey, Trenton, NJ, Attorney for State of New Jersey, Department of Labor and Workforce Development, Unemployment Insurance.

MEMORANDUM OPINION

GLORIA M. BURNS, Bankruptcy Judge.

Before the Court is Debtor, Robert E. Mewborn, Jr.'s ("Debtor"), motion to lift the attachment of unemployment benefits in violation of the § 362 stay. More specifically, the Debtor requests that the Court order the New Jersey Department of Labor and Workforce Development, Unemployment Insurance ("NJDOL") to cease seizing his unemployment benefits immediately and remit to him all funds seized during his 2004 period of eligibility. Also before the Court is the NJDOL's response thereto. For the reasons set forth below, the Court denies the Debtor's motion.

The Court has jurisdiction over this matter pursuant to 28 U.S.C. §§ 1334(a) and 157(a), and the Standing Order of the United States District Court for the District of New Jersey dated July 23, 1984, referring all bankruptcy cases to the bankruptcy, court. This is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(A). Venue of this case is proper in the District of New Jersey pursuant to 28 U.S.C. §§ 1408 and 1409. The following shall

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constitute findings of fact and conclusions of law in accordance with Federal Rule of Bankruptcy Procedure 7052.

FACTUAL BACKGROUND

In 1993, the Debtor applied to the NJDOL for unemployment benefits in the amount of $261.00 per week. After issuing the benefits, the NJDOL learned that the Debtor had in fact been employed by three different employers while receiving the benefits from May until December 1993. Accordingly, the NJDOL determined that the Debtor was ineligible to receive unemployment benefits during that period. The NJDOL notified the Debtor of the overpayment, but the Debtor failed to respond. As a result, the NJDOL administratively determined that the Debtor obtained the 1993 benefits through fraud and wilful misrepresentation. The Debtor did not appeal this determination. Consequently, a Certificate of Debt was entered against him on March 26, 1996 in the amount of $7,503.75.[1]

On September 1, 2000, the Debtor filed for chapter 13 bankruptcy protection. The Debtor's Schedule F lists a claim held by the NJDOL in the amount of $7,503.00. The NJDOL filed a proof of claim in the amount of $8,504.83 on October 11, 2000. The Debtor's chapter 13 plan, which was confirmed on March 27, 2001, provided for monthly payments of $75.00 for 36 months as well as a pro rata distribution to unsecured creditors. On March 8, 2002, the plan was amended to provide for payments of $50.00 per month for 42 months. On June 11, 2003, an Order was entered increasing the payments to $53.00 per month for the remaining 29 months. On May 5, 2004, the Debtor's plan was modified again to provide for payments of $79.00 per month for the remaining 17 months. Finally, on

March 9, 2005, an Order was entered stating that the plan shall continue at $1,816.55 paid to date then $100.00 for the remaining 8 months with a wage order, commencing March 1, 2005 for a total of 60 months. To date the Debtor has made payments totaling $2,719.54, which completed the Debtor's plan.

On August 13, 2004, the Debtor was laid off by his employer and became eligible to receive unemployment benefits. Instead of paying the Debtor unemployment benefits, the NJDOL applied the benefits to its overpayment claim arising from the 1993 benefits that the Debtor received fraudulently. The NJDOL has recouped approximately $2,961.85 of its claim by seizing the Debtor's benefits and by receiving a small payment from the chapter 13 Trustee. The NJDOL asserts that the balance remaining on its Maim is $3,041.15. The NJDOL acknowledges that its claim is dischargeable upon the successful completion of Debtor's chapter 13 plan.

In his motion, the Debtor argues that the NJDOL seized his 2004 benefits in violation of his § 362 stay. The Debtor also argues that the NJDOL is not entitled to recoup its 1993 overpayment claim by seizing his 2004 benefits, because the two do not arise from the same transaction, thereby failing to satisfy the Third Circuit's "integrated transaction test."

In its response, the NJDOL makes several arguments in support of its actions.

1. It is entitled to recoup overpayments pursuant to its police powers under N.J. Stat. § 43:21-1.

2. It distinguishes this case from the *Lee v. Schweiker*, because this case deals with unemployment benefits, while the *Lee* case dealt with social

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security benefits. More specifically, the NJDOL argues that New Jersey's unemployment benefits statute forms a contractual relationship, while social security benefits are social welfare "entitlements." The NJDOL further argues that unlike recipients of social security benefits, recipients of unemployment benefits do not contribute to the unemployment benefit fund individually. Finally, the NJDOL likens New. Jersey's statute and its requirements to "an on-going contract."

3. The Debtor's fraudulent receipt of the 1993 benefits and his eligibility for 2004 benefits arise from the same transaction.

4. It did not violate the Debtor's stay because the 2004 benefits are post-petition benefits that are "neither property of the Debtor nor property of the estate."

In response to the NJDOL's arguments, the Debtor asserts that "social security benefits, like unemployment benefits, require that you have worked for a qualifying period of time in order to be eligible for payments." As such, unemployment benefits are also social welfare payments.

LEGAL DISCUSSION

I. *The NJDOL is Subject to the Debtor's § 362 Stay*

Section 362 of the Code prohibits

the commencement or continuation, including the issuance or employment of process, of a judicial, administrative, or other action or proceeding against the debtor that was or could have been commenced before the commencement of the case under this title, or to recover a claim against the debtor that arose before the commencement of the case under this title.

11 U.S.C. § 362(a)(1) (2004). However, a debtor's automatic stay "does not affect the commencement or continuation of an action or proceeding by a governmental unit to enforce the governmental unit's police or regulatory power." *See* 11 U.S.C. § 362(b)(4); *see also* Advisory Committee Notes to § 362. Section 362(b)(4)

is intended to be given a narrow construction in order to permit governmental units to pursue actions to protect the public health and safety and not to apply to actions by a governmental unit to protect a pecuniary interest in property of the debtor or property of the estate.

Id. The Third Circuit has found that:

Congress intended this exception to apply where a governmental unit is suing a debtor to prevent or stop violation of fraud, environmental protection, consumer protection, safety, or similar police or regulatory laws, or attempting to fix damages for such laws.

In re University Medical Center, 973 F.2d 1065, 1074-75 (3d Cir.1992). In other words, "§ 362(b)(4) only limits the government's police and regulatory power to enforce a money judgment outside of the bankruptcy. The government's power to seek entry of a civil penalty judgment for violations ... is not precluded." *States of America v. LTV Steel Co., Inc.*, 269 B.R. 576, 582 (W.D.Pa.2001); *see also In re Ellis*, 66 B.R. 821, 826 (N.D.Ill.1986) (holding that the automatic stay was applicable, and state court action violated the stay where the focus of governmental police power was directed at the debtor's financial obligations rather than the state's health and safety concerns).

At issue in this motion is New Jersey's unemployment compensation statute. New Jersey's statute provides that, "under the police powers of the state ... the compulsory setting aside of unemployment reserves to be used for the benefit of persons unemployed after qualifying periods

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of employment." N.J. Stat. § 43:21-2 (2004). Courts interpreting the statute have found that it is "evident that the New Jersey unemployment compensation law was enacted for a public purpose and pursuant to the police power." *In re United Healthcare Systems, Inc.*, 282 B.R. 330, 337 (Bankr.D.N.J.2002).

In this case, the NJDOL is exercising its police power pursuant to its unemployment compensation statute, N.J. Stat. § 43:21-1, et. seq. However, the NJDOL does not qualify for the § 362(b)(4) exception to Debtor's automatic stay, because it is not attempting to prevent or stop a fraud. The 1993 fraud has already been completed and there is no indication that the Debtor's 2004 application for benefits was fraudulent. Further, the NJDOL's recoupment is not focused on health or safety concerns for its citizens, but on its financial claim against the Debtor's estate. Moreover, the NJDOL is not recouping the Debtor's 2004 benefits in an attempt to fix a money judgment or a penalty. The NJDOL fixed this amount when it filed its proof of claim in Debtor's case. Instead, the NJDOL is attempting to enforce its Certificate of Debt outside of the bankruptcy.

Therefore, based on the foregoing, as a preliminary matter, the NJDOL is bound by the Debtor's § 362 stay, because it does not qualify for the § 362(b)(4) police power exception. As the NJDOL is bound by the Debtor's § 362 stay, the issue remaining before this Court is whether the NJDOL properly recouped the Debtor's 2004 benefits, or whether it improperly seized the benefits in violation of the Debtor's stay.

II. *The Debtor's Unemployment Benefits Are Property of the Estate*

Pursuant to § 1306(a) of the Code, in addition to the property specified in § 541, a chapter 13 debtor's estate consists of:

(1) all property of the kind specified in such section that the debtor acquires after the commencement of the case but before the case is closed, dismissed, or converted to a case under chapter 7, or 11, or 12 of this title [11 USCS §§ 701 et seq., 1101 et seq., or 1201 et seq.], whichever occurs first; and

(2) earnings from services performed by the debtor after the commencement of the case but

before the case is closed, dismissed, or converted to a case under chapter 7, 11, or 12 of this title [11 USCS §§ 701 et seq., or 1101 et seq., or 1201 et seq.], whichever occurs first.

11 U.S.C. § 1306(a) (2004). The Third Circuit has found that "unemployment compensation benefits are earned by the employee because of past labor." *Gelof v. Papineau,* 829 F.2d 452, 454 (3d Cir.1987). Following that logic, the Debtor's 2004 unemployment benefits were earned prior to September 2004. As the Debtor's case has not been closed, dismissed, or converted, his 2004 benefits are property of his estate.[2]

Regardless of whether the Debtor's 2004 benefits are property of his estate, if the NJDOL did not properly recoup those benefits, it is not permitted to retain them.

III. *The NJDOL Properly Recouped the Debtor's 2004 Benefits*

The common law doctrine of recoupment "is an equitable exception to the

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automatic stay" and, as such, should be narrowly construed. *University Medical Center,* 973 F.2d at 1081; *In re Peterson Distributing, Inc.,* 82 F.3d 956, 959 (10th Cir.1996) (holding the doctrine of recoupment should be narrowly construed, in part because it "violates the basic principle of equal distribution to creditors"). Thus, unlike a creditor seeking a § 553 setoff, a creditor claiming recoupment need not apply for stay relief, because the "funds subject to recoupment are not the debtor's property." *In re Malinowski,* 156 F.3d 131, 133 (2nd Cir.1998).

"Recoupment is the setting up of a demand arising from the same transaction as the plaintiff's claim or cause of action, strictly for the purpose of abatement or reduction of such claim." *University Medical Center,* at 1079. Thus, as long as a "creditor's claim arises out of the identical transaction as the debtor's, that claim may be offset against the debt owed to the debtor, without concern for the limitations put on the doctrine of setoff by Code section 553." *Id.* at 1080. In the context of bankruptcy, recoupment has been applied "primarily where the creditor's claim against the debtor and the debtor's claim against the creditor arise out of the same contract." *Lee v. Schweiker,* 739 F.2d 870, 875 (3d Cir.1984). It has also been applied, albeit less often, in cases involving social welfare benefits. *Id.*

The Third Circuit has examined the doctrine of recoupment in the context of Medicare payments and social security benefits, but not unemployment compensation benefits. The Third Circuit has adopted an "integrated transaction test" to determine whether benefits arise from the same transaction for purposes of recoupment. *See Lee,* 739 F.2d at 875; *University Medical Center,* 973 F.2d at 1081.

The integrated transaction test requires more than a mere logical relationship for two events to qualify as arising out of the same transaction. *Id.* More specifically,

[f]or the purposes of recoupment ... the fact that the same two 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. Rather, both debts must arise out of a single integrated transaction so that it would be inequitable for the debtor to enjoy the benefits of that transaction without also meeting its obligations.

Id.

In *Lee v. Schweiker,* the Third Circuit held that the Social Security Administration ("SSA") could not recoup pre-petition overpayments post-petition without violating the debtor's stay. *Lee,* 739 F.2d at 876. In that case, Lee received overpayments of social security benefits in 1980. *Id.* at 872. Upon discovery of the overpayment, the SSA began deducting the overpayment amount from Lee's monthly benefits. *Id.* Three months later, unbeknownst to the SSA, Lee filed for bankruptcy. *Id.* The SSA continued to deduct the overpayment after Lee's automatic stay was in place. *Id.*

In holding that the SSA violated Lee's stay, the court distinguished between contract recoupment cases and social welfare benefit recoupment cases. *Id.* at 876 ("The courts have generally taken a different approach in dealing with government benefits to individuals, such as social security."). More specifically, the court noted 'that "[s]ocial welfare payments, such as social security, are statutory `entitlements' rather than contractual rights." *Id.* The court further noted that the primary purpose of such payments is to provide income security to qualifying recipients. *Id.* Finally, the court noted that:

Although the paying agency can ordinarily recover overpayments ... the

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Bankruptcy Code protects a debtor's future income from such claims once a petition has been filed, and the SSA violated the automatic stay in continuing to withhold part of Lee's benefits after she had filed her petition.

Id.

In *University Medical Center*, the Third Circuit examined a contract recoupment case. In that case, the Department of Health and Human Services ("HHS") withheld post-petition Medicare reimbursement payments from the debtor, University Medical Center ("UMC"), and applied them to its UMC's pre-petition overpayment. *Id.* at 1069. The court held that HHS improperly recouped the payments in violation of UMC's § 362 stay. *Id.* Relying on Medicare regulations, the court determined that UMC's pre-petition debt and its post-petition services did not arise from the same transaction. It noted that the regulations indicated that "reimbursement payments made for any one year [arose] from transactions wholly distinct from reimbursement payments made for subsequent years." *Id.* at 1080. The court further postulated that to find that the 1995 overpayment and the 1998 services rendered arose from the same transaction for the purposes of recoupment "would be to contort that doctrine beyond any justification for its creation." *Id.* at 1082.

The first court to discuss recoupment of unemployment compensation benefits was the Bankruptcy Court for the Western District of New York in *In re Maine*, 32 B.R. 452 (Bankr.W.D.N.Y.1983). In that case, the New York State Department of Labor ("NYDOL") filed a proof of claim in the debtor's case for overpayment of fraudulently received unemployment benefits. *Id.* at 453. The NYDOL also declared that the debtor was ineligible for benefits until his overpayment was paid in full. *Id.* Although the debtor had not reapplied for benefits, he challenged the NYDOL's future withholding of benefits as violating his stay. *Id.*

The *Maine* court held that the NYDOL was entitled to recoup the overpayment from the debtor by withholding future unemployment benefits. *Id.* at 455. In so holding, the court found that although the New York statute did not provide for recoupment of overpayments, the NYDOL's right to recoup overpayments was implicit in the statute. *Id.* at 454. The court also determined that the receipt of unemployment compensation benefits establishes a "societal contract" of sorts between the state and the recipient. *Id.* at 455. The court noted that state unemployment insurance law "establishes a continuing and ongoing relationship, and that recovery of overpayments from future benefits [is] an exercise of the State's common law right of recoupment." *Id.* The court further noted that although the NYDOL's claim would be discharged upon completion of the debtor's chapter 13 plan, the state's right to recoupment would survive. *Id.*

The Eastern District of Missouri adopted the *Maine* court's societal contract theory in *In re Ross*, 104 B.R. 171 (E.D.Mo.1989). In that case, Ross applied for and received unemployment compensation benefits in 1983. *Id.* at 172. In 1984, the Missouri Division of Employment Security ("MDES") discovered that Ross had obtained her 1983 benefits fraudulently and assessed her with an overpayment. *Id.* Thereafter, Ross filed for

chapter 13 bankruptcy. *Id.* In 1985, she filed for unemployment benefits again. *Id.* Instead of paying Ross her 1985 unemployment benefits, MDES recouped the funds in satisfaction of its 1983 overpayment. *Id.*

In holding that MDES properly recouped the overpayment from Ross, the court criticized the bankruptcy court for

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relying on the Third Circuit's decision in *Lee v. Schweiker*, instead of relying on the Bankruptcy Court for the Western District of New York's decision in *In re Maine*. *Id.* at 173. In so criticizing, the court noted that the bankruptcy court "failed to adequately reconcile the distinction between the nature of the benefits at issue. ..." *Id.* The court noted that "[u]nemployment compensation benefits, unlike social security benefits, are not the product of an employee's labor or the result of his individual contributions." *Id.* It also noted that "a debtor does not have a property right in the unemployment compensation the same way she would in her social security benefits, which she contributed to individually." *Id.* "Moreover, a debtor should not simply be permitted to avoid her pre-petition obligation to repay fraudulently obtained benefits by filing for bankruptcy and then filing a new claim for unemployment compensation." *Id.*

Although the court found that MDES properly recouped the overpayment, the court also noted that a hardship could occur "when an unemployed bankrupt would have to forego this sole subsistence as a penalty for receiving excess payments for earlier claims, especially when the overpayments might-have occurred a long time before. Equity demands some compromise." *Id.* In that vein, the court convinced MDES not to proceed against Ross for the balance of the overpayment (presumably allowing it to retain the money it already recouped). *Id.* MDES also made plans to file a request with the bankruptcy court for recoupment relief in the future. *Id.*

In *In the Matter of Gaither*, 200 B.R. 847 (Bankr.S.D.Ohio 1996), the court adopted the societal contract theory outlined in *Maine*. *Id. at* 852. In that case, the debtors obtained unemployment benefits in 1994 and 1995 through fraudulent misrepresentations. *Id. at* 848. The Ohio Bureau of Employment Services ("OBES") charged debtors with an overpayment and ordered that any future benefits be applied to the overpayment until it is paid in full. *Id.* In 1995, the debtors filed for chapter 13 bankruptcy. *Id.* After filing, the debtors submitted a new claim for benefits. *Id.* The OBES withheld the benefits and applied them to its 1994 and 1995 overpayments, pursuant to an Ohio statute. *Id.*

In adopting the societal contract theory, the *Gaither* court noted that "the terms of the societal contract for unemployment benefits are set forth in the Ohio Unemployment Compensation Act, which specifically provides for the recoupment of fraudulently obtained benefits." *Id. at* 852-53.

The court in *In re Stratman*, 217 B.R. 250 (Bankr.S.D.Ill.1998), also elected to follow the *Maine* court's societal contract theory. In that case, the debtor filed a claim for unemployment benefits in 1993. *In re Stratman*, 217 B.R. 250, 251 (Bankr. S.D.Ill.1998). In 1994, the Missouri Division of Employment Security ("MDES") discovered that the debtor had been employed in 1993, and determined that she was overpaid benefits in the amount of $953.00, due to a willful failure to disclose earned income in 1993. *Id.* In 1995, the debtor and her husband filed for chapter 13 bankruptcy. *Id.* at 252. In 1997, the debtor became unemployed and filed for unemployment benefits again. *Id.* Pursuant to the Missouri unemployment compensation statute, MDES applied the debtor's benefits to its 1993 overpayment. *Id.*

The *Stratman* court held that MDES properly withheld debtor's post-petition unemployment benefits because the prepetition overpayment and post-petition benefits arose from the same transaction. *Id.* In so holding, the court noted that "the right to recoupment arises

within the statutory scheme established" in Missouri, and that "there is a logical relationship

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between payment of Missouri unemployment benefits and the recovery of Missouri unemployment benefit overpayments. *Id.* Accordingly, the two arise from the same transaction." *Id.* at 253 (*citing In re Ross,* 104 B.R. 171 (E.D.Mo.1989); *Matter of Gaither,* 200 B.R. 847 (Bankr.S.D.Ohio 1996); *In re Maine,* 32 B.R. 452 (Bankr. W.D.N.Y.1983)).

Finally, in *In re Adamic,* 291 B.R. 175 (Bankr.D.Colo.2003), the Bankruptcy Court for the District of Colorado also held that the Colorado Department of Labor ("CDOL") properly recouped the debtor's post-petition unemployment benefits. *In re Adamic,* 291 B.R. 175, 184 (Bankr. D.Colo.2003). In that case, the debtor collected unemployment benefits in 1993. *Id.* at 178. In 1994, the CDOL discovered that the debtor was employed in 1993. *Id.* The CDOL concluded that he had received the 1993 payments by false representation and assessed a penalty. *Id.* The debtor did not appeal. *Id.* Thereafter, the debtor filed for chapter 13 bankruptcy. *Id.* at 179. He listed the CDOL's overpayment claim in his Schedule F, and the CDOL filed a proof of claim. *Id.* The debtor lost his job in 2002 and applied for unemployment compensation benefits. *Id.* The CDOL applied all of the debtor's 2002 benefits to its 1993 overpayment, because the debtor had "caused the overpayment by willfully giving false information or consciously holding back information." *Id.*

The *Adamic* court seemingly adopted the Third Circuit's integrated transaction test, noting that the doctrine of recoupment "is only applicable to claims that are so closely intertwined that allowing the debtor to escape [his or her] obligation would be inequitable notwithstanding the Bankruptcy Code's tenet that all unsecured creditors share equally in the debtor's estate." *Id.* at 182. Following the integrated transaction test, the court found that the debtor's pre-petition overpayment liability and his post-petition benefits arose from the same transaction. *Id.* at 184. More specifically, the court relied on the fact that Colorado's statute "conditioning receipt of current benefits on recovery of prior overpayments is expressly authorized by Congress,[3] as is denial of claims for benefits where state eligibility requirements have not been met." *Id.*

Going one step further than the other courts that have discussed this issue, the *Adamic* court found that irrespective of whether the CDOL improperly recouped the debtor's benefits, it did not violate the debtor's stay, because "the post-petition benefits are neither property of the Debtor nor property of the estate." *Id.* at 185. The court found that "[b]ecause the Debtor is not entitled to receive unemployment compensation under state law due to his prior fraud and/or failure to disclose a material fact, he never `acquired' the post-petition payments and those payments do not constitute `earnings for services performed.'" *Id.* at 187. Finally, the *Adamic* court noted that its decision differs from the Third Circuit's decision in *Lee* and

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notes that it agrees with other courts that have determined that a debtor does not have a property right in unemployment benefits like he or she does in social security benefits, because the latter benefits are statutory entitlements. *Id.* at 187.

Courts must also consider the equities of each case and in the absence of fraud recoupment may not be equitable. In *In re Malinowski,* 156 F.3d 131 (2nd Cir.1998), the Second Circuit reached a different conclusion than the *Maine* and *Ross* courts. In that case, pursuant to an initial determination of eligibility, the debtor collected unemployment benefits. *Id.* at 132. Later, the New York Department of Labor ("NYDOL") determined that the debtor was ineligible because he had voluntarily left his employment and without good cause. *Id.* The NYDOL charged the debtor with the overpayment. *Id.* Thereafter, the debtor filed for chapter 13 bankruptcy. *Id.* The following year,

the debtor filed for unemployment benefits again. *Id.* The NYDOL did not file a proof of claim in the debtor's case, but instead withheld his post-petition benefits to satisfy its pre-petition overpayment. *Id.*

The *Malinowski* court held that the NYDOL improperly recouped its overpayment in violation of the debtor's stay. In so holding, the court found that the pre-petition overpayment and the post-petition qualification for benefits did not arise from the same transaction, because "the two claims for unemployment benefits were based upon different episodes of unemployment." *Id.* at 134. Also, the court noted that the New York statute governing unemployment benefits required the debtor to have worked in the preceding year to qualify for benefits in the following year. *Id.* Further, the court noted that although "[t]he worker was the same, the agency was the same, the law was the same ... the claims arose from different sets of facts, each complete in itself." *Id.* Additionally, the court found it significant that "the two periods of employment were separated by the filing of a petition for bankruptcy." *Id.* at 135. Moreover, the court rejected the societal contract theory postulated by the *Maine* court in favor of the Third Circuit's social welfare benefits theory. *Id.* at 135.[4] Finally, the court found that "in light of the equitable nature of the recoupment remedy, the facts in the particular case are important. The Department asks us to take away the unemployment insurance safety net from a debtor in bankruptcy who has not been accused of willful wrongdoing in connection with the overpayment." *Id.* The court found that the lack of fraud in this case distinguished it "from *Maine* and others in which the government was permitted to recoup overpayments resulting from fraud." *Id.*

As the Third Circuit has not examined recoupment in the context of unemployment benefits the Court looks to the other Circuits for guidance on the issue. The Court finds the applicable law as follows: State Departments of Labor are entitled to recoup fraudulently received unemployment compensation benefits against future benefits. *In re Ross,* 104 B.R. 171 (E.D.Mo.1989); *In re Maine,* 32 B.R. 452 (Bankr.W.D.N.Y.1983); *In the Matter of Gaither,* 200 B.R. 847 (Bankr. S.D.Ohio 1996); *In re Adamic,* 291 B.R. 175 (Bankr.D.Colo.2003). Recoupment is justified because unemployment compensation, is a societal contract and not an entitlement. *See In re Maine,* 32 B.R. at 455; *In re Ross,* 104 B.R. at 173.

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First, as the *Adamic* court noted, states are authorized to recoup overpayments of unemployment benefits pursuant to federal statutes, such as the Social Security Act and the Federal Unemployment Tax Act. Second, unlike social security benefits, individuals do not contribute personally to unemployment benefit funds, they contribute minimal amounts to an unemployment insurance fund. This fund is a form of social insurance or a societal contract. The Debtor does not have a property right in unemployment benefits in the same way as social security benefits because they are not statutory entitlements. Also, unlike unemployment benefit claimants, social security benefit claimants cannot be disqualified from receiving benefits.[5]

Thus, unemployment benefits are distinguishable from social security benefits in that they are not clearly recognizable as social welfare benefits. Third, the majority of cases dealing with recoupment of unemployment benefits have found that recoupment was proper. Only one case found that recoupment was improper — *Malinowski.* The *Malinowski* case is distinguishable from this case in that there was no finding of fraud. In this case, as in the *Ross, Maine, Gaither,* and *Adamic* cases, there was a finding of fraud. Fourth, like the statutes in Colorado, Missouri, and Ohio, New Jersey's unemployment compensation benefits statute provides for recoupment of overpayments obtained through fraud.[6]

Finally, New Jersey courts have supported the statute's recoupment provisions. More

specifically, the courts note that the recoupment provisions of New Jersey's statute are "designed to preserve the Unemployment Trust Fund for the payment of benefits to those individuals entitled to receive them." *Bannan v. Board of Review*, 299 N.J.Super. 671, 674, 691 A.2d 895, 897 (1997). New Jersey courts also note that the State has the responsibility "to serve not only the interests of the individual unemployed, but also the interests of the general public." *Id.* "The public interest clearly is not served when the Unemployment Trust Fund is depleted by failure to recoup benefits erroneously paid to an unentitled recipient, however blameless he or she may have been." *Id.* The courts further note that the fact that the "individual suffers a hardship is unfortunate, but it is necessary to preserve the ongoing integrity of the unemployment compensation system." *Id.* at 675, 691 A.2d at 897.

Based on the foregoing, and in light of the purpose of New Jersey's unemployment compensation statute, the Court adopts the societal benefits theory with regard to recoupment of unemployment benefits. Accordingly, the Debtor's 1993 overpayment and 2004 benefits arose from

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the same transaction for purposes of recoupment. As such, the NJDOL properly recouped the Debtor's 2004 benefits. The NJDOL did not violate the Debtor's stay because the doctrine of recoupment operates outside of a debtor's 362 stay.

However, considering that recoupment is an equitable remedy, the Court must examine the facts of each case with particularity. In the case at bar, the Debtor fraudulently obtained unemployment benefits, but the overpayments occurred years before the Debtor filed for bankruptcy protection. Unemployment benefits, like social security benefits, are designed to provide a claimant with income security in the event that he or she loses his or her job. As such, the Court holds that the NJDOL was entitled to recoupment but it is limited to the amount already recouped. No further offsets are permitted. The Debtor has completed all payments required under his Plan. Accordingly, the remainder of the NJDOL's claim is discharged.

CONCLUSION

Based on the foregoing, the Court denies the Debtor's motion to lift attachment of unemployment benefits in violation of his stay because the NJDOL properly recouped its overpayment, and, as such, is not in violation of the Debtor's stay. However, the NJDOL's recoupment is limited to $2,961.85, and the reminder of its claim is discharged upon the completion of the Debtor's chapter 13 plan.

Notes:

1. This amount represents $6,003.00 in benefits paid, as well as $1,500.75, which represents a statutory fine and interest.

2. At least one other court has held that a debtor "is not entitled to receive unemployment compensation under state law due to his prior fraud and/or failure to disclose a material fact, [because] he never `acquired' the post-petition payments and those payments do not constitute `earnings for services performed.'" *In re Adamic*, 291 B.R. 175, 187 (Bankr. D.Colo.2003).

3. The court criticized the *Malinowski* court for failing to recognize that state unemployment statutes implement a federal program, and that federal statutes contemplate state statutes that "may terminate, deny, suspend or reduce any benefits for unemployment compensation in certain circumstances." *Id.* at 184. The court pointed to two federal statutes allowing a state to recoup overpayments-the Social Security Act and the Federal Unemployment Tax Act. The Social Security Act permits states to "deduct from unemployment benefits otherwise payable to an individual under an unemployment benefit program of the United States or of any other State, and not previously recovered." 42 U.S.C. § 503(g) (2004). The Federal Unemployment Tax Act permits states to deduct amounts "from unemployment benefits and used to repay overpayments as provided in section 503(g) of

the Social Security Act." 26 U.S.C. § 3304(a)(4)(D) (2004).

4. The court, however, did not explain how or why unemployment benefits constitute social welfare benefits.

5. Individuals who fraudulently obtain social security benefits can be convicted of a felony and imprisoned and/or fined. They cannot, however, be disqualified from receiving benefits. *See* 42 U.S.C. § 408 (2004). *Cf. with* N.J. Stat. § 43:21-5 (2004).

6. "When it is determined that a person has obtained benefits fraudulently or through misrepresentation, such person shall be liable to repay those benefits in full. The sum shall be deducted from any future benefits payable to the individual under this chapter." N.J. Stat. § 43:21-16(d)(1) (2004).

It should be noted that New York's statute, followed in the *Malinowski case*, provides that a claimant who wilfully makes a false statement or representation "shall forfeit benefits for at least the first four but not more than the first eighty effective days following discovery of such offense for which he otherwise would have been entitled to receive benefits." NY CLS Labor § 594 (2004). Thus, unlike New Jersey's statute, the New York statute does not expressly provide for recoupment.

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15 B.R. 834 (1981)
In re James Arthur ROWAN and Patricia Ann Rowan, Debtors.
James Arthur ROWAN and Patricia Ann Rowan, Debtors-Plaintiffs,
v.
Howard Z. MORGAN, Akron District Social Security Administration, William Driver, Commissioner — Social Security Administration, Richard S. Schweiker, Secretary Department of Health & Human Services, William French Smith, Attorney General, Department of Justice, James R. Williams, U.S. Attorney, Defendants.
Bankruptcy No. 581-31, Adv. No. 581-0471.
United States Bankruptcy Court, N.D. Ohio.
December 14, 1981.

[15 BR 835]

Martin L. Olson, Uniontown, Ohio, for debtors.

Randolph Baxter, Asst. U.S. Atty., Cleveland, Ohio, for defendants.

FINDING AS TO DISCHARGEABILITY

H.F. WHITE, Bankruptcy Judge.

This proceeding was commenced on May 29, 1981 by Debtors, James Arthur Rowan and Patricia Ann Rowan, to determine the dischargeability of a debt alleged to have been discharged by this Court on April 15, 1981. An answer was filed by the United

[15 BR 836]

States of America, on behalf of the federal defendants, on July 15, 1981. This answer was amended on July 24, 1981.

A Stipulation of Facts was filed by the parties on August 7, 1981 pursuant to an Order of this Court dated July 23, 1981. Briefs in support of their respective positions have been filed by both the Plaintiffs and the Defendants. This Court granted permission to Defendants on September 30, 1981 to file a Supplemental Memorandum in response to the Brief which had been filed by Plaintiffs. This Order likewise granted Plaintiffs permission to respond to Defendants' Supplemental Memorandum. No such response was filed by Plaintiffs.

FINDINGS OF FACT

Debtor, James Arthur Rowan, was notified on November 7, 1980 that the Social Security Administration (hereinafter referred to as "SSA") had determined that he had earned over the allowable amount in income for the year 1979. Because of this, Debtor had received overpayments in benefits from SSA.

On November 24, 1980, Debtor requested a waiver of the overpayment which request was denied on February 5, 1981. Debtor chose not to appeal this decision as he was told by Mrs. Kinney, his caseworker at SSA, that it would be useless to appeal the denial of waiver any further.

On January 12, 1981, debtors filed their Petition in Bankruptcy pursuant to Chapter 7 of the Bankruptcy Reform Act. April 10, 1981 was set as the last day for filing an objection to the discharge of debtors or for filing a complaint to determine the dischargeability of a debt pursuant to 11 U.S.C. Section 523.

SSA was not listed as a creditor on Debtors' original petition. On March 10, 1981, Debtors filed an Amendment to their Schedules which amendment added as a creditor the Department of Health and Human Services. The debt was listed as an "overpayment by Social Security benefits during 1979/80" and was listed in the amount of $2,269.00. In addition to service on the Department of Health and Human Services, the amendment requested that William J. Driver, Commissioner of the Social Security Administration; Robert A. Gross, Jr., Acting

Director of Operations for the Social Security Administration; and Howard Z. Morgan, District Director, Akron, Ohio for the Social Security Administration be notified of the scheduling of the debt.

The bankruptcy case file shows that a "Notice to Creditor Omitted from the Original Schedules of the Debtor" signed by this Court was sent to the above-mentioned individuals and the Department of Health and Human Services on March 18, 1981 by the Clerk's Office for the Bankruptcy Court. The file does not show that any of said notices were returned to the Clerk's Office. The Court therefore finds that the notices were in fact received by the Department of Health and Human Services; William J. Driver; Robert A. Gross, Jr.; and Howard Z. Morgan.

SSA did not file a proof of claim in this case. Said creditor likewise chose not to file an objection to the discharge of debtors nor to file a complaint to determine the dischargeability of SSA's claim against Debtor.

Debtors do not dispute Social Security's contention that Debtor, James Arthur Rowan, was overpaid in his Social Security benefits. They likewise have not disputed SSA's finding that said Debtor was "at fault" in the receipt of those overpayments. The SSA has admitted in the Joint Stipulation of Facts that Debtor did not act fraudulently in supplying information to SSA which information resulted in the overpayments to Debtor.

There is an inconsistency in the amount due SSA as set forth in Plaintiffs' and Defendants' Briefs. The parties did not stipulate in the Joint Stipulation of Facts to the amount due SSA. Debtors scheduled the debt due SSA in the amount of $2,296.00. SSA states in its Briefs that the amount due for overpayment is $1,079.90. A memorandum from Howard Z. Morgan, District Manager for SSA, to Randolph

[15 BR 837]

Baxter, Assistant U.S. Attorney, dated August 5, 1981, shows the amount due to be $1,186.40. Deductions of $69.00 per month from March 1981 through July 1981 were made, which together with a credit for an underpayment in benefits in 1980 in the amount of $106.50, left a balance due on the overpayment of $734.90. The Court finds that it is the amount of $1,186.40 which was over-paid to Debtor.

The schedules filed by Debtor show that Debtor, James Arthur Rowan, is no longer employed but is retired. Debtor is receiving pension funds in the amount of $168.00 monthly from North Canton Board of Education. Debtors received a discharge in bankruptcy on April 15, 1981.

ISSUE

The issue is whether the overpayment debt owed by Debtor, James Arthur Rowan, to the Social Security Administration is dischargeable in bankruptcy and whether SSA may offset the amount of $69.00 per month from future benefits due the debtor for recoupment of the overpayment.

LAW

In an amended answer filed July 24 1981, the United States of America, on behalf of all federal defendants named herein, set forth four affirmative defenses to Debtors' Complaint. Defendants alleged that: 1) the overpayment was not dischargeable in bankruptcy pursuant to a provision of the Social Security Act, 2) Plaintiffs had failed to exhaust their administrative remedies and thus this action was barred, 3) this Court had no jurisdiction as the government had not waived its sovereign immunity herein, and 4) the federal government is a secured creditor due to its statutory right of recoupment. For the reasons set forth below, the Court rejects each of these defenses and finds that the overpayment debt in question is a dischargeable debt.

The Defendants have raised two issues which are jurisdictional in nature — exhaustion of administrative remedies and sovereign immunity. The Court will therefore address the jurisdictional issues first.

When a Social Security benefit recipient receives notice that he has been overpaid, he may file a request for reconsideration and waiver of the overpayment with SSA. 20 C.F.R. Section 404.907. Following the reconsideration, the individual has a right to a hearing conducted by an administrative law judge appointed by the Associate Commissioner for Hearings and Appeals or his delegate. 20 C.F.R. Section 404.929. That decision may then be reviewed by the Appeals Council of the Bureau of Hearings and Appeals in the Social Security Administration. 20 C.F.R. Section 404.967. The decision of the Appeals Council then becomes the final decision of the Secretary. Baker v. Gardner, 362 F.2d 864 (3d Cir. 1966). The final decision of the Secretary is made reviewable by a civil action in the federal district court pursuant to 42 U.S.C. Section 405(g).

Review by the federal district court is conditioned upon the timely exhaustion of the successive steps of review by SSA. Messing v. Finch, 322 F.Supp. 1279 (E.D.Pa. 1971); Bohn v. Finch, 320 F.Supp. 270 (E.D. La.1970).

It is the Government's argument that Debtor's failure to exhaust his administrative remedies as allowed him under SSA's regulations bars Debtor from alleging the dischargeability of the overpayment debt in this Court. The Government cites a case from the Bankruptcy Court for the Central District of Illinois wherein it is stated that the Plaintiff's failure to exhaust his administrative remedies makes SSA's determination that Plaintiff was "at fault" for the overpayment binding. In Re Neavear, Case No. 180-00419, Adv. No. 180-0212 (Bkrtcy. C.D.Ill.1981), appeal docketed, No. 81-1860 (7th Cir.).

Debtor herein is not seeking a review of SSA's determination that he was at fault in the overpayment. Indeed, in his Brief, Debtor admits that he is indebted to SSA and states further that what he is seeking herein is not a trial on the merits as to SSA's claim. Instead, Debtor, while admitting the validity of the debt, seeks a determination

[15 BR 838]

that this Court's Order, dated April 15, 1981, discharged the debt to SSA.

An individual is not required to exhaust his administrative remedies prior to commencing a civil action in the federal courts where the relief sought in the civil action may not be granted by the administrative agency in question. United States Alkali Export Association, Inc. v. United States of America, 325 U.S. 196, 65 S.Ct. 1120, 89 L.Ed. 1554 (1945). Thus, in Finnerty v. Cowen, 508 F.2d 979 (2nd Cir. 1974), Plaintiff, without exhausting his remedies, commenced a civil action alleging that reductions made under the Social Security and Railroad Retirement Acts were unconstitutional. The district court dismissed for failure to exhaust administrative remedies.

The Court of Appeals for the Second Circuit reversed. The Court held that a federal agency has no authority to determine the constitutionality of administrative procedures. As Plaintiff sought a determination which could not be made by a federal agency, he was not required to first exhaust his administrative remedies. See also School District of City of Saginaw, Mich. v. U.S. Dept. of HEW, 431 F.Supp. 147 (E.D.Mich. 1977); Plano v. Baker, 504 F.2d 595 (2d Cir. 1974).

SSA has no power or ability to determine the dischargeability of a debt in bankruptcy. The review provided for in the Regulations concerns itself with the propriety of the determination of overpayment made by SSA and the availability of waiver to the overpaid recipient. These issues are not in dispute herein. As Debtor does not seek review of SSA's determination that Debtor was "at fault" in the overpayment and as SSA cannot make a determination as to the dischargeability of a debt in bankruptcy, Debtor was not required to exhaust his administrative remedies in order to file the complaint herein.

The second jurisdictional issue presented this Court is that of sovereign immunity. The Government argues that because it filed no proof

of claim herein, it has not waived its sovereign immunity and thus this Court does not have jurisdiction. Defendants' argument must be rejected.

An argument similar to that raised by SSA herein was raised by the Internal Revenue Service under the former Bankruptcy Act in In Re Gwilliam, 519 F.2d 407 (9th Cir. 1975). In that case, the Bankrupt filed a complaint to determine the dischargeability of federal taxes due Internal Revenue Service by the Bankrupt. The Internal Revenue Service failed to file a proof of claim in the bankruptcy. Upon the filing of the complaint to determine dischargeability, Internal Revenue Service contended that the Bankruptcy Court had no jurisdiction over the complaint as the Government had not waived sovereign immunity.

The Court held that the adoption of former section 17(c) 11 U.S.C. Section 35(c), granting the Bankruptcy Court jurisdiction to determine the dischargeability of any debt, gave the Court jurisdiction to determine the dischargeability of a federal tax debt notwithstanding the failure of the Government to file a proof of claim. The holding in In re Gwilliam, supra, was codified in 11 U.S.C. Section 106(c). 124 Cong. Rec.H. 11,091 (Sept. 28, 1978); S. 17,407 (Oct. 6, 1978).

Like the complaint in Gwilliam, the complaint herein seeks a determination of the dischargeability of a debt due the federal government. This Court has jurisdiction over the same pursuant to 28 U.S.C. Section 1471. Accordingly, the failure of the Government to file a proof of claim does not deny this Court jurisdiction over the complaint. In re Gwilliam, supra.

Additionally, social security benefits are property of the estate pursuant to 11 U.S.C. Section 541(a)(1). In Re Buren, 6 B.R. 744 (M.D.Tenn.1980), appeal docketed, No. 80-5427 (6th Cir.); In Re Hughes, 7 B.R. 791, 7 B.C.D. 12 (Bkrtcy.E.D.Tenn.1980). The Bankruptcy Court is empowered under 11 U.S.C. Section 105(a) to "issue any order ... necessary or appropriate to carry out the provisions of this title." The relief sought by Debtors herein is necessary or appropriate to carry out the provisions of Title 11 as it seeks to protect property of

[15 BR 839]

the estate. This Court has jurisdiction over this complaint and thus Defendants' first two arguments must be rejected.

Defendants next argue that the overpayment debt is not dischargeable pursuant to Section 207 of the Social Security Act. 42 U.S.C. Section 407 provides that:

> The right of any person to any future payment under this subchapter shall not be transferable or assignable, at law or in equity, and none of the moneys paid or payable or rights existing under this subchapter shall be subject to execution, levy, attachment, garnishment, or other legal process, or to the operation of any bankruptcy or insolvency law.

Defendants rely on this section for their contention that Social Security payments are not subject to bankruptcy law. Therefore, it is argued, the debt could not be discharged.

The argument raised by Defendants was recently rejected in a case before the District Court for the Northern District of Illinois, In Re Gutierrez, 15 B.R. 268 (N.D. Ill.1980), appeal docketed, Case No. 81-2243 (7th Cir.). That Court held that as SSA had failed to file an objection to discharge, the overpayment debt was discharged pursuant to 11 U.S.C. Section 523(c). The Court was of the opinion that the only objections that could possibly have been raised by SSA in a complaint were those set forth in 11 U.S.C. Section 523(a)(2), (4), and (6). As these debts are discharged if timely complaint to determine dischargeability is not

filed and as no such complaint was filed, the SSA overpayment was discharged in bankruptcy.

This Court approves of and follows the holding in Gutierrez. Defendants herein failed to file a complaint to determine the dischargeability of the SSA debt pursuant to 11 U.S.C. Section 523. As in Gutierrez, the sole grounds which appear to be available to Defendants under 11 U.S.C. Section 523(a) are those set forth in Subsections (2), (4), and (6). No complaint having been filed, 11 U.S.C. Section 523(c) renders the overpayment dischargeable. Moreover, this Court notes that SSA has stipulated that no element of fraud was involved in the overpayment on the part of Debtor, James Arthur Rowan. Accordingly, it is doubtful whether SSA would have had any grounds whatsoever under 11 U.S.C. Section 523 to object to the dischargeability of SSA's claim.

Defendants have argued strenuously that the notice given them by Debtors of the scheduling of the debt owed to SSA was insufficient. In addition to the Department of Health and Human Services, three individuals with highly responsible positions within SSA were served with notice of the filing of the Bankruptcy proceeding. This Court finds that the notice given SSA was sufficient to put that agency on notice of the pendency of the proceedings in this Court. If SSA believed that it could not file an objection to discharge or complaint to determine dischargeability within the time limits set by this Court, a request for extension of time could have been sought from the Court. Due to the fact that SSA was added as a creditor nearly two months after the Petition was filed and just one month before the last day to file objections to discharge, this Court would, no doubt, have granted SSA an extension of time to file any objections it had.

The Legislative History surrounding the Bankruptcy Reform Act of 1978 supports the holding that the SSA overpayment is a dischargeable debt. Shortly before the Reform Act was signed into law on November 6, 1978, in discussions in both the House of Representatives and the Senate, it was stated that: "Section 327 of the House Amendment adopts a comparable provision contained in the House bill consistent with the policy that all nondischargeable debts should be enumerated in section 523 of title 11." 124 Cong.Rec. S 17,425 (daily ed. Oct. 6, 1978); 124 Cong.Rec.H. 11,108 (daily ed. Sept. 28, 1978). The Section referred to in this passage from the Congressional Record is the section in the Reform Act which repealed 42 U.S.C. Section 656(b). That section had made nondischargeable in bankruptcy cases brought under the former Act those debts representing child support obligations

[15 BR 840]

assigned to the state pursuant to 42 U.S.C. Section 602(a)(6). By repealing this section, and as expressly set forth in the Congressional Record, Congress evidenced its intent that all nondischargeable debts be set forth in 11 U.S.C. Section 523, rather than declaring debts to be nondischargeable in various titles of the United States Code.

SSA overpayments are not set out in Section 523 as being nondischargeable debts. The overpayment debt is therefore dischargeable in keeping with Congress' expressed policy that all debts not specifically enumerated in Section 523 be dischargeable.

This Court's holding is not inconsistent with the purpose behind 42 U.S.C. Section 407. It has been said that the purpose of this section is to protect the Social Security benefits recipient and those dependent upon him from the claims of creditors. Brown v. Brown, 32 Ohio App.2d 139, 61 Ohio Op.2d 162, 282 N.E.2d 852 (C.A. Cuyahoga 1972). Indeed, the practical effect of this holding is to ensure that Debtor, James Arthur Rowan, receives the full monthly benefit payment to which he is entitled without reduction for the overpayments made to him by SSA, thus protecting Debtor and his dependents. Such an effect is entirely in keeping with the purpose of 42 U.S.C. Section 407.

Defendant's final argument states that SSA has a statutory right of recoupment pursuant to 42 U.S.C. Section 404. This right, it is argued, renders SSA a secured creditor. This Court has held, however, that the overpayment debt was discharged in its Order dated April 15, 1981 which relates back to the filing date of the Petition in Bankruptcy on January 12, 1981. As the debt has been discharged, there is nothing to recoup.

Defendants' characterization of its claim as a secured claim likewise must fail. Under the Code, a security interest, such as would render a claim secured, must be created by agreement between the parties or by a statutory provision. 11 U.S.C. Sections 101(35), (36), (37), and 506(a). There is no agreement between the parties herein to create a security interest. Although 42 U.S.C. Section 404 does provide for a right of recoupment, Califano v. Yamasaki, 442 U.S. 682, 99 S.Ct. 2545, 61 L.Ed.2d 176 (1979), it does not provide for the creation of a security interest in favor of SSA. As such, SSA is not a secured creditor.

Moreover, Debtor is entitled to Social Security benefits only until the month "preceding the month in which he dies". 42 U.S.C. Section 402(a). Continued receipt of benefits is conditioned upon Debtor living each full month. Only after Debtor survives for a full month is he entitled to benefits for that month.

Thus, on January 12, 1981 when Debtors filed their Petition in Bankruptcy, Debtor was not yet entitled to his January benefits payment as he had not yet survived the month. As Debtor would have received his December benefits payment by that date, no security for the overpayment debt existed on that date.

The right of setoff, found in 11 U.S.C. Section 553, also would not apply herein. On January 12, 1981 when the Petition was filed, there was no fund held by SSA against which it could off-set the debt owed it. This is due to the fact that Debtor was not yet entitled to Social Security benefits for January as he had not yet survived the month. As the fund against which the right of set-off is to be exercised must be in existence as of the commencement of the case, 11 U.S.C. Section 553(a), the right of set-off could not be utilized herein.

CONCLUSION

This Court having jurisdiction over the complaint to determine dischargeability of the SSA overpayment, it is the Court's holding that the overpayment debt is a dischargeable debt and was discharged in this Court's Order of Discharge dated April 15, 1981.

ORDER AS TO DISCHARGEABILITY

Pursuant to the Finding as entered by this Court on the 14th day of December 1981;

[15 BR 841]

IT IS ORDERED:

1. that the Social Security Administration overpayment debt due from the Debtor-Plaintiff to the Defendant is a dischargeable debt pursuant to 11 U.S.C. 523(c) and was in fact discharged by the Court's Order of Discharge as entered on April 15, 1981.

2. that the Social Security Administration is enjoined from making any future deductions from Debtor-Plaintiff's monthly benefit payment for the purpose of collecting the discharged overpayment debt to Social Security Administration.

3. that the Social Security Administration pay to the Debtor-Plaintiff that amount of money representing the deductions made from debtor's monthly benefit checks commencing March, 1981 through the date of this order.

23 B.R. 236 (1982)
In the Matter of Erwin M. HAWLEY and Shirley A. Hawley, Debtors.
Erwin M. HAWLEY and Shirley A. Hawley, Plaintiffs,
v.
UNITED STATES of America Social Security Administration Bureau of Disability Insurance, Defendant.
Bankruptcy No. 80-00184, Adv. No. 80-0054.
United States Bankruptcy Court, E.D. Michigan, N.D.
September 27, 1982.

[23 BR 237]

Arthur J. Spector, Bay City, Mich., for plaintiffs.

Richard Vary, Asst. U.S. Atty., Bay City, Mich., for defendant.

MEMORANDUM OPINION AND ORDER

HARVEY D. WALKER, Bankruptcy Judge.

Erwin M. Hawley and Shirley A. Hawley filed a Voluntary Petition under Chapter 7 of Title 11 of the United States Code on April 9, 1980. They listed as one of their creditors the Social Security Administration. The basis of the debt was some $4109.29 overpayment in disability benefits. From approximately April, 1976, the Plaintiff, Erwin M. Hawley, was legitimately receiving Social Security benefits from Defendant, Social Security Administration. From approximately January, 1978, through approximately June, 1978, (according to the Plaintiffs, or from approximately February, 1978 through January, 1979, according to the Defendant) Mr. Hawley received Social Security benefits, although he acknowledged that he was not entitled to the same and attempted on various occasions to both return the checks and to notify the Social Security Administration of its error in sending him the checks. Nonetheless, the Social Security Administration continued to send Social Security checks to Mr. Hawley, which Mr. Hawley eventually cashed and used. Commencing in March of 1979, the Social Security Administration made claim against the Plaintiffs for the amount of benefits they had improperly accepted. The Social Security Administration commenced proceedings to establish the fact of the overpayment. The Plaintiffs exercised their remedies in the administrative process, but eventually, the determination that the Plaintiffs were "at fault" for the overpayment was finally made. Their request for waiver of the overpayment was also denied by the Social Security Administration.

On various occasions, the Plaintiffs were advised by the Social Security Administration that as they were "at fault" for the overpayment, the Social Security Administration would set off this obligation against benefits legitimately earned upon the retirement of the Plaintiffs, and that, therefore, the Plaintiffs could expect not to receive their Social Security benefits upon retirement until the overpayment was liquidated.

The Debtors have filed a Complaint for Declaratory Relief and seek a ruling from the Bankruptcy Court that would bar the Social Security Administration from setting off the overpayment of $4109.20 from the Hawleys' prospective Social Security Retirement payments.

Although the issue of whether or not the amount of the overpayment is dischargeable in bankruptcy is a case of first impression in this Court, it has been addressed by other Courts. One such case is In re Rowan, 5 C.B.C.2d 1008, 15 B.R. 834 (Bkrtcy.N. D.Ohio 1981). In Rowan, the Debtor, James Arthur Rowan, was determined to have received overpayments in benefits from the Social Security Administration. In both the cases before this Court and Rowan the Social Security Administration chose not to file a Proof of Claim or an objection to the discharge of the

Debtors to determine the dischargeability of the Social Security Administration's claims against the respective Debtors. Neither of the Debtors dispute the Social Security Administration's finding that the Debtors were "at fault" in the receipt of the overpayments.

In Rowan, as in the instant case, the Social Security Administration alleged that:

1. The overpayment was not dischargeable in bankruptcy pursuant to a provision of the Social Security act.

2. Plaintiffs had failed to exhaust their administrative remedies and thus this action was barred.

3. This Court had no jurisdiction as the government had not waived its sovereign immunity herein, and

4. The Federal Government is a secured creditor due to its statutory right of recoupment.

[23 BR 238]

The Court in Rowan, however, rejected each of these affirmative defenses and found that the overpayment was dischargeable in Bankruptcy.

The Court held that the Debtor did not have to seek an administrative review of the Social Security's determination that he was at fault in the overpayment. "An individual is not required to exhaust his administrative remedies prior to commencing a civil action in the federal courts where the relief sought in the civil action may not be granted by the administrative agency in question." United States Alkali Export Association, Inc. v. United States, 325 U.S. 196, 65 S.Ct. 1120, 89 L.Ed. 1554 (1915); Id. 5 C.B.C.2d at 1012, 15 B.R. 834. The Court stated that as the Social Security Administration had no power or ability to determine the dischargeability of a debt in bankruptcy, the Debtor was not required to exhaust his administrative remedies.

As to the Social Security Administration's claim that because it filed no Proof of Claim and had, therefore, not waived its sovereign immunity, the Court found that it did have jurisdiction to determine the claim. To substantiate its decision, the Court cited the case of In re Gwilliam, 519 F.2d 407 (9th Cir. 1975). This case has been codified in 11 U.S.C. § 106(c). That section provides:

> "(c) Except as provided in subsections (a) and (b) of this section and notwithstanding any assertion of sovereign immunity (1) a provision of this title that contains `creditor\', `entity\', or `governmental unit\' applies to governmental units; and (2) a determination by the Court of issue arising under such a provision binds governmental units."

The Social Security Administration argued that the overpayment was not dischargeable pursuant to Section 207 of the Social Security Act, 42 U.S.C. § 407. This section provides that:

> "The right of any person to any future payment under this subchapter shall not be transferable or assignable, at law or in equity, and none of the moneys paid or payable or rights existing under this subchapter shall be subject to execution, levy, attachment, garnishment, or other legal process, or the operation of any bankruptcy or insolvency law."

The Rowan Court disagreed with this assumption and in doing so relied on the case of In re Gutierrez, Bankruptcy L Rep (CCH) ¶ 68,080 (N.D.Ill.1980). The Court in Gutierrez "was of the opinion that the only objections that could possibly have been raised by the Social Security Administration in a complaint were those set forth in 11 U.S.C. § 523(a)(2), (4) and (6). As these debts are discharged if a timely

complaint to determine dischargeability is not filed, and as no such complaint was filed, the Social Security overpayment was discharged in bankruptcy." Rowan at 1014. In the instant case since the Social Security Administration has not filed a complaint to determine the dischargeability of the debt, 11 U.S.C. § 523(c) renders the overpayment dischargeable.

The Court in Rowan also stated that it was Congress' express policy that all debts not specifically enumerated in Section 523 are dischargeable. Since Section 523 does not list Social Security Administration overpayments as nondischargeable the debt to the Social Security Administration's claim is dischargeable.

The Social Security Administration's final argument is that it has a statutory right of recoupment pursuant to 42 U.S.C. § 404 and that this right makes it a secured creditor. As the Court had already found the debt to be dischargeable, it held there was nothing for the Social Security Administration to recoup. The Court also found that while 42 U.S.C. § 404 does provide for a right of recoupment, the section does not create a security interest in favor of the Social Security Administration.

The 7th Circuit Court of Appeals has also addressed this question in In re Neavear, 6 C.B.C.2d 367, 674 F.2d 1201 (7th Cir. 1982). The Neavear Court found that Section 207 of the Social Security Act which provides that Social Security funds shall not be subject to Bankruptcy Laws provides only an exemption from the Bankruptcy Laws for

[23 BR 239]

the benefits of Social Security recipients. The section was not intended to operate so as to prevent a debtor from obtaining a discharge of a debt owed to the Social Security Administration because of an overpayment. The Court went on to state that not every Social Security recipient who receives an overpayment of benefits will be allowed to discharge such a debt through bankruptcy. For such a debt to be held nondischargeable under Section 523 of the Bankruptcy Code, the Social Security Administration will have to demonstrate that the debt is nondischargeable under either 523(a)(2), (6) or (4). This Court adopts the rationale of both In re Rowan, 5 C.B.C.2d 1008, 15 B.R. 834 (Bkrtcy.N.D.Ohio 1981) and In re Neavear, 674 F.2d 1201 (1982). The debt created by the overpayment of Social Security benefits to Mr. Hawley is, therefore, dischargeable and the Social Security Administration is ordered not to withhold the Plaintiff's Social Security benefits when earned or to offset or to attempt to offset the overpayment obligation against future benefits.

IT IS SO ORDERED.

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In re: DIEGO M. RODRIQUEZ, Chapter 7, Debtor.
DIEGO M. RODRIQUEZ, Plaintiff,
v.
UNITED STATES OF AMERICA, Defendant.
Case No. 09-93431-JB.
Adversary Proceeding No. 10-9006-JB.
United States Bankruptcy Court, N.D. Georgia, Atlanta Division.
March 23, 2010.
ORDER

JOYCE BIHARY, Bankruptcy Judge

This adversary proceeding relates to a dispute between the debtor and the United States of America on behalf of its agency, the U.S. Department of Health and Human Services, Social Security Administration (the "SSA"), regarding the overpayment of Social Security disability benefits that debtor received from 2000 to 2005 and the SSA's recoupment of those payments by withholding future benefits. In his pro se complaint, debtor seeks relief for the SSA's alleged failure to grant him a pre-recoupment hearing to determine debtor's entitlement to a waiver of the overpayments. The SSA filed a motion to dismiss for lack of subject matter jurisdiction, contending that debtor failed to exhaust his administrative remedies.

The relevant history is as follows. On December 15, 1993, debtor Diego Rodriquez applied for disability benefits with the SSA. Debtor was found disabled as of

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April 17, 1993 and entitled to benefits for the period beginning in October of 1993. Years later, debtor began working in a vocational rehabilitation program with Microsoft Corporation to gain certain computer certifications. Debtor accepted employment in 2000 and contends he notified the SSA of his employment by mailing two letters and carrying a copy of his offer letter to his local Social Security office. Even though he was earning above the income threshold to qualify for disability benefits, debtor continued to receive his monthly benefit payments from the SSA. Although the record is unclear, it appears that part of the dispute between the parties may stem from the fact that the SSA lost debtor's file for a period of five years.

In October of 2005, the SSA sent debtor letters stating that because of his employment, debtor's entitlement to disability benefits ended in October of 2000 and that debtor had received overpayments of benefits totaling $73,871.00. SSA records show that on October 26, 2005, debtor requested that the SSA reconsider this determination. Debtor contends he also requested a waiver of the overpayments in October of 2005 and on other occasions, because debtor contends that he was not at fault and he could not survive without the monthly benefit payments. For some period of time, it appears that the SSA recouped the overpayments by reducing or eliminating debtor's monthly benefits, although the record before the Court is not clear on the dates and amounts of the collections. It also appears that no action was taken on any request for a waiver. After filing a Chapter 7 bankruptcy petition before this Court on December 21, 2009, debtor filed a complaint claiming he was denied a pre-recoupment hearing, that overpayments were wrongfully collected from him and that the SSA did not follow its own procedures when he requested a waiver of the

Page 3

overpayments.

Before addressing defendant's arguments that the Court should dismiss the complaint

because debtor failed to exhaust his administrative remedies, there is the threshold issue of whether the Bankruptcy Court would have jurisdiction, assuming debtor had exhausted his administrative remedies. The Court raises this issue sua sponte and concludes that it does not have jurisdiction to hear this complaint.

Bankruptcy jurisdiction does not encompass the type of judicial proceeding brought by the debtor. Bankruptcy jurisdiction is granted in 28 U.S.C. § 1334. Under § 1334(b), district courts have original, but not exclusive, jurisdiction of "all civil proceedings arising under title 11, or arising in or related to cases under title 11." 28 U.S.C. § 1334(b). District courts refer proceedings "arising under"," arising in" or "related to" a Title 11 case to bankruptcy courts, and a bankruptcy court's jurisdiction must be based on the "arising under", "arising in" or "related to" language of § 1334(b). 28 U.S.C. § 157(a); Celotex Corp. v. Edwards, 514 U.S. 300, 307, 115 S.Ct. 1493 (1995). A claim "arises under" Title 11 if the cause of action invokes a right created by the Bankruptcy Code and "arises in" a case under Title 11 if the claim would arise only in a bankruptcy context. Cont'l Nat'l Bank of Miami v. Sanchez (In re Toledo), 170 F.3d 1340, 1344-1345 (11th Cir. 1999). Here, the claim, if one exists, does not arise under the Bankruptcy Code and is not dependent on bankruptcy law for its existence. If a cause of action exists, it exists under 42 U.S.C. § 405(g), the law governing judicial review of Social Security determinations.

Debtor's claim against the SSA in this adversary proceeding does not "relate to" a case under Title 11. The Eleventh Circuit adopted the Third Circuit's test in Pacor,

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Inc. v. Higgins for determining when a proceeding is "related to" a Title 11 case. Miller v. Kemira, Inc. (In re Lemco Gypsum, Inc.), 910 F.2d 784, 788 (11th Cir. 1990) (adopting Pacor, Inc. v. Higgins, 743 F.2d 984 (3rd Cir. 1984)). "Related to" proceedings possess" some nexus between the related civil proceeding and the Title 11 case" so that the proceeding "could conceivably have an effect on the estate being administered in bankruptcy." Id. at 787-788; see also Lawrence v. Goldberg, 573 F.3d 1265, 1270-1271 (11th Cir. 2009); Community Bank of Homestead v. Boone (In re Boone), 52 F.3d 958, 960 (11th Cir. 1995). Here, there is no nexus between debtor's SSA cause of action and the administration of the estate, because debtor's disability benefits would be exempt under both the federal exemption and the Georgia exemption statutes. 11 U.S.C. §522(d)(10); O.C.G.A. § 44-13-100. The parties have not argued and there is no indication that the Chapter 7 Trustee has or could have any interest in debtor's disability benefits. Thus, this dispute between the debtor and the SSA does not conceivably affect the administration of the estate and is not "related to" a case under Title 11 within the meaning of 28 U.S.C. §1334(b).

In addition, the Local Rules and Standing Orders make it clear that the magistrate judges, not bankruptcy judges, have the delegated authority to hear Social Security actions to review administrative determinations by the SSA. The Local Rules of the District Court for the Northern District of Georgia delegate jurisdiction to the Bankruptcy Court in LR 83.7, NDGa. This delegation does not include Social Security actions brought under 42 U.S.C. § 405(g). Section 405(g) provides that all actions by claimants for judicial review of a final decision of the Commissioner" shall be brought in the district court of the United States for the judicial district in which the plaintiff resides." 42 U.S.C. § 405(g). The

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District Court has in turn delegated judicial review of Social Security actions to the magistrate judges, not bankruptcy judges. LR 83.9, NDGa.; see also In re Cases Referred to Magistrate Judges, United States Court Northern District of Georgia, Standing Order 08-01, June 12, 2008 (holding that "[t]he Court designates the magistrate judges of this court to hear... all actions brought under Section 205(g) of the

Social Security Act, 42 U.S.C. § 405(g), and related statutes, to review administrative determinations which have come before the court on a developed administrative record."). While the Bankruptcy Court has jurisdiction under 28 U.S.C. § 1334(b) to determine Social Security matters arising in, arising under or related to bankruptcy cases, such as questions involving the bankruptcy discharge or the bankruptcy automatic stay, that jurisdiction is limited and does not include a judicial review of the matters at issue in the present adversary proceeding.

This Order could end here with the Court's conclusion regarding bankruptcy jurisdiction. However, because the parties have expended so much effort on the arguments related to exhaustion of administrative remedies, the Court will address those arguments with the hope that this review might assist the parties in coming to a prompt resolution of the dispute.

The SSA seeks dismissal of debtor's adversary proceeding for lack of subject matter jurisdiction, on the ground that debtor has failed to pursue administrative remedies that must be exhausted prior to securing judicial review of an SSA overpayment determination. Congress has authorized judicial review of final decisions of the SSA Commissioner (" the Commissioner") in cases arising under Title II and Title XVI of the Social Security Act ("the Act"). Those statutory provisions provide the exclusive

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jurisdictional basis for judicial review in cases arising under the Act.

Section 405(g) of the Act provides:

> Any individual, after any final decision of the Commissioner of Social Security made after a hearing to which he was a party, irrespective of the amount in controversy, may obtain a review of such decision by a civil action commenced within sixty days after the mailing to him of notice of such decision or within such further time as the Commissioner of Social Security may allow. Such action shall be brought in the district court of the United States for the judicial district in which the plaintiff resides, or has his principal place of business, or, if he does not reside or have his principal of business within any such judicial district, in the United States District Court for the District of Columbia....

42 U.S.C. § 405(g) (emphasis added).

Section 405(h) further provides:

> The findings and decision of the Commissioner of the Social Security after a hearing shall be binding upon all individuals who were parties to such hearing. No findings of fact or decision of the Commissioner of Social Security shall be reviewed by any person, tribunal, or governmental agency except as herein provided. No action against the United States, the Commissioner of Social Security, or any officer or employee thereof shall be brought under section 1331 or 1346 of Title 28 to recover on any claim arising under this subchapter.

42 U.S.C. § 405(h) (emphasis added).

Thus, Congress has explicitly stated that, in claims arising under the Act, judicial review is permitted only in accordance with the provisions of section 405(g) of the Act, as limited by section 405(h) of the Act, See, e.g., Shalala v. Ill. Council on Long Term Care, Inc., 529 U.S. 1, 10, 120 S.Ct. 1084 (2000). Sections 405(g)

and 405(h) limit judicial review of a claim arising out of the Act to review "after any final decision of the Commissioner." 42 U.S.C. § 405(g). A final decision is deemed to have been issued when

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claimant completes the review process proscribed by the Commissioner, because the statute authorizes the Commissioner to specify when a claim is administratively exhausted. Weinberger v. Salfi, 422 U.S. 749, 766, 95 S.Ct. 2457 (1975). A claimant can only seek judicial review in federal court after exhausting his or her administrative remedies. Schweiker v. Chilicky, 487 U.S. 412, 424, 108 S.Ct. 2460 (1988).

The SSA identifies two options available to a claimant to administratively appeal an SSA determination that overpayments have occurred: (1) a request for a reconsideration or (2) a request for a waiver of the recovery of the overpayment. If a request for reconsideration is made, the SSA will review the initial determination and issue a reconsideration determination. 20 C.F.R. §416.1407. If the claimant is dissatisfied with the SSA's reconsidered determination, the claimant may request a hearing with an administrative law judge. 20 C.F.R. § 404.930. After a decision is made by an administrative law judge, claimant may request review by the SSA Appeals Council. 20 C.F.R. § § 404.967,416.1467. It is only after the Appeals Council reviews a decision by the administrative law judge or denies review of the decision that a claimant is entitled to judicial review. See Ingram v. Comm'r of Soc. Sec. Admin., 496 F.3d 1253, 1261 (11th Cir. 2007).

The record reflects that debtor did not exhaust his administrative remedies with respect to a request for reconsideration. SSA records show that on October 26, 2005 debtor filed a request for reconsideration of the determination that he had been overpaid $73,871.00. Some nineteen months later, on June 5, 2007, the SSA responded to debtor's initial request for reconsideration by affirming its initial determination, apologizing for failing to stop benefits when debtor first reported he worked for Microsoft Corporation, and

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stating that the amount of the overpayment was now $54,264.50. The SSA contends that debtor never pursued the next step in the administrative process, which would have been to file a request for a hearing with an administrative law judge. The record also shows that debtor rescinded his request for reconsideration in a letter from debtor to the Appeals Council of the SSA dated March 12, 2007. Because debtor did not seek review of his reconsidered determination by an administrative law judge, the record demonstrates that he did not exhaust his administrative remedies, and defendant's motion to dismiss as to any claim for judicial review of the reconsideration determination has merit.

With respect to debtor's request for a waiver of the recovery of the overpayments, the record is less clear. The SSA claims that debtor did not request a hearing or waiver of the overpayment with his local Social Security office. See Def.'s Mot. Dismiss, Declaration of Roberta Heady, 110, filed February 18, 2010. However, debtor contends he made numerous requests for a waiver and that he is unable to exhaust his administrative remedies, because the SSA will not process his request for a waiver. It is difficult to understand from the current record what debtor needed to do in order to exhaust his administrative remedies on his request for a waiver.

Several documents attached to the parties' pleadings refer to debtor's request for a waiver. For example, in a letter dated January 9, 2006 from debtor to the SSA Billing Department for Overpayments, debtor stated that he twice requested the necessary documents to file a request for waiver of the overpayment and that he has not received the documents of a notice of a hearing. In a letter from debtor to Commissioner Michael J. Astrue dated March

12, 2007, debtor stated that he requested a waiver of overpayment immediately after

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he received notice of his overpayment in October of 2005. In a letter from debtor to the SSA Appeals Council dated March 12, 2007, debtor stated that he requested a waiver in October of 2005 and that he was continuing to pursue this waiver request. In a letter dated June 29, 2007 from debtor to Mr. Stephen Breen with the SSA, debtor reiterated his request for a waiver. Mr. Breen is the assistant regional commissioner for processing center operations who wrote debtor informing him of both the October 2, 2005 initial determination and the June 5, 2007 reconsidered determination. In a letter from debtor to the Disability Adjudication and Review Board dated November 27, 2007, debtor reiterated his requests for a pre-recoupment hearing. In a letter dated August 3, 2009 from debtor to Mr. Breen, debtor again requested a waiver of overpayment, and stated that he has been requesting a waiver since 2005.

In a letter dated November 19, 2007 to the debtor from the Appeals Council of the SSA, the Appeals Council advised debtor that he had mailed his letters of January, 2005 and March 12, 2007 to the wrong SSA entity and that he needed to request a hearing with his local Social Security office in Portland, Oregon. The Appeals Council directed debtor to make his requests with this local Social Security office and indicated that it was sending debtor's file to the Portland office for review.

In view of the history of correspondence and proceedings between the parties, the Court encourages the SSA to explain to the debtor why no pre-recoupment hearing was made available to the debtor and whether he has any remedy available to him at this time. It might be helpful if the SSA could respond to debtor's contention that he made numerous requests for a waiver of the overpayments. If these requests were not made on the proper

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form or at the proper office, it would be helpful if the SSA could explain to the debtor what he did incorrectly in each instance. If it turns out that debtor did make a proper request for a waiver of the overpayments, it would be helpful if the SSA could explain why he did not have a pre-recoupment hearing. If the debtor should have had a pre-recoupment hearing and disability benefits were withheld by mistake, it would be helpful if the SSA could explain to the debtor whether he has any administrative remedies available.

Finally, the debtor has filed pleadings in which he states that the SSA will not currently process his January, 2010 application for waiver of the overpayments without written orders from the Bankruptcy Court. The SSA recently filed a copy of a March 16, 2010 letter from the Assistant Regional Counsel to debtor in which the SSA states that it is SSA policy not to process a waiver request until after debtor's bankruptcy case is closed and that he should re-file his request with the Gwinnett District office. The parties should understand that when the debtor receives a Chapter 7 discharge, it will discharge any overpayment claim by the SSA. The Court explained this principle to the parties at the February 22, 2010 hearing. See Neavear v. Sckweiker (In re Neavear), 674 F.2d 1201, 1206 (7th Cir. 1982) (holding that an overpayment debt of Social Security benefits is dischargeable unless the debtor falls within the exceptions to discharge enumerated under 11 U.S.C. § 523); Rowen v. Morgan, 747 F.2d 1052, 1055 (6th Cir. 1984); Hawley v. United States of America (In re Hawley), 23 B.R. 236, 238-239 (Bankr. E.D. Mich. 1982). The deadline for filing complaints objecting to the debtor's discharge or dischargeability of debts was March 22, 2010. No such complaints have been filed, and thus the debtor will receive a Chapter 7 discharge shortly. Importantly, that discharge will include any obligation by the debtor to

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the SSA for overpayments as of the date this bankruptcy was filed. The bankruptcy discharge should not, however, affect any claim the debtor

might have, if one exists, arising from the alleged failure to process a request for a waiver of overpayments in 2005, 2006, 2007 and 2009.

In accordance with the above reasoning, this adversary proceeding is dismissed without prejudice to debtor's right to exhaust any administrative remedies he may have and then to seek judicial review, if appropriate, in the District Court.

It is so ORDERED.

364 B.R. 304
In re Meridee HODGES, Debtor.
No. 05 B 46676.
United States Bankruptcy Court, N.D. Illinois, Eastern Division.
February 28, 2007.
Page 305

James J. Burns, Jr., Burns & Wincek, Chicago, IL, for Meridee Hodges.

Joel R. Nathan, United States Attorney, Chicago, IL, for Social Security Administration.

AMENDED ORDER ON FEDERAL GOVERNMENT'S MOTION TO DISMISS

JACQUELINE P. COX, Bankruptcy Judge.

The debtor filed for relief under Chapter 13 of the Bankruptcy Code on October 9, 2005. Debtor's Chapter 13 plan was confirmed on January 23, 2006. On April 7, 2006 the debtor filed a proof of claim herein on behalf of the Social Security Administration (SSA) for overpayment of disability benefits; the debtor objected to this claim on September 5, 2006. The debtor claims that the SSA violated the automatic stay by sending her a collection letter post-petition on March 20, 2006 with an unreadable breakdown of its claim and a demand for payment.

The SSA asks that this Court find that, it lacks subject matter jurisdiction to resolve the debtor's claim objection due to debtor's failure to exhaust her, administrative remedies as required by the governing statute and regulations.

Jurisdiction

District courts have exclusive jurisdiction over Title 11 bankruptcy cases. 28 U.S.C. § 1334(a). Pursuant to 28 U.S.C. § 157(a), each district court may provide that any or all cases under Title 11 shall be referred to the bankruptcy judges for the district; the referral to the district's bankruptcy judges may include proceedings arising in or under Title 11 or proceedings related to a case under Title 11. By its Internal Operating Procedure 15(a), the District Court for the Northern District of Illinois has referred its bankruptcy cases to the bankruptcy judges of this district. The pending motion concerns the allowance or disallowance of claims against the estate which is a core matter regarding which bankruptcy judges have jurisdiction to enter a judgment, subject to review on appeal to the District Court under 28 U.S.C. § 157(b)(2)(B) and 28 U.S.C. § 158(a)(1).

Social Security Administration Assertion That The Court Lacks Jurisdiction

The SSA proceeds herein under Federal Rule of Civil Procedure 12(b)(1), as adopted by Rule 7012 of the Federal Rules of Bankruptcy Procedure, requesting dismissal due to the debtor's failure to exhaust administrative remedies as required by 42 U.S.C. § 405(g) which states: "Any

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individual, after any final decision of the Commissioner of Social Security made after a hearing to which he was a party, irrespective of the amount in controversy, may obtain a review of such decision by a civil action commenced within 60 days after the mailing to him of notice of such decision or within such further time as the Commissioner of Social Security may allow." Section 405(h) states that "[t]he findings and decision of the Commissioner of Social Security shall be binding upon all individuals who were parties to such hearing. No findings of fact or decision shall be reviewed by any person, tribunal or government agency except as provided therein. No action against the United States, the Commissioner of Social Security, or any other officer or employee thereof shall be brought under § 1331 or § 1346 of Title 28 to recover on any claim arising under this subchapter." 42 U.S.C. § 405(h).

The debtor argues that the § 405(h) limitation of jurisdiction does not mention 28 U.S.C. § 1334, the Judicial Code grant of Title 11 Bankruptcy Code jurisdiction to the district courts.

The § 405(h) jurisdiction limitation has been held to apply to jurisdictional grants other than those specifically listed. In *Bodimetric Health Services, Inc. v. Aetna Life and Casualty* the Seventh Circuit held that despite the fact that the 28 U.S.C. § 1332 diversity jurisdiction grant was not specifically limited in § 405(h), the scope of § 405(h) subjected several jurisdictional grants not delineated therein to the exhaustion of administrative remedies requirement. 903 F.2d 480, 489 (7th Cir. 1990), *cert. denied*, 498 U.S. 1012, 111 S.Ct. 579, 112 L.Ed.2d 584 (1990). The Court held that when originally enacted, § 405(h) prohibited any action under § 24 of the Judicial Code which included nearly all jurisdictional grants, including diversity jurisdiction and bankruptcy jurisdiction and that when § 405(h) was amended no change was intended. *See id.* at 488-89.

This Court agrees and finds that the § 405(h) limitation includes 28 U.S.C. § 1334; until the debtor exhausts her administrative remedies this Court lacks subject matter jurisdiction over the claim regarding the SSA's assertion that the debtor has received an overpayment of benefits.

The Automatic Stay Issue

The automatic stay is one of the Bankruptcy Code's fundamental elements of debtor protection. Provided for in 11 U.S.C. § 362, it prohibits the commencement or continuation of a judicial or administrative proceeding against the debtor that could have been initiated before the petition was filed, or to recover on a claim that arose pre-bankruptcy. *United States v. Nicolet, Inc.*, 857 F.2d 202, 207 (3d Cir.1988).

The Bankruptcy Code subjects the government, acting as a creditor, to the automatic stay provision, as it applies to all entities seeking to recover on prepetition debts. The Bankruptcy Code at 11 U.S.C. § 101(15) defines "entities" as inclusive of government agencies. Government agencies are excepted from the scope of the automatic stay when commencing or continuing an action or proceeding to enforce such governmental unit's or organization's police or regulatory power. Does the SSA's regulatory power qualify it for an exception to the imposition of the automatic stay? According to the Third Circuit in *University Medical Center v. Sullivan*, quoting the congressional record, "Congress intended this exception to apply where a governmental unit is suing a debtor to prevent or stop violation of fraud, environmental protection, consumer protection, safety, or similar police or regulatory laws, or fixing damages for violation

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of such law." *See* 973 F.2d 1065, 1074-75 (3d Cir.1992)(citing H.R.Rep. No. 595, 95th Cong., 1st Sess. 343 (1977), reprinted in 1978 U.S.C.C.A.N. 5963, 6299; S.Rep. No. 989, 95th Cong., 2d Sess. 52, reprinted in U.S.C.C.A.N. 5787, 5838). The stay exception is not implicated herein.

While the debtor complains that the SSA violated the automatic stay of 11 U.S.C. § 362 when it sent her the postpetition March 20, 2006 letter demanding payment, the debtor has not moved for damages pursuant to 11 U.S.C. § 362(k)(1) which allows an individual injured by a willful violation of a stay to recover actual damages, including costs, attorneys' fees and punitive damages depending on the creditor. *See* 11 U.S.C. § 106(a)(3). Even though the debtor does not seek damages, analysis of the exhaustion of administrative remedies requirement is prompted by her allegation that the SSA has violated the automatic stay. Does adjudication of the automatic stay issue directly implicate any substantive area of social security law?

In *University Medical Center*, the Third Circuit held that a bankruptcy court had

independent jurisdiction to determine an automatic stay violation in a medicare case because it does not impinge on the authority of the Secretary of Health and Human Services as protected by 42 U.S.C. § 405(h). *See* 973 F.2d at 1073. Does the Commissioner of the SSA have authority to resolve matters involving violations of the automatic stay? Does the SSA's system of administrative review address these issues?

The policy of having matters involving disability payments resolved by the SSA addresses the need for nationwide consistency of decisions involving those benefits and the exercise of that agency's considerable experience and expertise in doing so. However, matters outside their substantive area of disability law, such as alleged violations of the automatic stay, should not require exhaustion of administrative remedies by a debtor.

The stay was violated when the SSA sent the debtor the post-petition letter seeking resolution of the pre-petition debt. However, because the debtor filed a proof of claim on behalf of the SSA 3 weeks after receipt of the SSA letter demanding payment, and objected to the claim on behalf of the SSA, it is questionable whether stay violation damages would lie.[1]

The debtor complains in response to the government's motion that the SSA won't give her a hearing, suggesting that she is proceeding in Bankruptcy Court for that reason. The SSA has promised to proceed with her appeal. The Social Security Administration's Motion to Dismiss is **GRANTED.** The Debtor's Claim Objection is **DISMISSED.**

Notes:

1. As this Court held in the Chapter 11 setting, the automatic stay does not operate to prevent a trustee or debtor-in-possession from prosecuting a suit against a creditor. *See In re Mid-City Parking, Inc.*, 332 B.R. 798 (Bankr. N.D.Ill.2005). This conclusion holds regardless of the bankruptcy chapter at issue. Although the SSA is prohibited by the automatic stay from pursuing the debtor for payment, § 362 of the Bankruptcy Code does not prohibit the debtor from pursuing an appeal through the administrative process or filing and objecting to the SSA claim.

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15 B.R. 268 (1981)
Margaret I. GUTIERREZ, Plaintiff,
v.
Richard S. SCHWEIKER, Secretary of the United States Department of Health and Human Services, Defendant.
No. 80 C 2592.
United States District Court, N.D. Illinois, E.D.
June 2, 1981.

Louisa P. Seston, Lillian O. Johnson, Legal Assistance Foundation of Chicago, Garfield/Austin Legal Services, Barbara L. Samuels, Legal Assistance Foundation of Chicago, Lawndale Legal Services, Chicago, Ill., for plaintiff.

[15 BR 269]

Roderick A. Palmore, Asst. U.S. Atty., Chicago, Ill., for defendant.

ORDER

ROSZKOWSKI, District Judge.

Before the court is defendant's motion to reconsider this court's order of March 12, 1981 by which plaintiff's motion for summary judgment and defendant's cross-motion for summary judgment were denied. For the reasons hereinafter stated, plaintiff's motion for summary judgment is hereby granted.

This case is an action for judicial review of a final administrative decision by the Secretary of the United States Department of Health and Human Services finding that plaintiff no longer met the definition of disability under Title II of the Social Security Act because she performed substantial gainful activity within the meaning of the Act.

Plaintiff, Margaret I. Gutierrez, was born on August 17, 1946 and has an 8th grade education. She had been employed by Goldblatt's Department Store as a department manager for 7 years before she became ill and was forced to quit in October 1975.

Plaintiff filed an application under Title II of the Social Security Act for disability benefits on January 16, 1976. Plaintiff was found disabled within the meaning of the Act, due to systemic lupus erythematosus and congestive heart failure as of October 24, 1975. Plaintiff began to receive disability benefits in April 1976.

In March, 1976, against her doctor's advice to avoid physical exertion and mental stress, plaintiff returned to work at Goldblatt's. She was assigned to a smaller department and her staff covered for her on tasks that she was physically unable to perform. Plaintiff was absent from work due to illness approximately 4 to 5 days each month. Plaintiff remained employed at Goldblatt's from March of 1976 until January of 1977. When plaintiff returned to work in March of 1976, she notified Social Security that she was working. Plaintiff remained unemployed until August, 1977 when she obtained a job as a clerk typist at Onward Neighborhood House. Plaintiff resigned in February, 1978 and has been unemployed since that date.

On April 10, 1978, plaintiff was informed by Social Security that her work record did not indicate a twelve month period since the finding of disability when she was not engaged in substantial gainful activity. On September 25, 1978, in a Notice of Reconsideration, plaintiff was informed that the determination that she was capable of substantial gainful activity was affirmed. Plaintiff was assessed an overpayment of $18,996.40 for the benefits received during the period of April of 1976 through August of 1978.

On March 6, 1979, a hearing was held before an Administrative Law Judge. The Administrative Law Judge found that plaintiff's employment at Goldblatt's was substantial

gainful activity, but that her employment at Onward Neighborhood House was not. It was also found that plaintiff was overpaid $9,453.10 and that recovery could not be waived as plaintiff was not without fault in accepting the overpayment.

Plaintiff appealed the decision to the Appeals Council on July 2, 1979 and advised the Social Security Administration that bankruptcy proceedings had been initiated on June 29, 1979 to discharge the debt. On September 7, 1979, the overpayment of $9,453.10 was discharged by the Bankruptcy Court. The Appeals Council upheld the decision of the Administrative Law Judge on March 19, 1980. Despite the discharge of the overpayment in bankruptcy, the Social Security Administration recovered the full amount of the discharged debt by withholding from plaintiff and her children retroactive benefits, and by making deductions from their benefits thereafter.

Plaintiff contends that because the Social Security Administration did not file an application for determination of dischargeability of the overpayment, the overpayment was effectively discharged when plaintiff's debts were discharged in bankruptcy.

[15 BR 270]

Defendant contends that overpayments incurred under the Social Security Act are not discharged in bankruptcy. Defendant cites 42 U.S.C. § 407 for the proposition that social security benefits are unaffected by the operation of any bankruptcy law. Section 407 provides as follows:

> The right of any person to any future payment under this title shall not be transferable or assignable, at law or in equity, and none of the monies paid or payable or rights existing under this title shall be subject to execution, levy, attachment, garnishment, or other legal process, or to the operation of any bankruptcy or insolvency law. . . .

In re: Danny Ray Buren, et al, 6 B.R. 744 (Bkrtcy.M.Dist. of Tenn., Nashville Div., 1980) recently faced the conflicting provisions of the new Bankruptcy Act and the Social Security Act. The District Court held that, notwithstanding the language of 42 U.S.C. § 407, social security benefits are subject to the operation of the bankruptcy laws only insofar as the debtor is allowed voluntarily to include the benefits as property of the estate and the bankruptcy proceeding. The conclusion of the court in Danny Ray Buren was that the later-enacted statute effected a repeal of the Social Security Act insofar as the two were in conflict.

Plaintiff listed in her petition for bankruptcy the sum of $9,453.10 as an alleged overpayment of social security disability insurance benefits. Defendant failed to file an objection to discharge within the time period fixed for filing objections. 11 U.S.C. § 523(a)(9)(c) provides:

> Except as provided in subsection (a)(3)(B) of this section, the debtor shall be discharged from a debt specified in paragraph (2), (4), or (6) of subsection (a) of this section unless, on request of the creditor to whom such debt is owed, and after notice and hearing the court determines such debt to be excepted from discharge under paragraph (2), (4), or (6), as the case may be, of subsection (a) of this section.

Sections (a)(2), (4), and (6) are the exceptions to discharge pertaining to false statements, defalcation or larceny misappropriation, and willful and malicious injury which this court believes are the types of claims that had to be raised to justify an exception to discharge for an overpayment found to be accepted not without fault. Defendant failed to initiate these proceedings in

the bankruptcy court for an exception to discharge. Therefore, the overpayment was discharged.

Accordingly, it is ordered that plaintiff's motion for summary judgment be and the same is hereby granted. Defendant is ordered to repay to plaintiff all monies withheld from plaintiff subsequent to the filing of her bankruptcy petition.

Page 1201
674 F.2d 1201
6 Collier Bankr.Cas.2d 367, 9 Bankr.Ct.Dec. 132,
Bankr. L. Rep. P 68,656
In the Matter of Randall B. NEAVEAR, Debtor.
Randall B. NEAVEAR, Plaintiff-Appellant,
v.
Richard S. SCHWEIKER, Secretary of Health and Human Services, Defendant-Appellee.
No. 81-1860.
United States Court of Appeals,
Seventh Circuit.
Argued Feb. 11, 1982.
Decided April 5, 1982.

Page 1202

James S. Brannon, Peoria, Ill., for plaintiff-appellant.

Frank A. Rosenfeld, Appellate Staff, Civil Division, Dept. of Justice, Washington, D. C., for defendant-appellee.

Before CUDAHY, Circuit Judge, FAIRCHILD, Senior Circuit Judge, and POSNER, Circuit Judge.

CUDAHY, Circuit Judge.

In this appeal we are presented with a question of first impression at the federal appellate level: whether section 207 of the Social Security Act, 42 U.S.C. § 407 (1976), confers on the Social Security Administration ("SSA") a blanket exemption from the operation of the bankruptcy laws, so that a debt owing to the SSA because of an overpayment of benefits cannot be discharged in bankruptcy. We hold that the SSA enjoys no such immunity from the bankruptcy laws and that the overpayment debt is dischargeable under the provisions of the Bankruptcy Reform Act of 1978, 11 U.S.C. § 1 et seq. (Supp. III 1979) (the "Code" or "Bankruptcy Code").

I.

The debtor and plaintiff in this action, Randall B. Neavear, began receiving social security disability benefits in 1968. Beginning in January, 1976, and continuing until August, 1979, Neavear was not disabled, having engaged in substantial gainful activity as a part-time, self-employed real estate broker. Neavear failed to report this activity to the SSA as required by 20 C.F.R. § 404.1588 (1981), and he and his family continued to receive disability benefits until they were terminated by the SSA in August of 1978.

In August, 1979, Neavear again became disabled and was thus entitled to receive benefits under the statute. The SSA, however, commenced a proceeding to offset the earlier payments improperly received by Neavear against the future benefits to which he was now entitled. Section 204(a) of the Social Security Act, 42 U.S.C. § 404(a) (1976), authorizes such a recovery or recoupment of overpayments by decreasing future benefits. In a decision issued on February 26, 1980, the Administrative Law Judge ("ALJ") found that Neavear had been overpaid $19,818.10 in disability benefits. The ALJ further ruled that a waiver of the recoupment was not warranted because, under section 204(b), 42 U.S.C. § 404(b) (1976), Neavear was not "without fault" in receiving the overpayments and because recoupment would not "defeat the purpose" of the statute. The ALJ accordingly ordered that future benefits payable to Neavear be reduced in satisfaction of the overpayment debt. [1] Neavear did not seek

administrative or judicial review of this decision. [2]

On April 8, 1980, Neavear filed his Chapter 7 bankruptcy petition, listing on his

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schedule of debts the $19,818.10 overpayment debt to the SSA. Neavear was subsequently granted a discharge by the bankruptcy court but the SSA continued to reduce his disability benefits pursuant to the ALJ's recoupment order. On July 14, 1980, Neavear filed a complaint in the bankruptcy court seeking a declaration that the overpayment debt had been discharged. The Secretary answered the complaint and interposed four affirmative defenses: (1) that Neavear's action was barred because of his failure to exhaust administrative remedies; (2) that the court lacked jurisdiction because the government had not waived its defense of sovereign immunity; (3) that section 207 of the Social Security Act, 42 U.S.C. § 407 (1976), rendered the debt nondischargeable in bankruptcy; and (4) that the SSA's right of recoupment created a statutory lien precluding discharge of the overpayment debt. [3] The bankruptcy court found in favor of the SSA on the first three affirmative defenses, but did not address the question of a statutory lien. Neavear v. Schweiker, 16 B.R. 528 (Bkrtcy, C.D.Ill.1981). The district court affirmed without opinion.

II.

At the outset we are faced with two issues in the nature of jurisdictional obstacles to Neavear's action against the Secretary: the applicability of the doctrines of administrative exhaustion and sovereign immunity.

The bankruptcy court held that Neavear's complaint was barred because of his failure to seek administrative review of the Secretary's determination that he was at fault in receiving the overpayments of benefits. This ruling was erroneous. "The basic purpose of the exhaustion doctrine is to allow the administrative agency to perform functions within its special competence-to make a factual record, to apply its expertise, and to correct its own errors so as to moot judicial controversies." Continental Can Co. v. Marshall, 603 F.2d 590, 597 (7th Cir. 1979); see Parisi v. Davidson, 405 U.S. 34, 37, 92 S.Ct. 815, 817, 31 L.Ed.2d 17 (1972); McKart v. United States, 395 U.S. 185, 193-95, 89 S.Ct. 1657, 1662-63, 23 L.Ed.2d 194 (1969). None of these purposes would be even remotely served by applying the exhaustion doctrine in the instant case.

The bankruptcy court apparently believed that Neavear's complaint in effect sought review of the ALJ's recoupment order. To the contrary, Neavear does not contest the validity of that administrative determination but instead seeks from the bankruptcy court an order declaring that the overpayment debt has been discharged. Neavear thus requests relief that could not have been granted in the administrative proceeding, and the issue of dischargeability presented to the bankruptcy court does not invoke the "special competence" of the SSA. Rowan v. Morgan, 15 B.R. 834, 837-38 (Bkrtcy, N.D.Ohio 1981). [4] We thus conclude that Neavear was not required, as a condition of obtaining relief in the bankruptcy court, to pursue lengthy and quite possibly groundless administrative appeals of the ALJ's recoupment decision.

There is a somewhat more challenging question whether the Secretary's invocation of the defense of sovereign immunity precludes Neavear's action. The bankruptcy court held that it did, reasoning that sovereign immunity may be waived only where the government files a proof of claim. Because the Secretary did not file a claim in the instant case, the court concluded, he was not amenable to suit at the instance of a Chapter 7 debtor.

The bankruptcy court's decision appears to have ignored section 106(c) of the Code,

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11 U.S.C. § 106(c) (Supp. III 1979). [5] That section, unlike sections 106(a) and (b), does not condition the waiver of sovereign immunity upon the filing of a proof of claim. [6] The legislative history of section 106(c) indicates that it was enacted in order to codify the Ninth Circuit's decision in Gwilliam v. United States, 519 F.2d 407 (9th Cir. 1975). 124 Cong.Rec. H11,091 (daily ed. Sept. 28, 1978); 124 Cong.Rec. S17,407 (daily ed. Oct. 6, 1978). Gwilliam held that, notwithstanding the failure by the government to file a proof of claim, the bankruptcy court possessed jurisdiction under section 17(c) of the former Bankruptcy Act, 11 U.S.C. § 35(c) (1976), to determine the dischargeability of tax debts upon application of the debtor. [7] See also McGugin v. District Director of IRS (In re Dolard), 519 F.2d 282 (9th Cir. 1975). This court followed Gwilliam in McKenzie v. United States, 536 F.2d 726 (7th Cir. 1976), where we upheld the jurisdiction of the bankruptcy court to determine the dischargeability of a tax debt despite the government's failure to file a proof of claim:

We hold that Section 17(c), in explicitly allowing the bankrupt to file an application for the determination of the dischargeability of "any debt" waives the sovereign immunity of the United States in any bankruptcy action in which the United States is alleged to be a creditor of the bankrupt, including instances in which federal taxes have become due and owing.

536 F.2d at 729 (emphasis supplied).

Section 106(c) thus preserves the rule, established in Gwilliam and approved by this court in McKenzie, that a debtor may seek a declaration from the bankruptcy court that a debt owed to an agency of the United States is dischargeable. Just as in McKenzie, we perceive no basis for distinguishing between a debt owed to the SSA and those debts owed to the Internal Revenue Service at issue in Gwilliam and McKenzie. Accordingly, we hold that section 106(c) of the Bankruptcy Code waives the sovereign immunity of the United States with respect to questions relating to the dischargeability of debts owed to the government. The bankruptcy court thus committed error when it refused, on grounds of sovereign immunity, to adjudicate the dischargeability of Neavear's overpayment debt.

Having concluded that the bankruptcy court had jurisdiction to adjudicate the dischargeability of the overpayment debt, we turn now to the question whether that debt was dischargeable in bankruptcy.

III.

Section 727(b) of the Bankruptcy Code, 11 U.S.C. § 727(b) (Supp. III 1979), provides

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that a discharge in bankruptcy "discharges the debtor from all debts that arose before the date of the order for relief," (emphasis supplied), except as provided in section 523. [8] The issue presented in the instant case is whether section 207 of the Social Security Act, 42 U.S.C. § 407 (1976), confers on the SSA a blanket exemption from the operation of the Bankruptcy Code, so that an overpayment debt is nondischargeable regardless whether the debt falls within one of the exceptions to discharge listed in section 523.

Section 207 provides:

The right of any person to any future payment under this subchapter shall not be transferable or assignable, at law or in equity, and none of the moneys paid or payable or rights existing under this subchapter shall be subject to execution, levy, attachment, garnishment, or other legal process, or to the operation of any bankruptcy or insolvency law.

42 U.S.C. § 407 (1976). By its terms, section 207 is concerned with the protection of social security benefits from the reach of creditors. Since 1963, however, the SSA has interpreted this provision more expansively. Social Security Ruling SSR 63-7 (1963). The SSA believes that the reference in section 207 to "rights existing under this subchapter" embraces

not only the rights of social security recipients but also the rights of the agency itself-including the SSA's right to recoup overpayments under section 204, 42 U.S.C. § 404 (1976). The SSA asserts, therefore, that Congress in section 207 conferred upon it a total exemption from the operation of all bankruptcy laws.

In support of the SSA's interpretation of section 207, the Secretary relies solely on the language of the statute. [9] He offers no reasons of policy to explain why Congress supposedly gave the SSA rights enjoyed by no other creditor, [10] and he does not point to any legislative history supporting his sweeping interpretation. Above all, however, the Secretary's argument must fail because it asks us, in construing the reference to "rights" in section 207, to disregard the surrounding text. Section 207 speaks throughout in terms of the rights of social security recipients (the rights to "future payment," and to "moneys paid or payable") and the protection of their benefits from the reach of creditors (through "execution, levy, attachment, garnishment, or other legal process"). The exemption from "the operation of any bankruptcy or insolvency law" (which should be construed as parallel to the preceding forms of legal process) simply closes off what would otherwise be an additional avenue for creditors to satisfy their claims from the social security

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benefits of the debtor. [11] Thus, section 207 deals only with the protection of social security benefits from creditor action. The Secretary's interpretation of the section turns the statute on its head, since this interpretation would transform a provision designed to protect social security recipients from creditors into a provision conferring super-creditor status on the SSA. We thus conclude that section 207 provides an exemption from the bankruptcy laws only for the benefits of social security recipients, and does not operate to prevent a debtor from obtaining a discharge of a debt owed to the SSA because of an overpayment. [12]

Our conclusion that section 207 poses no obstacle to a debtor seeking a discharge of an overpayment debt does not, of course, mean that every social security recipient who receives, not without fault, an overpayment of benefits may escape his duty to repay those benefits by means of a quick discharge in bankruptcy. To the contrary, section 523 of the Code provides that debts arising from transactions involving "false pretenses, a false representation, or actual fraud," are not dischargeable. 11 U.S.C. § 523(a)(2)(A) (Supp. III 1979). While we do not necessarily accept what appears to have been the Secretary's argument in the bankruptcy court-that the ALJ's determination that Neavear was at fault in obtaining the overpayments constitutes a finding of a "false representation" precluding discharge-we do agree that at least in some cases an overpayment debt may fall within this category of exceptions to discharge. Whether Neavear's debt to the SSA is such a nondischargeable debt under section 523 is a question we leave for the bankruptcy court to decide on remand of this case. [13]

Finally, we pause to note that two recent cases, one now awaiting review in this court, have concluded as we do today that overpayment debts owing to the SSA are dischargeable in bankruptcy. Rowan v. Morgan, 15 B.R. 834 (Bkrtcy, N.D.Ohio 1981); Gutierrez v. Schweiker, 15 B.R. 268 (N.D.Ill.1981), appeal docketed, No. 81-2243 (7th Cir. 1981). The reasoning employed in these cases, however, is different from ours. Both cases held that the SSA had failed to make timely objections under section 523(c) to the discharge of the overpayment debts. Both courts either accepted or ignored the argument that section 207 of the Social Security Act itself exempts overpayment debts from discharge under the Bankruptcy

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Code, and found instead that the Code repealed section 207 by implication. [14] We take a more direct path, however, and hold that section 207

does not by itself render overpayment debts nondischargeable. We thus have no occasion to reach the question of an implied repeal.

IV.

For the reasons stated herein, we hold that the bankruptcy court had jurisdiction to adjudicate the dischargeability of an overpayment debt owed to the SSA and that section 207 of the Social Security Act does not prevent the discharge of such a debt. We therefore reverse the judgments of the courts below and remand the case for a consideration of the two issues not yet addressed by the bankruptcy court: whether Neavear's overpayment debt is nondischargeable under section 523 of the Code and whether the overpayment debt creates a statutory lien precluding discharge.

Reversed and remanded.

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1 By June 30, 1980, the overpayment debt had been reduced to $11,407.20 as a result of the recoupment order.

2 Neavear could have appealed the ALJ's decision, first to an ALJ appointed by the Associate Commissioner for Hearings and Appeals, 20 C.F.R. § 404.929 (1981), then to the Appeals Council within the SSA, 20 C.F.R. § 404.967 (1981), and finally to the district court, 42 U.S.C. § 405(g) (1976).

3 The SSA also asserted a defense based on an alleged absence of a justiciable case or controversy. That argument appears to have been abandoned.

4 Cf. Finnerty v. Cowen, 508 F.2d 979 (2d Cir. 1974) (plaintiff not required to exhaust administrative remedies where he sought judicial resolution of a constitutional question that could not be adjudicated by the federal agency).

5 Section 106(c), 11 U.S.C. § 106(c) (Supp. III 1979), provides:

(c) Except as provided in subsections (a) and (b) of this section and notwithstanding any assertion of sovereign immunity-

(1) a provision of this title that contains "creditor", "entity", or "governmental unit" applied to governmental units; and

(2) a determination by the court of an issue arising under such a provision binds governmental units.

6 That a waiver of sovereign immunity may be found even though the government has not filed a proof of claim is illustrated by Remke, Inc. v. United States, 5 B.R. 299 (Bkrtcy, E.D.Mich.1980), in which a bankruptcy court held that a Chapter 11 debtor could recover a preferential transfer from the Internal Revenue Service pursuant to section 547 of the Code. 11 U.S.C. § 547 (Supp. III 1979). In reaching this conclusion, the court stated, "the government's contention that a governmental unit's defense of sovereign immunity is waived only in cases in which the government has filed a proof of claim, is without merit." 5 B.R. at 302 (footnote omitted).

7 Section 17(c), 11 U.S.C. § 35(c) (1976), authorized the bankrupt to file an application with the bankruptcy court for "the determination of the dischargeability of any debt." (Emphasis supplied). This provision was not carried forward into the new Bankruptcy Code, but this fact does not detract from the continued applicability of Gwilliam and related cases. The legislative history of the Code indicates that section 17(c) was "deleted as unnecessary, in view of the comprehensive grant of jurisdiction prescribed in proposed 28 U.S.C. 1471(b), which is adequate to cover the full jurisdiction that the bankruptcy courts have today over dischargeability and related issues under Bankruptcy Act § 17c." H.Rep.No.95-595, 95th Cong., 1st Sess. 363 (1977), U.S.Code Cong. & Admin.News 1978, pp. 5787, 6319.

8 Section 523, 11 U.S.C. § 523 (Supp. III 1979), provides in pertinent part:

(a) A discharge under section 727, 1141, or 1328(b) of this title does not discharge an individual debtor from any debt-

(2) for obtaining money, property, services, or an extension, renewal, or refinance of credit, by-

(A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition ....

9 In its interpretive ruling, the SSA relied on the Supreme Court's decision in United States v. Munsey

Trust Co., 332 U.S. 234, 239, 67 S.Ct. 1599, 1601, 91 L.Ed. 2022 (1947), as authority for the conclusion that the agency's right to recoup overpayments is one of the "rights" protected by section 207. Munsey Trust was a government contract case, however, and not a case arising under the Social Security Act. The decision thus sheds no light on the question whether Congress intended section 207 to exempt the SSA in its role as a creditor from the operation of the Bankruptcy Code.

10 Not even the Internal Revenue Service has been accorded the favorable treatment in bankruptcy that the SSA now contends it was granted. Under the Bankruptcy Code, tax claims generally receive a sixth priority, 11 U.S.C. § 507(a)(6) (Supp. III 1979), and are nondischargeable only if they fall within the limited exceptions of section 523, 11 U.S.C. § 523 (Supp. III 1979).

11 Under the Bankruptcy Code, social security benefits are included in the property of the estate. 11 U.S.C. § 541(c) (Supp. III 1979). Such benefits can be exempted, however, either under section 522(d)(10)(A), or, if the debtor so elects, under section 522(b)(2)(A), which grants an exemption for "any property that is exempt under Federal law, other than" section 522(d). Section 207 is one of the "Federal law" exemptions. See In re Smith, 640 F.2d 888, 890 (7th Cir. 1981); Cheeseman v. Nachman, 656 F.2d 60, 62 n.5 (4th Cir. 1981). Thus, section 207 operates to exempt social security benefits from the property of the estate.

12 Section 207 is similar to other statutes that remove government benefits from the reach of creditors. See, e.g., 5 U.S.C. § 8130 (1976); 33 U.S.C. § 775 (1976); 38 U.S.C. § 770(g) (1976); 38 U.S.C. § 3101 (1976); 42 U.S.C. § 1717 (1976). Other statutes that expressly conferred on government agencies in their role as creditors an exemption from discharges in bankruptcy, however, were repealed when the Bankruptcy Code was enacted. See 20 U.S.C. § 1087-3 (1976), repealed by Pub.L.No. 95-598, Title III, § 317, 92 Stat. 2678 (1978); 42 U.S.C. § 294f(g) (1976), repealed by Pub.L.No. 95-598, Title III, § 327, 92 Stat. 2679 (1978); 42 U.S.C. § 656(b) (1976), repealed by Pub.L.No. 95-598, Title III, § 328, 92 Stat. 2679 (1978). Although not conclusive, the fact that Congress did not repeal section 207 when these other statutes granting exceptions to discharge were repealed is some evidence that Congress never regarded section 207 as rendering social security overpayment debts nondischargeable.

13 The Secretary apparently raised the argument that the overpayment debt was nondischargeable under section 523(a)(2) for the first time in his memorandum in opposition to Neavear's motion to strike the affirmative defenses. In light of this fact, we suggest that the bankruptcy court on remand consider the timeliness of the Secretary's objection to discharge. 11 U.S.C. § 523(c) (Supp. III 1979). See Rowan v. Morgan, 15 B.R. 834, 839 (Bkrtcy, N.D.Ohio 1981); Gutierrez v. Schweiker, 15 B.R. 268 (D.C.N.D.Ill.1981), appeal docketed, No. 81-2243 (7th Cir. 1981).

14 Rowan and Gutierrez relied on In re Buren, 6 B.R. 744 (D.C.M.D.Tenn.1980), appeal docketed, No. 80-5427 (6th Cir. 1981), for their conclusion that the Bankruptcy Code impliedly repealed section 207. Buren does hold that the Code effected an implied repeal of section 207, but in circumstances quite different than those in the instant case. At issue in Buren was the power of the bankruptcy court under 11 U.S.C. § 1325(b) (Supp. III 1979) to order the SSA to deduct benefits owing to the debtor and to pay these benefits directly to the Chapter 13 trustee. Thus, the challenged income deduction order implicated the central purpose of section 207: the protection of debtors from the transfer or assignment of social security benefits to creditors. The Buren court held that, given Congress' expressed desire to broaden the availability of Chapter 13 relief to include individuals whose only regular income consisted of social security benefits, Congress could not have intended section 207 to prevent Chapter 13 debtors from voluntarily subjecting their benefits to income deduction orders. The court held that section 207 was accordingly repealed by implication, but only insofar as it involved income deduction orders under section 1325(b). The Buren case thus has little relevance to the question whether the discharge provisions of the Code also work an implied repeal of section 207.

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In re Bruce ADAMIC f/k/a Eagle Bear Holdings, LLC, Debtor.
No. 99-25928 SBB.
United States Bankruptcy Court, D. Colorado.
March 26, 2003.
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Deanna L. Westfall, Denver, CO, for Debtor.

Stephen G. Smith, Assistant Attorney General, State Services Section, Denver, CO, for Colorado Department of Labor.

MEMORANDUM OPINION AND ORDER REGARDING MOTION FOR ENTRY OF ORDER TO SHOW CAUSE WHY SANCTIONS SHOULD NOT ENTER

SIDNEY B. BROOKS, Chief Judge.

THIS MATTER is before the Court after a hearing on February 19, 2003, concerning the Debtor's Motion for Entry of Order to Show Cause Why Sanctions Should Not Enter Pursuant to 11 U.S.C. § 362(h).

The Debtor, Bruce Adamic, requests that the Court enter an order to show cause, directed to the Colorado Department of Labor and Employment, Division of Employment and Training ("Department"), requiring it to demonstrate why sanctions should not be imposed for its alleged violation of the automatic stay in collecting pre-petition unemployment compensation

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overpayments. The Department filed a written response to the Debtor's motion, but did not appear at the hearing.[1] The Court took the matter under advisement and the following constitutes the Court's findings of fact and conclusions of law. Fed. R. Bankr.P. 9014(c); Fed.R.Civ.P. 52(a).[2]

I. Background

For a period of weeks in the fall of 1993, the Debtor collected state unemployment benefits under the Colorado Employment Security Act. *See* Colo.Rev.Stat. §§ 8-70-101 to 8-82-105; 7 Colo.Code Regs. 1101-2. The following year, the Department audited the Debtor's claims and determined that he had worked at a company called Sygma Network in Westminster, Colorado while receiving unemployment compensation. The Debtor never disclosed to the Department that he had obtained another job while he was receiving payments for unemployment.

After its initial audit, the Department sent a letter to the Debtor requesting more information and the Debtor conceded in a written response that he had worked temporarily while receiving unemployment payments. (Department's Response Ex. A through C)

In November, 1994, the Department issued a formal "Determination of Overpayment of Benefits," in which it calculated that the Debtor had received $2,370.00 in overpayments. (Department's Response Ex. E) The Department concluded that the Debtor had received those payments "by reason of false representation or willful failure to disclose a material fact," and it assessed a fifty percent monetary penalty in the amount of $1,185.00 in accordance with Colo.Rev.Stat. § 8-81-101(4)(a)(II).[3] The Department also imposed a non-monetary penalty of forty weeks under the statute.[4] The penalties were effective under the Department's formal determination on November 14, 1994.

The Debtor did not appeal the Department's determination as to the amount of the overpayment or the penalties assessed. Colo.Rev.Stat. § 8-74-106 (governing time

limits and procedures for appeal). The monetary obligation remained unsatisfied

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when the Debtor filed for Chapter 13 relief five years later.

The Debtor filed a voluntary Chapter 13 petition on December 27, 1999.[5] In Schedule F, he listed the debt to the Department in the amount of $3,555.00 as an unsecured, non-priority claim. In Schedule I, the Debtor disclosed that was employed in Fort Collins, Colorado as a regional manager at "DalTile," with $4,900.00 of gross monthly income. *See generally* 11 U.S.C. §§ 101(30); 109(e).[6]

The Department filed a proof of claim on January 31, 2000, asserting a $3,094.32 unsecured claim for "overpayment of unemployment insurance benefits due to fraud/misrepresentation." The Debtor's Third Amended Chapter 13 Plan, which proposed no special treatment for the Department's general unsecured claim, was confirmed without objections on October 24, 2000, and it requires plan payments of $632.00 each month for a period of fifty-four months.[7]

The Debtor lost his job in August, 2002, and again applied to the Department for unemployment benefits. The Department issued a "Monetary Determination of Unemployment Insurance Benefits" on August 29, 2002, indicating that the Debtor was eligible to receive weekly unemployment benefits of $398.00 for twenty-six weeks (or total benefits of $10,348.00). (Debtor's Motion Ex. A) The Department also sent a form "Overpayment Reminder" indicating that the remaining balance of the 1993 overpayments owed by the Debtor was $2,972.50.[8] (Docket Entry No. 92, filed Nov. 4, 2002, Ex. 1) The "reminder" also indicated that, although the debt for the overpayments was "pending bankruptcy," all of the Debtor's weekly unemployment benefits "will be used to pay off the [1993] overpayment" because he had "caused the overpayment by willfully giving false information or consciously holding back information." (*Id.*)

According to a handwritten notation on the "reminder," the forty-week penalty assessed under Colo.Rev.Stat. § 8-81-101(4)(a)(II) is "not dischargeable by [sic] bankruptcy." (Docket Entry No. 92, filed Nov. 4, 2002, Ex. 1) A subsequent letter from the Department to the Debtor in October, 2002, confirmed that, in its opinion, the Debtor is required to "serve" the penalty weeks. (Debtor's Motion Ex. B)

In November, 2002, the Debtor filed a *pro se* letter with the Court, complaining that the Department was "not following the rules," by penalizing him and withholding his current unemployment benefits to recover the 1993 overpayments. The Debtor retained counsel (after a letter from the Court's staff advised that it could not accept his *ex parte* communication), and on January 24, 2003, the Debtor filed the present Motion for Entry of Order to Show Cause Why Sanctions Should Not Enter Pursuant to 11 U.S.C. § 362(h).

In his motion, the Debtor claims that the Department is bound by the terms of the confirmed Chapter 13 plan, and that its efforts to collect the 1993 overpayments by withholding his current unemployment

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benefits and exacting the forty penalty weeks is a "clear violation" of the automatic stay. *See* 11 U.S.C. § 362(a)(6) (precluding "any act to collect, assess or recover a claim against the debtor that arose before the commencement of the case").

The Department filed a responsive pleading on January 24, 2003, arguing that the automatic stay does not preclude it from recouping the 1993 overpayments or from denying the Debtor's claim for current unemployment benefits. Following the hearing in this matter, the Debtor filed a reply brief, refuting the Department's arguments concerning recoupment and its denial of benefits and requesting an

order: (1) requiring the Department to pay the Debtor all post-petition unemployment compensation due and owing from August, 2002 to the present; and (2) imposing sanctions on the Department for violating the automatic stay, including reasonable attorney fees.

As the parties recognize, courts addressing whether a governmental unit may satisfy a debtor's pre-petition obligation for receiving overpayments of unemployment benefits by offsetting or applying post-petition benefits to the outstanding debt have reached different conclusions. *Compare In re Malinowski*, 156 F.3d 131, 135 (2d Cir.1998) (concluding that New York state labor department could not recoup pre-petition overpayments from Chapter 13 debtor post-petition) *with In re Ross*, 104 B.R. 171, 174 (E.D.Mo.1989) (concluding that state of Missouri could recover overpayments from Chapter 13 debtor's post-petition claim for unemployment benefits without violating automatic stay); *In re Gaither*, 200 B.R. 847, 853 (Bankr.S.D.Ohio 1996) (same under Ohio law).

Insofar as this case arises "[u]nder the unique statutory scheme of the Colorado Employment Security Act"; *Velo v. Employment Solutions Personnel*, 988 P.2d 1139, 1141 (Colo.App.1998); opinions from other jurisdictions offer little substantive guidance. Although debts for overpayment of unemployment compensation benefits in Colorado may be excepted from a Chapter 7 discharge under 11 U.S.C. § 523(a)(2)(A), and monetary penalties may be excepted under 11 U.S.C. § 523(a)(7); *see State ex rel. Central Collection Service v. O'Brien (In re O'Brien)*, 110 B.R. 27, 31 (Bankr.D.Colo.1990); this case presents an issue of first impression concerning whether the Department violated the automatic stay by: (1) applying the Debtor's post-petition weekly benefits to the outstanding debt due for the overpayments; and (2) enforcing a penalty for the Debtor's pre-petition receipt of unemployment benefit overpayments, precluding him from receiving post-petition unemployment compensation.

II. Discussion

Section 362(a) of the Bankruptcy Code provides that the filing of a bankruptcy petition operates as a stay, applicable to all entities, of acts "to collect, assess or recover a claim against the debtor that arose before the commencement of the case." 11 U.S.C. § 362(a)(6). The stay also precludes "the enforcement, against the debtor or against property of the estate, of a judgment obtained before commencement of the case." 11 U.S.C. § 362(a)(2). Actions taken in violation of the automatic stay are void and have no effect; *Franklin Sav. Ass'n v. Office of Thrift Supervision*, 31 F.3d 1020, 1022 (10th Cir.1994); and "an individual injured by any willful violation" of the automatic stay "shall recover actual damages, including costs and attorneys' fees, and, in appropriate circumstances, may recover punitive damages." 11 U.S.C. § 362(h).

A. Recoupment/Setoff

The Debtor argues that the Department may not recoup the 1993 overpayments

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from his current unemployment compensation benefits without violating the automatic stay, because it is attempting to collect on its pre-petition claim and/or enforce its own judgment as to the 1993 overpayments.

The Debtor relies on the general proposition that the Department is bound by the terms of his confirmed Chapter 13 plan as to the amount and character of its pre-petition claim for 1993 overpayments. 11 U.S.C. § 1327; *see Andersen v. UNIPAC-NEBHELP (In re Andersen)*, 179 F.3d 1253, 1258 (10th Cir.1999) (recognizing that a final "order confirming a chapter 13 plan represents a binding determination of the rights and liabilities of the parties as ordained by the plan" and that terms of plan are res judicata). The Debtor maintains that the Department's actions in this case constitute a setoff, rather than recoupment, of its pre-petition claim, and that the cases from other jurisdictions

permitting recoupment in this context are "ill-reasoned."

"The common law doctrine of setoff, as recognized in section 553 of the Bankruptcy Code, grants a creditor the right `to offset a mutual debt owing by such creditor to the debtor' so long as both debts arose before commencement of the bankruptcy action and are indeed mutual." *Davidovich v. Welton (In re Davidovich),* 901 F.2d 1533, 1537 (10th Cir.1990) (per curiam) (quoting 11 U.S.C. § 553(a)); *see Citizens Bank of Maryland v. Strumpf,* 516 U.S. 16, 18, 116 S.Ct. 286, 133 L.Ed.2d 258 (1995) (recognizing that § 553(a) of the Bankruptcy Code creates no federal right, but preserves "whatever right of setoff otherwise exists").

"The right of setoff (also called `offset') allows entities that owe each other money to apply their mutual debts against each other, thereby avoiding `the absurdity of making A pay B when B owes A.'" *Strumpf,* 516 U.S. at 18, 116 S.Ct. 286 (quoting *Studley v. Boylston Nat'l Bank,* 229 U.S. 523, 528, 33 S.Ct. 806, 57 L.Ed. 1313 (1913)). Although the debts generally arise in separate transactions where setoff applies, the "mutuality requirement mandates that the debts involved be between the same parties standing in the same capacity." *Davidovich,* 901 F.2d at 1537. A creditor's setoff rights are automatically stayed upon the filing of a bankruptcy petition; 11 U.S.C. § 362(a)(7); *Strumpf,* 516 U.S. at 17, 116 S.Ct. 286; and "[s]etoff is allowed in only very narrow circumstances in bankruptcy." *Ashland Petroleum Co. v. Appel (In re B & L Oil Co.),* 782 F.2d 155, 157 (10th Cir.1986). "But a creditor properly invoking the recoupment doctrine can receive preferred treatment even though setoff would not be permitted." *Id.*

Recoupment "is a distinct doctrine in bankruptcy cases"; *Davidovich,* 901 F.2d at 1537; permitting a creditor to defend against a debtor's claim or cause of action by resort to matters arising from the same transaction. *Conoco, Inc. v. Styler (In re Peterson Distributing, Inc.),* 82 F.3d 956, 959 (10th Cir.1996). "[R]ecoupment is an equitable doctrine that allows the determination of a `just and proper liability' regarding such a claim." *Id.; see Davidovich,* 901 F.2d at 1537 (noting that equitable doctrine of recoupment in bankruptcy context "permit[s] a creditor to offset a claim that arises from the same transaction as the debtor's claim without reliance on the setoff provisions and limitations of section 553"); *B & L Oil,* 782 F.2d at 157 (recognizing that, under recoupment, a creditor may meet a debtor's claim "with a countervailing claim that arose out of the same transaction").

"Equitable recoupment permits one party to a transaction to withhold funds

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due the other party, *as long as both debts arise from the same transaction.*" *In re Healthback, LLC,* 226 B.R. 464, 475 (Bankr.W.D.Okla.1998). "The `same transaction' requirement acts as a mechanism to ensure that equitable reasons for recoupment are present before a creditor may attain priority through the doctrine of recoupment." *Peterson Distributing,* 82 F.3d at 960.

A creditor's proper exercise of recoupment in bankruptcy is not a violation of the automatic stay. *Malinowski,* 156 F.3d at 133 ("The automatic stay is inapplicable because the funds subject to recoupment are not the debtor's property."); *Aetna U.S. Healthcare, Inc. v. Madigan (In re Madigan),* 270 B.R. 749, 754 (9th Cir. BAP 2001) ("Since recoupment is neither a claim nor a debt, it is unaffected by either the automatic stay or the debtor's discharge."); *Continental Cas. Co. v. Gullett (In re Gullett),* 253 B.R. 796, 806 (S.D.Tex.1999), *aff'd mem.,* 220 F.3d 585 (5th Cir.2000) ("Any actions related to [a] recoupment cannot, as a matter of law, violate the automatic stay."); *Powell v. FELRA and UFCW Health and Welfare Fund (In re Powell),* 284 B.R. 573, 576 (Bankr.D.Md.2002) (recognizing that a creditor "is not required to seek judicial approval prior to recoupment because the `right of recoupment does not constitute a debt which is dischargeable'").

Despite its equitable underpinnings, "[r]ecoupment is `narrowly construed' in bankruptcy cases because it violates the basic principle of equal distribution to creditors." *Peterson Distributing,* 82 F.3d at 959; *see B & L Oil,* 782 F.2d at 158 (noting that recoupment exception to general bankruptcy principles "should be narrowly construed"). Similarly, the phrase "`same transaction' is a term of art that must be narrowly defined." *Peterson Distributing,* 82 F.3d at 960.

"[C]ourts generally have only found this `same transaction' requirement to be satisfied when the debts to be offset arise out of a single, integrated contract or similar transaction." *Davidovich,* 901 F.2d at 1538; *see B & L Oil,* 782 F.2d at 157 (recognizing that recoupment often applies where a contract expressly permits withholding of overpayments from future payments). "[F]or claims to arise from the `same transaction' for the purposes of recoupment `both debts must arise out of a single integrated transaction so that it would be inequitable for the debtor to enjoy the benefits of that transaction without also meeting [his or her] obligations.'" *Peterson Distributing,* 82 F.3d at 960 (quoting *University Medical Ctr. v. Sullivan (In re University Medical Ctr.),* 973 F.2d 1065, 1081 (3d Cir.1992)); *accord Malinowski,* 156 F.3d at 133 (applying "restricted" definition of "transaction" for purposes of recoupment); *contra Madigan,* 270 B.R. at 755 (applying "logical relationship" test and giving "the word `transaction' ... a liberal and flexible construction"); *Stratman v. Missouri Div. of Employment Security (In re Stratman),* 217 B.R. 250, 253 (Bankr.S.D.Ill.1998) (same).

Ultimately, in considering whether a creditor's claim arises from the "same transaction," the Court must examine the equities of the case. *Peterson Distributing,* 82 F.3d at 960. "In light of recoupment's equitable foundation, the doctrine is only applicable to claims that are so closely intertwined that allowing the debtor to escape [his or her] obligation would be inequitable notwithstanding the Bankruptcy Code's tenet that all unsecured creditors share equally in the debtor's estate." *Id.*

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The Debtor urges this Court to follow the reasoning of the United States Court of Appeals for the Second Circuit in *Malinowski,* and to conclude that his claims for unemployment compensation benefits — one in 1993 and the other in 2002 — were not part of the "same transaction" for purposes of recoupment. In *Malinowski,* the Second Circuit applied, as this Court must, a narrow test for the "same transaction" in the context of recoupment of unemployment benefits under New York law, and it considered and rejected "two theories under which governmental entities have sought to consolidate claims arising out of independent sets of facts giving rise to statutory rights." *Malinowski,* 156 F.3d at 134; *cf. Madigan,* 270 B.R. at 755 (noting split among circuits as to breadth of "same transaction" for recoupment in bankruptcy).

The first theory concerns a governmental unit's "attempt to consolidate the claims by defining present substantive rights by reference to past events." *Id.* The Second Circuit concluded that, although Congress may decide which *federal* benefits override rights and obligations under the Bankruptcy Code, "a state may not choose to define its rights in a way that defeats the ends of federal bankruptcy law." *Id.* (distinguishing *United States v. Consumer Health Services, Inc.,* 108 F.3d 390, 394 (D.C.Cir.1997)).

The court in *Malinowski* expressed its view that a state statutory scheme mandating recovery of overpayments in contravention of the Bankruptcy Code's general framework for distribution of assets to creditors may not automatically transform two separate claims for unemployment compensation into the "same transaction" for purposes of recoupment. *Malinowski,* 156 F.3d at 134 n. 2. In this connection, the court intimated that, while Congress may be empowered to "override federal bankruptcy laws" by requiring repayment of federal benefits, a state has no such power. *Id.*

The Second Circuit also rejected the "contract analogy" that considers the relationship between a state government and a debtor as an ongoing contractual relationship to facilitate a finding that the past overpayments and future benefits stem from the "same transaction." *Id.* at 134-35; *see Ross,* 104 B.R. at 173 (noting that pre-petition debt for overpayment of unemployment benefits "is part of the same quasi-contractual claim" that the state asserted against post-petition claim for new benefits); *Gaither,* 200 B.R. at 852 (agreeing that, when a debtor files pre-petition claim for unemployment compensation, relationship resembling "societal contract" is established for purposes of "same transaction" analysis). In rejecting both theories concerning the "same transaction" in the context of recoupment of unemployment overpayments, the Second Circuit determined that the New York "statute provides for discrete and independent claims for different periods of unemployment, with different periods of employment creating eligibility for specific periods of unemployment benefits." *Malinowski,* 156 F.3d at 135.

Conspicuously absent from the Second Circuit's opinion in *Malinowski,* however, is any recognition that state unemployment compensation statutes implement a *federal* program. *See New York Telephone Co. v. New York State Dept. of Labor,* 440 U.S. 519, 536, 536 n. 27, 99 S.Ct. 1328, 59 L.Ed.2d 553 (1979) (noting that New York's unemployment compensation program "is structured to comply with a federal statute" and acknowledging that all states have implemented programs to mitigate federal taxes for employers by enacting unemployment compensation statutes in compliance with federal law);

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Shaw v. Valdez, 819 F.2d 965, 967 (10th Cir.1987) ("The federal unemployment compensation program is implemented and administered by the states."); *Losey v. Roberts,* 677 F.Supp. 101, 106 (N.D.N.Y.1986) ("The unemployment compensation program is a joint federal-state effort."); *accord Paul v. Industrial Comm'n,* 632 P.2d 638, 639 (Colo.App.1981) (recognizing that "Colorado's unemployment compensation statutes are intended to further the same goals" as the federal statutes).**Under both the Social Security Act, 42 U.S.C. § 503(g)(1), and the Federal Unemployment Tax Act, 26 U.S.C. 3304(a)(4)(D),**[9] **Congress expressly authorizes states to enact provisions that permit recoupment of overpayments by withholding benefits.**[10] And the Social Security Act contemplates state schemes that "may terminate, deny, suspend or reduce any benefits" for unemployment compensation in certain circumstances. 42 U.S.C. §§ 503(f); 1320b-7(b) and (c); *see also Ohio Bureau of Employment Servs. v. Hodory,* 431 U.S. 471, 483, 97 S.Ct. 1898, 52 L.Ed.2d 513 (1977) (construing Social Security Act and Federal Unemployment Tax Act).

In this Court's view, the two claims for unemployment compensation in this case are part of the "same transaction" for purposes of recoupment. A state statutory scheme conditioning receipt of current benefits on recovery of prior overpayments is expressly authorized by Congress, as is denial of claims for benefits where state eligibility requirements have not been met.

Under the Colorado Employment Security Act, eligibility for unemployment benefits and entitlement to those benefits "are distinct and separate matters that relate to whether a claimant may receive unemployment compensation." *Velo,* 988 P.2d at 1141; *City and County of Denver v. Industrial Claim Appeals Office,* 833 P.2d 881, 883 (Colo.App.1992). "Eligibility" for unemployment compensation relates to the monetary provisions of the statute, while "entitlement" concerns the non-monetary provisions. *Velo,* 988 P.2d at 1141; *Denver v. Industrial Claim,* 833 P.2d at 882; *see O'Brien,* 110 B.R. at 32 (discussing eligibility requirements). Each is an equal element of a claim for unemployment compensation benefits. *Arteaga v. Industrial Claim Appeals Office,* 781 P.2d 98, 100 (Colo.App.), *cert. denied,* 781 P.2d 98 (Colo.App.1989).

Although monetary eligibility for benefits is determined weekly, and it "encompasses many different aspects" of a claimant's request for benefits, the non-monetary provisions of the Colorado Employment Security Act have equal weight and may preclude a claimant from receiving unemployment compensation. *Id.; see* Colo.Rev.Stat. § 8-73-107 (listing eligibility requirements); Colo.Rev.Stat. § 8-73-108 (non-monetary provisions). Under Colo.Rev.Stat. § 8-73-108(1), an otherwise eligible claimant may be "disqualified" from receiving benefits. Section 8-73-108(3)(d) expressly permits denial of benefits, or disqualification, "by

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reason of ... fraud in connection with a claim for benefits." Indeed, the "Monetary Determination of Unemployment Insurance Benefits" sent to the Debtor by the Department in August, 2002, states unequivocally that "[b]eing monetarily eligible does not automatically mean that you will receive benefits." (Debtor's Motion Ex. A)

The Debtor, while eligible under Colorado law, is not entitled to receive benefits due to his prior conduct in collecting the 1993 overpayments. Once the Department determined in 1994 that it had overpaid benefits and that the Debtor had obtained those overpayments by false representation and/or willful failure to disclose material facts, the state statute allowed it to, "in addition to instituting collection procedures, withhold subsequent benefit payments to which the claimant is or becomes entitled and apply the amount withheld as an offset against the overpayment." Colo.Rev.Stat. § 8-79-102(1); *accord* 26 U.S.C. § 3304(a)(4)(D); 42 U.S.C. § 503(g)(1). The Department's 1994 determination that the Debtor had received overpayments circumscribed, or limited, any future claims for benefits, permitting outright denial of benefits and a recoupment of the amount of the overpayments. In that sense, the Debtor's post-petition entitlement to unemployment benefits was intertwined by statute with his pre-petition receipt of overpayments. *Peterson Distributing,* 82 F.3d at 960.

The acts that disentitle the Debtor to receive payment on his current claims for benefits, and that allow the Department to apply any current benefits to the overpayments, occurred in connection with the Debtor's 1993 receipt of the overpayments due to false representation or willful failure to disclose a material fact. Simply because the Department has a pre-petition claim against the Debtor for the 1993 overpayments does not preclude it from obtaining satisfaction of that claim out of property to which the Debtor is not entitled under state law. *See O'Brien,* 110 B.R. at 30-31 (recognizing that debtor collecting unemployment compensation does not receive his own contributed funds; "[e]mployees do not make a contribution to Colorado's unemployment fund, employers do").

Under Tenth Circuit precedent, the crux of recoupment in bankruptcy turns on the equities of the case. *Peterson Distributing,* 82 F.3d at 960. In this case, the Department determined that the Debtor had willfully failed to disclose a material fact as to his employment status while collecting benefits in 1993. The Debtor conceded in a written response that he had obtained a "temporary job," but he nevertheless continued to collect unemployment benefits. The facts of this case in relation to the equities differ markedly from those facing the Second Circuit in *Malinowski,* 156 F.3d at 135 (noting that the debtor had "not been accused of willful wrongdoing" and that the "lack of fraud" tipped the equities in the debtor's favor against recoupment). The equities of the case favor the Department and the Court concludes that it is entitled to recoup the 1993 overpayments from the Debtor's current claim for benefits without violating the automatic stay. The two episodes of unemployment in this case, although temporally distinct, are "so closely intertwined" that allowing the Debtor to shirk his repayment obligations would be inequitable. *Peterson Distributing,* 82 F.3d at 960.

In fact, the Department could not have violated the automatic stay because the post-petition benefits are neither property of the Debtor nor property of the estate. *Montoya v.*

Vigil (In re Vigil), 250 B.R. 394, 396 n. 2 (Bankr.D.N.M.2000) (recognizing that, "[a]s a general matter,

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the automatic stay does not apply to property which is not property of the estate"); *In re Wilkerson Enter., Inc.,* 95 B.R. 213, 215 (Bankr.N.D.Okla.1989) (same). Under the Colorado Employment Security Act, the Debtor was not entitled to post-petition benefits and those benefit payments are not property of the estate. *See Cassidy v. Adams,* 872 F.2d 729, 733 (6th Cir.1989) (concluding that employee "had no protectible [sic] property right" in recouped unemployment overpayments).

The Debtor's present entitlement to payment of the post-petition benefits is limited under state law. Colo.Rev.Stat. §§ 8-70-106; 8-73-108(3)(d). State law is determinative as to the extent of the Debtor's interest in property — including his interest in current unemployment benefits. *Bailey v. Big Sky Motors, Inc. (In re Ogden),* 314 F.3d 1190, 1197 (10th Cir.2002) ("For purposes of most bankruptcy proceedings, `[p]roperty interests are created and defined by state law.'"); *see Taylor v. Rupp (In re Taylor),* 133 F.3d 1336, 1341 (10th Cir.1998). Federal law controls whether the interest, as determined by state law, is property of the estate. *Id.; see* 11 U.S.C. §§ 541; 1306.

Section 1306(a) of the Bankruptcy Code defines property of the estate as all pre-petition property specified in 11 U.S.C. § 541 plus all property "that the debtor acquires after commencement of the case but before the case is closes, dismissed, or converted" and "earnings from services performed by the debtor after commencement of the case but before the case is closed, dismissed, or converted ...." 11 U.S.C. § 1306(a)(1) and (2).[11] Section 1327(b) provides that, upon confirmation of a Chapter 13 plan, all property of the estate vests in the debtor.

Because the Debtor is not entitled to receive unemployment compensation under state law due to his prior fraud and/or failure to disclose a material fact, he never "acquired" the post-petition payments and those payments do not constitute "earnings for services performed." Accordingly, weekly unemployment payments to which the Debtor is not entitled under the Colorado Employment Security Act cannot be property of the estate; and the Department's exercise of its right to withhold the post-petition benefits is not an "act to collect, assess, or recover a [pre-petition] claim *against the debtor*." 11 U.S.C. § 362(a)(6) (emphasis added).

The Court recognizes that cases considering recoupment in bankruptcy in the context of other federal benefit programs have reached different conclusions. For example, in considering recoupment of overpayments of Social Security benefits, the Third Circuit noted that, "in spite of statutory or contractual provisions providing for `recoupment' of previous overpayments, the primary purpose of [the Social Security Act] is to provide income security to the recipients." *Lee v. Schweiker,* 739 F.2d 870, 876 (3d Cir.1984). Accordingly, those social welfare payments "should be protected by the automatic stay" and "subject to the ordinary rules of bankruptcy." *Id.; Neavear v. Schweiker,* 674 F.2d 1201, 1206 (7th Cir.1982) (determining that debts for Social Security overpayments are dischargeable in bankruptcy); *United States v. Brown (In re Brown),* 40 B.R. 923, 925 (Bankr.D.Kan.1984) (concluding that Social Security Administration could not recoup overpayments after bankruptcy discharge); *see also*

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University Medical Center v. Sullivan (In re University Medical Center), 973 F.2d 1065, 1081 (3d Cir.1992) (precluding recoupment of Medicare overpayments); *but see United States v. Consumer Health Servs.,* 108 F.3d 390, 395 (D.C.Cir.1997) (permitting recoupment of Medicare overpayments).[12]

As the United States District Court for the Eastern District of Missouri noted in *Ross,* however, "[u]nemployment compensation

benefits, unlike social security benefits, are not a product of an employee's labor or the result of his [or her] individual contributions ... As such, a debtor does not have a property right in the unemployment compensation the same way [he or] she would in [his or] her social security benefits ...." *Ross,* 104 B.R. at 173; *accord O'Brien*, 110 B.R. at 31; *cf. Lee,* 739 F.2d at 876 (noting that Social Security benefits are statutory entitlements). In enacting the federal unemployment compensation statutes, "Congress did not intend to require that the States give coverage to every person involuntarily unemployed." *Hodory,* 431 U.S. at 483, 97 S.Ct. 1898. If, pursuant to federal law, the state determines that a claimant is not entitled to unemployment benefits, this Court is powerless to order otherwise. *Id.* at 490, 97 S.Ct. 1898 (recognizing that "the Fourteenth Amendment gives the federal courts no power to impose upon the States their views of what constitutes wise economic or social policy").

As a practical matter in this case, the Department has determined that the Debtor is not entitled to receive post-petition unemployment compensation benefits. Even if this Court were to conclude that "recoupment" of the 1993 overpayments violates the automatic stay, it could not order the state to deem the Debtor entitled to post-petition payments. That is, under the Colorado Employment Security Act, the Debtor's pre-petition conduct precludes him from receiving post-petition benefits. The Department may choose to "apply" some of the post-petition benefits, to which the Debtor otherwise would have been entitled, to the outstanding obligation for the 1993 overpayments, notwithstanding its acceptance of unsecured treatment of that claim under the Debtor's confirmed Chapter 13 plan.

As long as the penalties precluding the Debtor from receiving unemployment benefits were imposed and enforced without violating the automatic stay, the Department's refusal to pay post-petition benefits and its "use" of some of those otherwise allowable benefits to recoup the 1993 overpayments was proper.

B. Penalty Enforcement

The Debtor contends that the Department's exaction of the forty-week penalty violates the automatic stay and that, contrary to the Department's claim, it is not a valid exercise of the police and regulatory power of the state. *See* 11 U.S.C. § 362(b)(4) (excepting from automatic stay acts of a governmental unit to enforce police and regulatory powers). According to the Debtor, the imposition of the forty-week penalty is a pecuniary penalty, aimed at recovering the pre-petition overpayments.

It is beyond cavil that the unemployment compensation statutes in Colorado are enacted pursuant to the general assembly's police power. *Cottrell Clothing Co. v. Teets,* 139 Colo. 558, 342 P.2d 1016, 1019 (1959); *Industrial Comm'n v. Northwestern Mut. Life Ins. Co.*, 103 Colo. 550, 88 P.2d 560, 563 (1939) (construing prior

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Unemployment Compensation Act). The state legislature expressly states in the Colorado Employment Security Act that

in its considered judgment the public good and the general welfare of the citizens of this state require the enactment of this measure, under the police powers of the state, for the compulsory setting aside of unemployment reserves to be used for the benefit of persons unemployed through no fault of their own.

Colo.Rev.Stat. § 8-70-102.

In determining whether a governmental unit's actions fall within the parameters of § 362(b)(4), however, the Court must consider the "pecuniary purpose" test and the "public policy" test. *Yellow Cab Cooperative Ass'n v. Metro Taxi, Inc. (In re Yellow Cab Cooperative Ass'n),* 132 F.3d 591, 597 (10th Cir.1997) (quoting *Eddleman v. United States Dep't of Labor,* 923 F.2d 782, 791 (10th Cir.1991)). As explained by the Tenth Circuit:

Under the "pecuniary purpose" test, the court asks whether the government's proceeding

relates primarily to the protection of the government's pecuniary interest in the debtor's property and not to matters of public policy. If it is evident that a governmental action is primarily for the purpose of protecting a pecuniary interest, then the action should not be excepted from the stay.

Id.

The Tenth Circuit has contrasted the "public policy" test by stating that it "distinguishes between government proceedings aimed at effectuating public policy and those aimed at adjudicating private rights.... [A]ctions taken for the purpose of advancing private rights are not excepted from the stay." *Id.*

In this case, the Colorado Employment Security Act authorizes the imposition of a "four-for-one" penalty for each week that a person received benefits to which he or she was not entitled. Colo.Rev.Stat. § 8-81-104(a)(II). The statute requires recovery of the overpayments and imposition of a fifty percent monetary penalty. *Id.*

The repayment and monetary penalty provisions are mandatory. *See* Colo.Rev.Stat. § 8-81-101(4)(a)(I) ("Any person who has received any sum as a benefit ... to which he was not entitled shall be required to repay such amount"); § 8-81-101(4)(a)(II) ("If any person receives any such overpayment because of his or her false representation or willful failure to disclose a material fact ... the person shall be required to pay the total amount of the over payment ... plus a fifty percent penalty"); *see Woollems v. Industrial Claim Appeals Office,* 43 P.3d 725, 726 (Colo.App.2001) (concluding that monetary penalty is mandatory). But the provisions concerning recovery of past overpayments by withholding current benefits are permissive. *See* Colo.Rev.Stat. § 8-79-102(1) (providing that, in the case of overpayment of benefits, the state "may" withhold subsequent benefits as an offset in addition to other collection actions); § 8-81-801(4)(a)(II) (stating that any person who receives overpayments by reason of false representation or willful failure to disclose a material fact "may" be denied benefits when otherwise eligible); *In re Lishnevsky,* 981 P.2d 609, 611 (Colo.App.1999) (recognizing that the use of the term "may" in Colorado statutes generally indicates that action is discretionary).

According to the Department's "Determination of Overpayment of Benefits," it imposed the penalties on the Debtor, both monetary and temporal, several years pre-petition — on November 14, 1994. (Department's Response Ex. E) Thus, both penalties were imposed pre-petition and the question devolves to whether *enforcement*

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of the forty-week penalty is "primarily" to protect the Department's pecuniary interest in recovering the 1993 overpayments and monetary assessment, or whether it is "aimed at effectuating public policy." *Yellow Cab,* 132 F.3d at 597.

In the Department's view, "[t]he public policy behind the 40-week penalty is to protect the integrity of the unemployment insurance system by deterring the filing of false or misleading claims for unemployment benefits." The Court agrees and concludes that enforcement of the forty-week penalty is not primarily for recovery of the 1993 overpayments.

If the primary purpose of the temporal penalty is to collect prior unemployment overpayments and the fifty percent monetary penalty, the statutory provisions for withholding current benefits and imposing the penalties would be mandatory, rather than permissive or discretionary. *See* Colo.Rev.Stat. §§ 8-79-102(1); 8-81-801(4)(a)(II). In addition, the amount of the overpayments has little monetary correlation, if any, to the duration of the penalty.

In this case for example, the Department determined that the Debtor was monetarily eligible to receive $398.00 per week in post-petition benefits, or total benefits of $10,348.00.

The outstanding 1993 overpayments and fifty percent penalty, however, total $2,972.50. If collection of the prior overpayments is the "primary" purpose of the penalty provisions, the entire debt would be satisfied after approximately eight weeks of the Debtor's post-petition benefits.

In other words, the exaction of the forty-week penalty, at $398.00 per week for twenty-six weeks of current eligibility, results in a pecuniary recovery of $10,348.00 — more than three times the amount of the outstanding 1993 overpayments and fifty percent monetary penalty. Given the permissive nature of the penalties and that the temporal penalty assessed does not correlate to the amount of the overpayments, the Court cannot conclude in this case that the "primary" purpose of withholding the Debtor's current benefits is pecuniary. Accordingly, enforcement of the temporal penalty is not barred by the automatic stay under 11 U.S.C. § 362(b)(4).

III. Conclusion

For all of the foregoing reasons, the Court concludes that the Department did not violate the automatic stay by recouping the 1993 overpayments and withholding the Debtor's current unemployment compensation benefits as a penalty. Therefore, it is

ORDERED that the Debtor's Motion for Entry of Order to Show Cause Why Sanctions Should Not Enter Pursuant to 11 U.S.C. § 362(h) and the Debtor's request for an order imposing sanctions on the Colorado Department of Labor and Employment, Division of Employment and Training, are DENIED.

Notes:

1. The file reflects that the Department did not receive notice of the hearing. The factual issues in this case are not in dispute, however, and the resolution of the matter is predominantly, if not exclusively, a question of law. Accordingly, the Court need not take further evidence. 11 U.S.C. § 105(a); Fed. R. Bankr.P. 9017; Fed.R.Civ.P. 43(e).

2. Jurisdiction is predicated on 28 U.S.C. §§ 157(a); 1334(a) and D.C. COLO. L. Civ. R. 84.1(A). This is a core proceeding. 28 U.S.C. § 157(b)(2)(A) and (O). The Court recognizes that claims for damages under 11 U.S.C. § 362(h) are generally brought as adversary proceedings in this district. Fed. R. Bankr.P. 7001(1), (7) and (9).

3. Colo.Rev.Stat. § 8-81-101(4)(a)(II) states that, "[i]f any person receives any such overpayment because of his or her false representation or willful failure to disclose a material fact ... the person shall be required to pay the total amount of the overpayment, which shall be paid into the unemployment trust fund, plus a penalty of fifty percent of such overpayment ...."

4. With respect to temporal penalties, Colo.Rev.Stat. § 8-81-101(4)(a)(II) provides that, "[i]f any person receives any such overpayment because of his or her false representation or willful failure to disclose a material fact ... such person may be denied benefits, when otherwise eligible, for four-week period for each one-week period in which such person filed claim for or received benefits to which he or she was not entitled." The file reflects that the Department determined that the Debtor had received benefit overpayments for a ten week period from October 2, 1993 to December 4, 1993, and it assessed the forty-week penalty accordingly. (Department's Response Ex. E)

5. The Debtor's prior Chapter 13 case, Case No. 99-18141 PAC, was filed in June, 1999 and dismissed in November, 1999; no plan was confirmed.

6. The Debtor filed an Amended Schedule I on May 1, 2000, disclosing gross monthly income of $5,416.66.

7. Should the Debtor complete the required payments, he will be eligible for a discharge in July, 2004. 11 U.S.C. § 1328(a).

8. The Debtor presumes that the reduction in the amount of the outstanding overpayment is a result of payments made by the Chapter 13 Trustee.

9. As amended by the Job Creation and Worker Assistance Act, Pub.L. 107-147 § 206(a)(1) and (c)(1), 116 Stat. 21 (Mar. 9, 2002).

10. Specifically, the Social Security Act provides that "[a] State may deduct from unemployment benefits otherwise payable to an individual an amount equal to any overpayment made to such individual under an unemployment benefit program of the United States or of any other State, and not previously recovered." 42 U.S.C. § 503(g)(1). Likewise, the Federal Unemployment Tax Act states that "amounts may be deducted from unemployment benefits and used to repay overpayments as provided in section 303(g) of the Social Security Act," which is codified at 42 U.S.C. § 503(g). 26 U.S.C. § 3304(a)(4)(D).

11. Section 541 of the Code defines "property of the estate" broadly, encompassing "all legal or equitable interests of the debtor in property as of the commencement of the case." 11 U.S.C. § 541(a)(1).

12. Even the Third Circuit has recognized generally, however, that the government may recover Social Security overpayments if it demonstrates that the claimant is not otherwise entitled to receive benefits. *Cannuni v. Schweiker*, 740 F.2d 260, 263 (3d Cir.1984).

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790 F.Supp.2d 1322
Larry FORTELNEY, Brandon Stoup, David Carter, Chelsea Carter, Individually, and on behalf of all others similarly situated, Plaintiffs,
v.
LIBERTY LIFE ASSURANCE COMPANY OF BOSTON, The Bassett Law Firm, LLC, Greta Bassett, John R. Nelson, and Integrated Benefits, Inc., Defendants.
Case No. CIV–09–1205–F.
United States District Court, W.D. Oklahoma.
May 16, 2011.

[790 F.Supp.2d 1326]

Jennifer S. Montagna, William B. Federman, Federman & Sherwood, R. Robyn Assaf, Oklahoma City, OK, for Plaintiffs.Brian E. Robison, Russell Yager, Vinson & Elkins, Dallas, TX, Kristin M. Simpsen, Reid E. Robison, McAfee & Taft, Sarah K. Oberndorfer, Susanna M. Gattoni, Hall Estill, Oklahoma City, OK, Miriam M. Burke, Vinson & Elkins, Austin, TX,

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Carolyn J. Fairless, Michael D. Alper, Michael L. O'Donnell, Wheeler Trigg & O'Donnell, Denver, CO, John H. Tucker, Theresa Noble Hill, Rhodes Hieronymus Jones Tucker & Gable, Tulsa, OK, for Defendants.**ORDERSTEPHEN P. FRIOT, District Judge.**

Before the court are Defendant Liberty Life Assurance Company of Boston's Motion to Dismiss Plaintiffs' First Amended Class Action Complaint (doc. no. 54), Defendants Bassett Law Firm LLC, Greta Bassett, and John R. Nelson's Motion to Dismiss Plaintiffs' First Amended Complaint (doc. no. 56) and Defendant Integrated Benefits, Inc.'s Motion to Dismiss Plaintiffs' First Amended Class Action Complaint (doc. no. 74). Upon review of all of the parties' submissions in support of and in opposition to the motions, the court makes its determination.

Introduction

Plaintiffs, Larry Fortelney, Brandon Stoup, David Carter and Chelsea Carter, bring this action individually and on behalf of similarly situated individuals who received long term disability benefits from defendant, Liberty Life Assurance Company of Boston, and were required to pay defendant, Liberty Life Assurance Company of Boston, for alleged "overpayments" after receipt of social security and/or workers' compensation benefits. In their First Amended Class Action Complaint ("Amended Complaint"), plaintiffs allege both statutory and common law claims against defendant, Liberty Life Assurance Company of Boston ("Liberty"), defendants, The Bassett Law Firm, LLC, Greta Bassett and John R. Nelson (collectively "the Bassett defendants") and defendant, Integrated Benefits, Inc. ("IBI").[1] Plaintiffs seek actual and punitive damages and injunctive relief against defendants. Defendants, in their motions, seek dismissal of the Amended Complaint pursuant to Rule 12(b)(6) and Rule 9(b), Fed.R.Civ.P.

Standard of Review

The inquiry under Rule 12(b)(6), Fed.R.Civ.P., is whether the Amended Complaint " 'contains enough facts to state a claim for relief that is plausible on its face.' " Ridge at Red Hawk, L.L.C. v. Schneider, 493 F.3d 1174, 1177 (10th Cir.2007) (quoting Bell Atlantic Corp. v. Twombly, 550 U.S. 544, 570, 127 S.Ct. 1955, 167 L.Ed.2d 929 (2007)). To survive a motion to dismiss, plaintiffs must nudge their claims across the line from conceivable to plausible. Id. The mere metaphysical possibility that some plaintiff could prove some set of facts in support of the pleaded claims is insufficient; the Amended Complaint must give the court reason to believe that these plaintiffs have a reasonable likelihood of mustering factual support for these claims.

Ridge at Red Hawk, 493 F.3d at 1177. The court assumes the truth of plaintiffs' well-pleaded factual allegations and views them in the light most favorable to plaintiffs. Id. Pleadings that are no more than legal conclusions are not entitled to the assumption of truth; while legal conclusions can provide the framework of the Amended Complaint, they must be supported by factual allegations. Ashcroft v. Iqbal, 556 U.S. 662, 129 S.Ct. 1937, 1950, 173 L.Ed.2d 868 (2009). When there are well-pleaded factual allegations, a court should assume their veracity and then determine whether they plausibly give rise to an entitlement to relief. Id.

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Rule 9(b), Fed.R.Civ.P., governs the pleading of certain special matters. Rule 9(b) provides in pertinent part: "In alleging fraud ... a party must state with particularity the circumstances constituting fraud.... Malice, intent, knowledge, and other conditions of a person's mind may be alleged generally." The requirements of Rule 9(b) are to be read in conjunction with the general pleading principles of Rule 8, Fed.R.Civ.P., calling for the pleadings to be "simple, concise, and direct, ... [and] be construed so as to do justice." Rule 8(d) and (e), Fed.R.Civ.P.; Schwartz v. Celestial Seasonings, Inc., 124 F.3d 1246, 1252 (10th Cir.1997). As with Rule 8, Rule 9(b)'s purpose is to afford the defendant fair notice of plaintiffs' claim and the factual ground upon which it is based. Id. In order to plead fraud with particularity, plaintiffs' Amended Complaint must "set forth the time, place, and contents of the false representation, the identity of the party making the false statements and the consequences thereof." Koch v. Koch Indus., 203 F.3d 1202, 1236 (10th Cir.2000) (quotations omitted). This means " 'the who, what, when, where, and how: the first paragraph of any newspaper story.' " Caprin v. Simon Transportation Services, Inc., 99 Fed.Appx. 150, 158 (10th Cir.2004) (quoting DiLeo v. Ernst & Young, 901 F.2d 624, 627 (7th Cir.1990)).

Allegations of Plaintiffs' First Amended Class Action Complaint

Plaintiffs make the following factual allegations in the Amended Complaint, which, as previously stated, the court assumes for present purposes to be true, viewing them in a light most favorable to plaintiffs. Ridge at Red Hawk, L.L.C. v. Schneider, 493 F.3d at 1177.

Liberty, an insurance company, issues group disability income policies through numerous employers throughout the United States. These policies provide long term disability benefits ("LTD benefits") to covered employees if they are unable to perform the material and substantial duties of their occupation due to injury or sickness.

One such policy ("LTD policy") is issued through OGE Energy Corp. ("OG & E") for its employees. See, Amended Complaint, ¶¶ 15, 21, and 22.

A. Plaintiff Larry Fortelney

Plaintiff, Larry Fortelney ("Fortelney"), worked for OG & E. Fortelney contributed to the LTD policy issued by Liberty. In March or April of 2005, Fortelney was injured at work. He thereafter applied for LTD benefits under the LTD policy. See, Amended Complaint, ¶ 23.

By letter dated November 16, 2005, Liberty informed Fortelney that he qualified for LTD benefits. Liberty stated that Fortelney's date of disability was June 21, 2005, making him eligible for LTD benefits beginning on December 18, 2005, pursuant to the 180 day elimination period standard in the LTD policy. Liberty stated that the LTD policy required Fortelney to apply for social security benefits should his disability be expected to extend for twelve months. Liberty requested Fortelney to complete an enclosed Social Security/Reimbursement Agreement ("SSRA") and referred to an enclosed fact sheet about the advantages of applying for social security benefits. Id., ¶ 24.

The fact sheet enclosed in the November 16th letter encouraged the filing of a claim for social security benefits and stated that recipients

"typically receive a large retroactive payment from Social Security shortly after their claim is approved." It advised that "[m]uch of this money is essentially money that Liberty [has] advanced to you while you were awaiting Social Security's decision, and you must pay it back to Liberty immediately." The fact sheet, however, advised that the social

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security cost of living increases are "yours to keep" and that it could amount to over $238,000 in additional benefits over 26 years. See, Amended Complaint, ¶ 24.

The fact sheet additionally stated that it was not necessary to hire a lawyer to assist with the social security process. It advised that if a Liberty case manager believed legal assistance was necessary, Liberty would provide it and would pay for it. It further stated that Liberty had identified legal representatives throughout the United States with a strong track record in securing social security benefits for their clients and if necessary, Liberty would put that expertise to work for the policyholder. See, Amended Complaint, ¶ 25.

On November 25, 2005, Fortelney signed the SSRA which provided in part:

If disability benefits are approved I request that Liberty Life Assurance Company of Boston (Liberty Life) pay me my benefits with no reduction for estimated Social Security Disability benefits until Social Security makes a decision. I understand that this may result in an overpayment of disability benefits paid to me if Social Security subsequently awards benefits to me, and I understand that I must repay this overpayment to Liberty Life. In consideration of Liberty Life paying me a disability benefit with no reduction for estimated Social Security benefits until Social Security makes a decision, I agree to the following:

* * *

I agree to apply for Social Security benefits within 45 days of Liberty Life's written request and provide proof of such application.

* * *

If Social Security awards benefits to me, I agree that Liberty Life has a first lien on all such benefits to the extent of any overpayment or debt, and I agree to hold such Social Security benefits in a trust for the benefit of Liberty Life until the amount of Liberty Life's overpayment has been repaid in full.

I agree to repay Liberty Life in full within the time period specified in my policy/plan provision.

* * *

If I do not repay any overpayment due to Liberty Life in full, I understand Liberty Life will discontinue payment of benefits to me, including payments for insurance premiums and other deductions paid on my behalf, and Liberty Life may withhold future disability benefits until the overpayment is recovered in full. In addition, Liberty Life may also pursue other means permitted by law to collect the overpayment amount owed.

Id., ¶ 26; see also, Ex. 2 to Liberty's supplement to motion to dismiss (doc. no. 64).[2]

A Liberty case manager placed Fortelney in contact with the law firm Bassett, Nelson & Associates ("BNA"), now known as defendant, Bassett Law Firm, LLC, [3] to

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assist with filing a claim for social security benefits. In a letter dated March 3, 2006, defendant, John R. Nelson ("Nelson"), an attorney and then principal of BNA, enclosed several forms for Fortelney to complete, along with a document that listed and explained the forms he was asked to sign. The forms included the Appointment of Representative, the Social Security Fee Agreement, the Social Security Representation Agreement, the Consent to Share

Information Regarding Social Security Disability Claim and the Client Overpayment Assistance Program Authorization. The Social Security Representation Agreement was described as the "contract [that] officially hires the BNA representative as your attorney and states the 'rules' governing our relationship." The Client Overpayment Assistance Program Authorization was described as follows:

While you wait to receive a favorable decision on your Social Security Disability claim, your insurance company has advanced you benefits. As a result, when your Social Security claim is allowed, this creates an overpayment of long term disability benefits. To assist you in your repayment obligation to the insurance company, BNA will verify that the amount to be repaid was correctly calculated by the long term disability insurance carrier and send the repayment on your behalf. This added service is offered at no cost to you and frees you from the frustration of repaying the insurance company on your own. By sending the Social Security retroactive benefit amount to your attorney at BNA, you are relieved of the burden and confusion of the LTD repayment process. Your attorney will then return the balance of the funds not due to the carrier directly to you.See, Amended Complaint, ¶ 27. On March 13, 2006, Fortelney executed the Client Overpayment Assistance Program Authorization, which specifically stated:

I, Larry Fortelney, hereby retain Bassett, Nelson & Associates LLP ("BNA"), in the event that I am awarded Social Security Disability benefits, to assist me in meeting my contractual obligation to reimburse Liberty Life Assurance Company of Boston—AZ under the terms of my Long Term Disability Insurance Policy....

I promise to undertake the following actions:

Notify BNA when I receive retroactive benefits from the Social Security Administration and the amount received.

Forward a check made payable to Bassett, Nelson & Associates, LLP to be deposited in a trust account, for the total amount received for me and all eligible dependents.

I authorize BNA to take the following actions on my behalf:

Notify Liberty Life Assurance Company of Boston—AZ of the amount of Social Security Disability benefits received for myself and all eligible dependents.

Verify the correct amount of my Long Term Disability overpayment.

Disburse funds to Liberty Life Assurance Company of Boston—AZ for reimbursement of LTD overpayment.

(Emphasis in original). See, Amended Complaint, ¶ 28.

Fortelney also executed the Consent to Share Information Regarding Social Security Disability Claim which provided:

I understand that by signing this form, I am authorizing Bassett, Nelson & Associates, LLP, to share information about my Social Security Disability Claim, including medical, vocational, and award

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data, with my long-term disability claims administrator....

See, Amended Complaint, ¶ 29.

Fortelney further executed the Social Security Representative Agreement which provided:

BASSETT, NELSON & ASSOCIATES, LLP, ATTORNEYS AT LAW, hereinafter referred to as "BNA" will provide legal services to the undersigned, Larry Fortelney ... "Client," on the terms set forth below.

* * *

Scope of Services: Client retains BNA for the sole purpose of pursuing a claim for disability benefits under the Social Security Act ...

* * *

Client: BNA is representing the Client, Larry Fortelney only in this matter. It is understood by Client ... that BNA's duty is to act in the best interests of the Client ...

* * *

BNA will maintain Client's file for two years after this matter is concluded ... Two years after the conclusion of this matter, the file may be destroyed without further notice to Client.

* * *

This Agreement contains the entire agreement of the parties. No other agreement, statement or promise made on or before the effective date of this Agreement will be binding on the parties.

See, Amended Complaint, ¶ 30.

On March 17, 2006, Nelson sent a letter to Fortelney notifying him that he had received the forms and authorizations. He stated that "I want you to know that my goal is to provide you with the finest representation. At the conclusion of your social security claim, I hope you will feel that I have represented you in a professional and efficient manner." See, Amended Complaint, ¶ 31.

On April 13, 2007, Leah Kanne, an attorney with BNA, sent a letter to Fortelney stating that due to reorganization of caseloads, she would be handling his case and hearing. She requested that he sign two forms to change his representation with the Social Security Administration. On May 1, 2007, Fortelney signed the Third Party Fee Agreement which stated that Fortelney, the client, retained Leah Kanne to represent him for his claims for disability benefits under the Social Security Act. On May 7, 2007, Fortelney executed the Appointment of Representative, appointing Leah Kanne, as his representative in connection with his claim for social security benefits. See, Amended Complaint, ¶ 32.

On January 10, 2008, Fortelney received a letter from Maren Mellem, an attorney with BNA, stating his case had been transferred to her. Fortelney executed another Third Party Fee Agreement retaining Maren Mellem to represent him in his claim for social security benefits. See, Amended Complaint, ¶ 33.

Fortelney received a letter from Maren Mellem dated March 18, 2008 with a "friendly reminder" to advise BNA if his long term disability benefits with Liberty end at any time because it would better equip her to assist him with his social security claim. It further stated: "We want to be sure that you realize that we are here to assist you and our services will not end solely because your insurance company has stopped your benefits for long-term disability." (Emphasis in original). See, Amended Complaint, ¶ 34.

On May 19, 2008, Liberty sent a letter to Fortelney thanking him for notifying it that he was awarded social security benefits. The letter instructed Fortelney to notify Liberty immediately when he received his social security benefits check.

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Liberty stated that "during the time it took Social Security to make its decision, Liberty has paid you full disability benefits. In effect, we advanced you the money we expected Social Security would ultimately pay, and you signed an agreement to repay the advance upon receiving Social Security benefits.... You must repay any overpayment immediately...." See, Amended Complaint, ¶ 35.

On July 16, 2008, defendant, Bassett Law Firm, LLC, sent a letter to Fortelney advising of the receipt of a favorable decision on Fortelney's claim for social security benefits and enclosing

the notice of award of $60,671.40 in past due benefits. The letter further stated:

As we discussed previously, your disability plan requires Liberty ... to reduce your ... benefits by the amount of income received from Social Security. Because you received ... benefits with no reduction for Social Security benefits, Liberty ... in effect advanced you the money they expected Social Security would ultimately pay to you. You also signed an agreement with your insurance provider to repay this advance upon receiving Social Security benefits. Now that you have been awarded Social Security benefits, the Bassett Law Firm is here to assist you in repaying Liberty....

Please check your bank account for a deposit from the U.S. Treasury or for a paper check in the mail from Social Security. When you receive the past due benefits from Social Security, please prepare a check, made payable to The Bassett Law Firm, in the amount of $60[,]671.40 and forward to our office.... In accordance with our Client Overpayment Assistance Program ... we will then confirm the net overpayment due under the terms of your ... policy and contact you for permission to pay that amount to Liberty ... Any remaining monies will be returned to you without delay.

Please note that if full reimbursement is not made to Liberty ... they **may** refer your account to a collection agency. To avoid such action by the disability carrier, please forward the above amount to our office at your earliest convenience. Remember, our job is to make the repayment process as simple and pain-free as possible....

* * *

We look forward to receiving your payment or response by July 31, 2008.

See, Amended Complaint, ¶ 36 (Emphasis in original).

Two days later, on July 18, 2008, Liberty sent a letter to Fortelney regarding the "Overpayment Calculation and Repayment." In that letter, Liberty made statements (similar to the statements made by defendant, Bassett Law Firm, LLC) about Fortelney's obligation to repay Liberty because Liberty had "in effect advanced [him] the money [it] expected Social Security would ultimately pay." Liberty however specifically informed Fortelney of what his reduction in benefits would be and attached an exhibit that "explain[ed] the calculation of [his] $59,121.30 balance." Liberty also stated that it would work with defendant, Bassett Law Firm, LLC, in collecting the overpayment. See, Amended Complaint, ¶ 38.

According to plaintiffs, Liberty's calculation of the alleged overpayment was grossly overstated. See, Amended Complaint, ¶ 39.

Fortelney wrote a check to defendant, Bassett Law Firm, LLC, for $59,121.30 on July 28, 2008. The check was deposited on August 7, 2008. Subsequently, on August 18, 2008, defendant, Greta Bassett, a principal of defendant, Bassett Law Firm, LLC, sent a letter to Liberty enclosing a

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check in the amount of $59,121.30, stating it "cover[ed] the Net Overpayment Due for Fortelney." Maren Mellem advised Fortelney by letter that defendant, Bassett Law Firm, LLC, had forwarded the payment of $59,121.30 to Liberty and that it was the "amount due under the terms" of his LTD policy. She also advised that the firm considered his case closed and they were no longer representing him in the matter. See, Amended Complaint, ¶¶ 17, 40–41.

According to plaintiffs, despite representing that it would confirm the net overpayment due, defendant, Bassett Law Firm, LLC, never informed Fortelney that $59,121.30 was not the correct amount due to Liberty and never returned any funds to him.

On August 21, 2008, Liberty sent Fortelney a letter stating that it had received his check and

it satisfied Fortelney's overpayment in full. See, Amended Complaint, ¶ 42.

B. Plaintiff Brandon Stoup

Plaintiff, Brandon Stoup ("Stoup"), also worked for OG & E. On October 21, 2005, Stoup sustained injuries at work. On August 10, 2006, he was awarded workers' compensation benefits for those injuries. Liberty notified Stoup on June 7, 2007 that he was eligible for LTD benefits under the LTD policy. Liberty informed Stoup that his date of disability was November 21, 2006, making him eligible to receive LTD benefits as of May 20, 2007. Liberty requested that Stoup complete an Agreement Concerning Benefits and provide his notice of award of workers' compensation benefits. See, Amended Complaint, ¶¶ 43–44.

On June 12, 2007, Stoup executed the Agreement Concerning Benefits. The agreement provided:

In return for the advance payment of group disability benefits made to me by the Liberty Life Assurance Company of Boston which may be in excess of the amount due to me under the terms [of the LTD policy], I ... agree:

1) That I am not currently receiving any benefits from ... Workers' Compensation.

2) If I apply for Social Security benefits and/or Workers' Compensation benefits[,] I will notify Liberty Life Assurance Company of Boston.

3) If I ... receive any benefits payments ... I ... will immediately notify Liberty Life Assurance Company of Boston of such benefits payments and pay back any overpayment resulting from this award in accordance with my Policy provisions.

4) I understand that thereafter Liberty Life Assurance Company of Boston is entitled to integrate any amounts received from Social Security and/or Workers' Compensation with the benefits payable under the Policy in accordance with the terms of the Policy.

See, Amended Complaint, ¶ 45, Ex. 3 to Liberty's supplement to motion to dismiss. According to plaintiffs, Liberty's "advanced payment of group disability benefits" statement was made for the purpose of getting Stoup to sign the agreement. Plaintiffs allege that Stoup was already eligible for his benefits from Liberty when he signed the agreement. See, Amended Complaint, ¶ 45.

On September 15, 2008, the Workers' Compensation Court determined that Stoup had sustained consequential injuries as a result of the accident at work and awarded him additional benefits for permanent partial disability and disfigurement. See, Amended Complaint, ¶ 46.

On December 10, 2008, Liberty sent a letter to Stoup seeking $6,782.33 because of an alleged overpayment by Liberty due to Stoup's receipt of workers' compensation

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benefits. The letter demanded that Stoup send payment by December 24, 2008. See, Amended Complaint, ¶ 47.

On January 7, 2009, Stoup and his attorney sent a letter questioning the validity of the requested reimbursement. Liberty responded on January 8, 2009, attaching a copy of the Agreement Concerning Benefits signed by Stoup. On February 2, 2009, Liberty sent a "Second Request" letter to Stoup threatening that Liberty would refer the overpayment balance to their "external collection agency to assist with the recovery of this overpayment balance...." See, Amended Complaint, ¶ 48.

Stoup's attorney sent a letter to Liberty on February 5, 2009, stating that workers' compensation benefits were exempt from collection under Oklahoma law. The attorney "also requested authority for the action so as to avoid harm to Stoup." See, Amended Complaint, ¶ 49.

Liberty responded on September 17, 2009, again enclosing the Agreement Concerning Benefits and citing policy provisions that

allegedly entitled Liberty to the overpayment. Liberty stated that "[i]f we do not receive payment or a response from you by October 1, 2009, we will refer the overpayment balance to our external collection agency...." See, Amended Complaint, ¶ 50.

C. Plaintiffs David and Chelsea Carter

Plaintiff, David Carter ("Carter"), also worked for OG & E and contributed to the LTD policy issued by Liberty. Carter suffered major heart problems and applied for LTD benefits under the LTD policy. See, Amended Complaint, ¶ 60.

In a letter dated July 9, 2008, Liberty informed Carter that he qualified for LTD benefits. Liberty stated that Carter's date of disability was February 1, 2008, making him eligible for benefits beginning on July 30, 2008. The letter stated that the policy required Carter to apply for social security benefits should his disability be expected to extend for twelve months. As with Fortelney, Liberty requested Carter to complete an enclosed SSRA. Liberty enclosed fact sheet advising about the advantages of applying for social security, and informed Carter that if legal assistance was required, Liberty would provide and pay for it.

Insisting that Carter apply for social security benefits, a Liberty case manager placed Carter in contact with defendant, IBI.[4] In a letter dated July 10, 2008 from attorney Otis L. Darby to Carter, Mr. Darby enclosed several forms for Carter's signature, including Appointment of Representative and Representation Agreement. The Representation Agreement provided that Carter retained Otis L. Darby, John Burris, Timothy J. Peters and Ted Norwood to represent him in his claim for social security disability income benefits. IBI also enclosed a Social Security Electronic Repayment Authorization form, which stated:

To satisfy my responsibility under the terms of the Social Security repayment agreement I signed with Liberty Mutual, I authorize Integrated Benefits, Inc. (IBI) to take the following actions:

Withdraw from my bank account, designated below, Social Security amounts deposited for me and all my dependents and transfer those payments to an account established at Premier Bank in Jefferson City, MO for the purpose of satisfying my repayment agreement....

See, Amended Complaint, ¶ 62.

IBI also enclosed an Application for Disability Insurance Benefits that IBI had

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already completed for Carter's signature, as well as an Application for Child's Insurance Benefits for Carter's daughter, plaintiff, Chelsea Carter. See, Amended Complaint, ¶ 63.

When Carter did not immediately respond to IBI's letter of July 10, 2008 and return the enclosed forms, IBI sent another letter on July 30, 2008, with the same completed forms for Carter's signature. An IBI representative told Carter he had to apply for social security benefits in order to receive his disability benefits under his LTD policy. See, Amended Complaint, ¶ 64.

On August 8, 2008, Carter signed the SSRA that Liberty sent to him so that he could obtain his benefits under the LTD policy. The SSRA Carter signed was identical to that signed by Fortelney. See, Amended Complaint, ¶ 65; Ex. 2 to Liberty's supplement to motion to dismiss.

On August 10, 2008, Carter also executed the forms requested by IBI, including the Representation Agreement and Social Security Electronic Repayment Authorization. Carter also signed the Appointment of Representative that named Timothy J. Peters, attorney, as his main representative. It also listed, as accepting the appointment, John Burris, Otis L. Darby, Timothy J. Peters, "Esq." and Ted Norwood, "Esq." The box indicating the representative is

an attorney was also checked. See, Amended Complaint, ¶ 66.

On December 17, 2008, Liberty sent a letter to Carter thanking him for providing a copy of his notice of award from the Social Security Administration. The letter stated that Liberty would begin reducing his benefit to offset his social security benefits. It further stated that Carter had to repay any overpayment immediately. Liberty strongly suggested that he set aside his retroactive payment from social security to repay the obligation. See, Amended Complaint, ¶ 67.

On December 28, 2008, Liberty sent a letter to Carter which stated:

As you know, your employer's disability plan calls for us to reduce your disability benefits by the amount of income received from other sources, including Social Security, for you and any eligible dependents. Since you received disability benefits for the period July 30, 2008 to November 30, 2008, with no reduction for Social Security benefits, we in effect advanced you the money we expected Social Security would ultimately pay. You also signed an agreement to repay this advance upon receiving Social Security benefits.

Your notice states that you currently receive monthly Social Security Disability benefits of $1,893.00. It also indicates that Social Security paid you retroactive benefits of $7,098.75 for the period of July 1, 2008 to November 30, 2008. Thereafter as outlined on the attached exhibit:

1. We have reduced your net benefit from Liberty from $3,133.81 to $1,240.81, to reflect your Social Security benefit.

2. The attached exhibit explains the calculation of your **$5,323.72** overpayment balance. ***Note: You will have an additional overpayment once your dependent is awarded benefits.**

3. Liberty Life will work with IBI in regards to collecting this overpayment. You will be contacted by a representative from IBI regarding repayment of this overpayment....

(Emphasis in original). The attachment stated that the overpayment due was $7,690.97 after Liberty deducted the amount it claimed it should have paid. Liberty then deducted $2,366.25 for "attorney fees" to calculate a "net overpayment due" of $5,324.72. See, Amended Complaint, ¶ 68.

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IBI also contacted Carter to tell him he had to pay Liberty from his social security lump sum. IBI recovered the alleged "overpayment" directly from Carter's bank account by using the Social Security Electronic Repayment Authorization. See, Amended Complaint, ¶ 69.

On January 18, 2009, the Social Security Administration sent a notice of award to "David Carter for Chelsea Linn Carter" stating that plaintiff, Chelsea Carter, is entitled to child's benefits beginning July 2008. The notice also stated: "We have chosen you to be her representative payee. Therefore, you will receive her checks and use the money for her needs." The Social Security Administration stated that it would pay $5,731.00 around January 24, 2009 for the money due from July 2008 through December 2008. See, Amended Complaint, ¶ 70; Ex. 6 to Liberty's supplement to motion to dismiss.

On January 28, 2009, IBI e-mailed Liberty stating that it had mailed a check for $5,323.72 to Liberty. IBI stated that it was continuing to follow up on the dependent award information. IBI e-mailed Liberty on February 19, 2009 with the social security award information with respect to plaintiff, Chelsea Carter, stating that she had been paid on January 21, 2009. See, Amended Complaint, ¶ 71.

On February 23, 2009, Liberty sent a letter to Carter regarding the overpayment calculation because his "dependents were awarded Social Security benefits." The letter stated:

As you know, your employer's disability plan calls for us to reduce your disability benefits by the amount of income received from other sources, including Social Security, for you and any eligible dependents. Since you received disability benefits for the period July 30, 2008 to January 31, 2009, with no reduction for Social Security Dependent benefits, we in effect advanced you the money we expected Social Security would ultimately pay you.

Your notice states that you currently receive monthly Social Security Dependent Disability benefits of $1,001.00. Thereafter as outline on the attached exhibit:

1. We have reduced your net benefit from Liberty from $3,133.81 to $294.81, to reflect you and your dependents Social Security benefit.

2. The attached exhibit explains the calculation of your $5,735.44 overpayment balance.

3. Liberty Life will work with IBI in regards to collecting this overpayment. You will be contacted by a representative from IBI regarding repayment of this overpayment....

The attachment stated that the overpayment due was $13,426.41 after Liberty deducted the amount it alleged it should have paid. Liberty then deducted $2,366.25 for “attorney fees” and $5,324.72 for recovery of prior overpayment to calculate a “net overpayment due” of $5,735.44. According to plaintiffs, this amount was more than the lump sum amount the Social Security Administration stated it would pay for plaintiff, Chelsea Carter. See, Amended Complaint, ¶ 72.

During this time, IBI was also telling Carter that he was obligated to pay Liberty from Chelsea Carter's social security lump sum payment. See, Amended Complaint, ¶ 73.

On February 28, 2009, Carter received only $206.81 in benefits from Liberty after it offset $2,839.00 and withheld $88.00 in federal income taxes. See, Amended Complaint, ¶ 75.

On March 10, 2009, Liberty sent a letter to Carter which advised that Liberty would begin applying the monthly benefit of $294.81 toward the outstanding overpayment

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of $5,735.44 resulting from the dependent award. Liberty further advised that the reduction would remain in place until the overpayment was recovered. See, Amended Complaint, ¶ 76.

Carter called the Social Security Administration and informed it that Liberty wanted him to send plaintiff, Chelsea Carter's social security benefits to them for an alleged overpayment. The representative for the Social Security Administration told Carter that it was illegal for him to use plaintiff, Chelsea Carter's money for anything other than her needs. See, Amended Complaint, ¶ 77.

On March 12, 2009, the Social Security Administration provided a Report of Confidential Social Security Benefit Information. The Social Security Administration representative stated the following:

David Carter receives a benefit from Social Security for his disability. His daughter is also entitled to receive a benefit. He is her payee. That means that he is to use the money for her food, clothing and shelter. The money is not his income. It is not to be used as his income. It is not to be used to pay his bills or debts. The cash benefits used in any other way besides her needs is fraud. If you have any questions please contact me.

See, Amended Complaint, ¶ 78.

On March 30, 2009, Liberty ceased paying Carter any disability benefits. The explanation of benefits stated that it offset $2,839.00 for social security benefits and applied $294.81 as a benefit adjustment amount. Liberty also applied the $88.00 it previously withheld for taxes to pay itself, as opposed to paying it to the government as Carter had directed. See, Amended Complaint, ¶ 79.

On May 7, 2009, Liberty sent a letter to Carter after receiving correspondence from the Social Security Administration regarding social security benefits paid to Carter and his daughter. Liberty stated in the letter:

The Social Security Administration is correct in stating that benefits paid to you on behalf of your daughter must be used for her welfare. You receive those benefits from Social Security and I am sure you are using them appropriately. When calculating the long-term disability benefit due you from Liberty, we are offsetting amounts identified as your dependent's SS disability benefit, which reduces the benefit amount you are entitled to receive from Liberty. Neither this provision nor this action in any way affects what you receive from Social Security or how you choose to use those funds. Further, any overpayment of disability benefits is against funds we have previously paid you for the same period that Social Security is now paying retroactively, and this amount includes the offset for dependent benefits as stated above. How you choose to pay this overpayment is your decision; should you not repay us by personal check or other means, we are administrating the contract language in Section 7, General Provisions, which states:

Right of Recovery

* * *

Liberty may recover an overpayment by, but not limited to, the following:

1. requesting a lump sum payment of the overpaid amount;

2. reducing any benefits payable under this policy;

3. Taking any appropriate collection activity available including any legal action needed; and

4. placing a lien, if not prohibited by law, in the amount of the overpayment on the proceeds of any Other Income Benefits, whether on a periodic or lump sum basis.

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It is required that full reimbursement be made to Liberty.

Therefore, we will continue to apply your net benefit of $294.81 towards this balance due.

See, Amended Complaint, ¶ 80.

Carter spoke to an IBI representative who told him he must pay Liberty from the lump sum attributable to plaintiff Chelsea Carter. Carter told the IBI representative about the Social Security Administration's notice that use of the funds in such a manner was fraud. Subsequently, a different IBI representative contacted Carter and told Carter that IBI had nothing more to do with the issue. The IBI representative said that IBI had not received any payment from plaintiff, Chelsea Carter and were not representing her. See, Amended Complaint, ¶ 81.

According to plaintiffs, Liberty has taken Chelsea Carter's past due social security benefits by withholding all benefits owed to Carter that he would have otherwise been paid. Liberty offsets Carter's LTD benefits by the amount of benefits plaintiff, Chelsea Carter, receives. However, plaintiffs allege that Liberty does not pay any extra benefits to policyholders who have dependents. Liberty also charged Carter the same premium it charged other policyholders whose benefits were not reduced by dependents' social security benefits. See, Amended Complaint, ¶¶ 82, 83.[5]

D. Other Class Members

Plaintiffs allege, on information and belief, Liberty seeks recoupment from all of its policyholders who receive funds from social security or workers' compensation for "overpayments." According to plaintiffs, the policyholders, entitled to LTD benefits, are induced to execute agreements to repay Liberty for the "overpayments" from their social security or workers' compensation benefits.

Plaintiffs also allege, on information and belief, that Liberty seeks recoupment of

"overpayments" from all of its policyholders whose dependents receive social security benefits. Plaintiffs allege that Liberty has either directly taken the lump sum social security payments received by these dependents or Liberty has obtained the funds by other means, such as deducting all of the policyholders' benefits to recoup the alleged "overpayments."

In the Amended Complaint, plaintiffs seek to prosecute a class action under Rule 23, Fed.R.Civ.P., and propose six subclasses. The first five subclasses are all individuals who received long term disability benefits from Liberty and

(1) assigned or paid funds to Liberty from payments received from the Social Security Administration ("Liberty/SS subclass");

(2) assigned or paid funds to Liberty from payments received from the Social Security Administration for the benefit of their dependents ("Liberty/SS payee subclass");

(3) assigned or paid funds to Liberty from payments received pursuant to Oklahoma Workers' Compensation law ("Liberty/WC subclass");

(4) retained the Bassett Law Firm, LLC, Greta Bassett, Leah Kanne, Maren Mellem or John Nelson as their legal counsel ("Bassett subclass");

(5) retained IBI as their legal counsel or social security representative ("IBI subclass").

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The sixth subclass proposed by plaintiffs consists of all dependents of Liberty policyholders whose social security benefits were taken by Liberty ("Liberty/SS dependent subclass").

Claims Against Liberty

The Amended Complaint (Counts I through X) alleges one federal claim and nine state law claims against Liberty. The claims and the plaintiffs who allege the claims are as follows:

A. Federal Claim—Statutory

Count I—Violation of Social Security Act, 42 U.S.C. § 407—Fortelney, Carter, Chelsea Carter, Liberty/SS subclass, Liberty/SS payee subclass and Liberty/SS dependent subclass

B. State Claims—Statutory and Common Law

Count II—Violation of the Oklahoma Workers' Compensation Act, 85 O.S. § 48—Stoup and Liberty/WC subclass

Count III—Fraud Under Oklahoma and Massachusetts Law—Fortelney, Stoup, Carter, Liberty/SS subclass, Liberty/SS payee subclass and Liberty/WC subclass

Count IV—Violation of 76 O.S. § 2—Deceit—Fortelney, Stoup, Carter, Liberty/SS subclass, Liberty/SS payee subclass and Liberty/WC subclass

Count V—Conspiracy Under Oklahoma and Massachusetts Law—Fortelney, Carter, Bassett subclass and IBI subclass

Count VI—Breach of Contract—Fortelney, Stoup, Carter, Liberty/SS subclass, Liberty/SS payee subclass and Liberty/WC subclass

Count VII—Violation of Massachusetts Unfair Trade Practices Act, Mass. Gen. Laws Ch. 93A § 2—All plaintiffs and all subclasses

Count VIII—Violation of 36 O.S. § 902—Excessive Premiums—Fortelney, Stoup, Carter, Liberty/SS subclass, Liberty/SS payee subclass and Liberty/WC subclass

Count IX—Unjust Enrichment—All plaintiffs and all subclasses

Count X—Conversion—All plaintiffs and all subclasses

Claims Against Bassett Defendants

The Amended Complaint (Counts XI–XVIII) alleges one federal claim and seven state law claims against the Bassett defendants. The federal claim and state law claims are alleged by Fortelney and the Bassett subclass.

A. Federal Claim—Statutory

Count XI—Violation of Social Security Act, 42 U.S.C. § 407

B. State Claims—Statutory and Common Law

Count XII—Fraud under Oklahoma and Missouri Law

Count XIII—Violation of 76 O.S. § 2—Deceit

Count XIV—Conspiracy under Oklahoma and Missouri Law

Count XV—Breach of Contract

Count XVI—Breach of Fiduciary Duty under Oklahoma and Missouri Law

Count XVII—Negligence under Oklahoma and Missouri Law

Count XVIII—Conversion

Claims Against IBI

The Amended Complaint (Counts XIX–XXV) alleges one federal claim and six state law claims against IBI. The federal law claim is alleged by Carter, Chelsea Carter and the IBI subclass. The state claims are alleged by Carter and the IBI subclass.

[790 F.Supp.2d 1340]

A. Federal Claim—Statutory

Count XIX—Violation of Social Security Act, 42 U.S.C. § 407

B. State Claim—Statutory and Common Law

Count XX—Fraud under Oklahoma and Missouri Law

Count XXI—Violation of 76 O.S. § 2—Deceit

Count XXII—Conspiracy under Oklahoma and Missouri Law

Count XXIII—Breach of Fiduciary Duty Under Oklahoma and Missouri Law

Count XXIV—Negligence Under Oklahoma and Missouri Law

Count XXV—Conversion

In sum, twenty-five claims are alleged in plaintiffs' Amended Complaint. Defendants, as stated, seek to dismiss all of the claims. Specifically, defendants seek to dismiss the federal statutory claims (violation of the Social Security Act, 42 U.S.C. § 407) under Rule 12(b)(6), Fed.R.Civ.P., for failure to state a claim upon which relief can be granted. As to the state statutory and common law claims, defendants seek dismissal on the basis that the claims are either preempted by the Employee Retirement Income Security Act of 1974, as amended, 29 U.S.C. §§ 1002–1461 ("ERISA") or they fail to state a claim upon which relief can be granted. Defendants further assert that the fraud and deceit claims are subject to dismissal because they are not alleged with particularity as required by Rule 9(b), Fed.R.Civ.P.

Pertinent Provisions of LTD Policy

The LTD Policy [6] provides in pertinent part:

When Liberty receives Proof that a Covered Person is Disabled due to Injury or Sickness and requires the Regular Attendance of a Physician, Liberty will pay the Covered Person a Monthly Benefit after the end of the Elimination Period, subject to any other provisions of this policy.

* * *

" Monthly Benefit " means the monthly amount payable by Liberty to the Disabled ... Covered Person.

* * *

To figure the amount of Monthly Benefit:

1. Take the lesser of:

a. the Covered Person's Basic Monthly Earnings multiplied by the benefit percentage shown in the Schedule of Benefits; or

b. the Maximum Monthly Benefit shown in the Schedule of Benefits; and then

2. Deduct Other Income Benefits and Other Income Earnings, (shown in the Other Income Benefits and Other Income Earnings provision of this policy), from this amount[.]

The Monthly Benefit payable will not be less than the Minimum Monthly Benefit shown in the Schedule of Benefits. However, if an overpayment is due to Liberty, the Minimum Monthly Benefit otherwise payable under this provision will be applied toward satisfying the overpayment.

Ex. 1 to Liberty's motion, Section 2, DEF–6/7, Section 4, LTD–1 (Emphasis added).

Other Income Benefits means:

1. The amount for which the Covered Person is eligible under:

[790 F.Supp.2d 1341]

a. Workers' or Workmen's Compensation Laws

* * *

4. The amount of Disability and/or Retirement Benefits under the United States Social Security Act ... which

a. the Covered Person receives or is eligible to receive; and

b. his spouse, child or children receives or are eligible to receive because of his Disability

* * *

Other Income Benefits ... must be payable as a result of the same Disability for which Liberty pays a benefit. The sum of Other Income Benefits ... will be deducted in accordance with the provisions of this policy.

Ex. 1 to Liberty's motion, Section 4, LTD–22, LTD–23 (Emphasis added).

Liberty will reduce the Covered Person's Disability ... benefits by the amount of Other Income Benefits that we estimate are payable to the Covered Person and his dependents.

The Covered Person's Disability benefit will not be reduced by the estimated amount of Other Income Benefits if the Covered Person:

1. provides satisfactory proof of application for Other Income Benefits;

2. signs a reimbursement agreement under which, in part, the Covered Person agrees to repay Liberty for any overpayment resulting from the award or receipt of Other Income Benefits;

3. if applicable, provides satisfactory proof that all appeals for Other Income Benefits have been made on a timely basis to the highest administrative level unless Liberty determines that further appeals are not likely to succeed; and

4. if applicable, submits satisfactory proof that Other Income Benefits have been denied at the highest administrative level unless Liberty determines that further appeals are not likely to succeed.

* * *

In the event that Liberty overestimates the amount payable to the Covered Person ..., Liberty will reimburse the Covered Person for such amount upon receipt of written proof of the amount of Other Income Benefits awarded (whether by compromise, settlement, award or judgement) or denied (after appeal through the highest administrative level).

* * *

Liberty may help a Covered Person in applying for Social Security Disability Income Benefits. In order to be eligible for assistance the Covered Person must be receiving a Monthly Benefit from Liberty. Such assistance will be provided only if Liberty determines that assistance would be beneficial.

Ex. 1 to Liberty's motion, Section 4, LTD–24 (Emphasis added).

* * *

Liberty has the right to recover any overpayment of benefits caused by, but not limited to, the following ...

3. the Covered Person's receipt of any Other Income Benefits.

Liberty may recover an overpayment by, but not limited to, the following:

1. requesting a lump sum payment of the overpaid amount;

2. reducing any benefits payable under this policy;

3. taking any appropriate collection activity available including any legal action needed; and

4. placing a lien, if not prohibited by law, in the amount of the overpayment

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on the proceeds of any Other Income Benefits, whether on a periodic or lump sum basis.

It is required that full reimbursement be made to Liberty.

Ex. 1 to Liberty's motion, Section 7, GNP–4.

DiscussionA. Social Security Claims

Fortelney, Carter, and Chelsea Carter allege claims for violation of the Social Security Act, specifically, 42 U.S.C. § 407(a). See, Amended Complaint (Counts I, XI and XIX). Under § 407(a), the right to future payment of social security benefits is not "transferable or assignable" and funds paid or payable for social security benefits are not "subject to execution, levy, attachment, garnishment, or other legal process." [7]

Defendants assert that § 407(a) does not bar Liberty's practice of offsetting social security benefits against the amount of LTD benefits payable under the LTD policy. According to defendants, the social security offset against LTD benefits reduces a participant's LTD benefits but does not alter the social security benefits received by a participant or his dependents. Moreover, defendants assert that Liberty's implementation of the offset through the recoupment of LTD benefits advanced pending the receipt of social security benefits (the "overpayment") is permissible under § 407(a). Defendants maintain that case law specifically authorizes an insurance company, such as Liberty, to recoup the amounts it has advanced to a participant. In so doing, defendants contend that Liberty is not asserting a right to the participant's social security benefits, rather it is seeking the return of the overpayment. Defendants also argue, as an additional basis for dismissal, that § 407(a) does not create a private right of action in favor plaintiffs.

In response, plaintiffs argue that defendants have mischaracterized the basis for their § 407(a) claims. Plaintiffs assert that their claims are not premised upon Liberty's contractual offset of social security benefits. They assert that their claims are based on the "illegal agreements assigning their Social Security money, the unlawful taking of their lump sum retroactive Social Security funds awarded to the policyholders and their dependents, and Liberty's practice of offsetting dependents' funds, which are not the policyholders' income under the law." See, plaintiffs' omnibus response, (doc. no. 73), p. 20. Specifically, plaintiffs assert that the SSRAs executed by Fortelney and Carter are prohibited under §

407(a). These agreements, plaintiffs assert, gave Liberty "a first lien" on their social security benefits and stated that the social security benefits were to be held "in trust" for the benefit of Liberty. Moreover, plaintiffs assert that while they do not have any evidence that defendants enforced the "lien" by way of a court action, defendants threatened to do so and these threats also constitute a violation of § 407(a).

In addition, plaintiffs assert that the Bassett defendants demanded that Fortelney execute the Client Overpayment Assistance Program Authorization, which required Fortelney to "promise" to forward a check to BNA for the total amount received as social security benefits. Plaintiffs contend that by such action, defendants

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were trying to do indirectly that which it was impermissible to do directly and therefore defendants' actions violated § 407(a). Plaintiffs further assert that IBI required Carter to execute the Social Security Electronic Payment Authorization which gave IBI the authority to withdraw his social security benefits directly from his bank account to pay Liberty. Plaintiffs maintain that this agreement expressly assigned the social security benefits to IBI for the benefit of Liberty. Finally, plaintiffs contend that Liberty's recoupment of plaintiff Chelsea Carter's social security benefits by offsetting plaintiff Carter's LTD benefits in the amount of her social security benefits violated § 407(a). Plaintiffs assert that it is unlawful to take or deduct a dependent's social security benefits from her parent's LTD benefits because those social security benefits belong to the dependent and not the parent. Plaintiffs maintain that the dependent's social security benefits are not part of the parent's income stream and therefore cannot be used to calculate the parent's LTD benefits.

In their papers, plaintiffs additionally argue that the cases cited and relied upon by defendants to support their arguments in regard to the § 407(a) claims are from outside the Tenth Circuit. Plaintiffs contend these cases are not controlling, the factual circumstances are distinguishable and the cases were erroneously decided. Although the Supreme Court and the Tenth Circuit have not directly addressed the issues in this case, plaintiffs contend that the Supreme Court's decision in Philpott v. Essex County Welfare Bd., 409 U.S. 413, 416, 93 S.Ct. 590, 34 L.Ed.2d 608 (1973), and the Tenth Circuit's decision in Tom v. First Amer. Credit Union, 151 F.3d 1289, 1292 (10th Cir.1998), are instructive and support plaintiffs' claims that defendants' actions violated § 407(a).

Upon review, the court concludes that dismissal of the § 407(a) claims is appropriate. Although defendants have challenged whether plaintiffs may bring a private right of action under § 407(a), the court, assumes without deciding, that § 407(a) creates a private right of action in favor of plaintiffs. Nonetheless, the court concludes that the allegations in the Amended Complaint fail to establish a violation of § 407(a) by the defendants.

Initially, the court finds that Liberty was authorized to require the offset of social security benefits paid to a policyholder and any dependents against the amounts payable to the policyholder under the LTD policy. Under the specific terms of the LTD policy, LTD benefits are reduced by "Other Income Benefits," which includes social security benefits that the policyholder "receives or is eligible to receive" and that "his spouse, child or children receives or are eligible to receive because of [the policyholder's] Disability." See, Liberty's motion, Ex. 1, LTD–1, LTD–22. Courts have enforced disability benefit plans which include such offset provisions. See, Leonelli v. Pennwalt Corp., 887 F.2d 1195, 1198–99 (2nd Cir.1989); Lamb v. Conn. Gen. Life Ins. Co., 643 F.2d 108, 109–12 (3rd Cir.1981), cert denied, 454 U.S. 836, 102 S.Ct. 139, 70 L.Ed.2d 116 (1981); Dowell v. Aetna Life Ins. Co., 468 F.2d 802, 804–05 (4th Cir.1972).[8] Moreover, courts have determined that such an

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offset provision does not violate section 407(a). Lamb, 643 F.2d at 111.[9]

The court additionally concludes that Liberty was entitled to seek reimbursement of LTD benefits paid to Fortelney and Carter, without a reduction for social security benefits, when they received their lump-sum retroactive social security benefits. The LTD policy expressly provides that Liberty has a right to recover any "overpayment of benefits" caused by the policyholder's receipt of "Other Income Benefits." See, Liberty's motion, Ex. 1, GNP–4. The LTD policy also provides that Liberty may recover an overpayment by "requesting a lump sum payment" of the overpaid amount; reducing "any benefits payable" under the policy; taking any "appropriate collection activity available" or "placing a lien, if not prohibited by law, in the amount of the overpayment." Id. It further provides that full reimbursement is to be made to Liberty. Id. Plaintiffs additionally signed a reimbursement agreement which provided for the repayment in full of an overpayment. Courts have permitted equitable claims to be filed against claimants, seeking restitution of the overpayments under ERISA, 29 U.S.C. § 1132(a)(3). See, Cusson v. Liberty Life Assur. Co. of Boston, 592 F.3d 215, 230–232 (1st Cir.2010); Dillard's Inc. v. Liberty Life Assur. Co. of Boston, 456 F.3d 894, 900–901 (8th Cir.2006); Gilchrest v. Unum Life Insurance Co. of America, 255 Fed.Appx. 38, 44–46 (6th Cir.2007). Courts have found these claims not to violate § 407(a) because the insurance company did not seek to recover the policyholder's social security benefits (although the amount in question was the same as the amount of the claimant's social security benefits), rather, the insurance company was seeking to recover in equity from funds the plan has already paid under the long term disability benefits plan. See, Cusson, 592 F.3d at 232; Parent v. Principal Life Ins. Co., 763 F.Supp.2d 257, 261–62 (D.Mass.2011); Schlenger v. Fidelity Employer Services Co., LLC, 785 F.Supp.2d 317, 334–35, 2011 WL 1236156 *13 (S.D.N.Y. Mar. 31, 2011); Mugan v. Hartford Life Group Ins. Co., 765 F.Supp.2d 359, 373–75 (S.D.N.Y.2011); Bosin v. Liberty Life Assur. Co. of Boston, 2007 WL 1101187 *11 (W.D.Mich. April 11, 2007).

In addition, a district court has permitted recoupment of an overpayment by withholding future benefit payments under a long term disability plan, finding that such action did not violate § 407(a). Stuart v. Metropolitan Life Ins. Company, 664 F.Supp. 619, 625 (D.Me.1987).[10] The court concluded that the recoupment for amounts not reimbursed was not a "transfer" under § 407(a). Id. Moreover, another district court decision permitted an insurer to receive a policyholder's retroactive social security benefits to reimburse the insurer for an overpayment when the policyholder chose to pay the benefits instead of having the insurer recover the overpayment by reducing the policyholder's future benefit payments.

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Poisson v. Allstate Life Insurance Co., 640 F.Supp. 147, 149 (D.Me.1986) ("The Defendant did not assert entitlement to the Plaintiff's Social Security benefits in any way. Rather, the Defendant asserted that its contractual obligation to the Plaintiff is payment of a dollar amount which maintains her income at a contractually agreed upon level, depending on other benefits she receives. The fact that Plaintiff ultimately received Social Security benefits for months past rather than present does not change the nature of the contract. Allstate sought return of an alleged overpayment, not a right to Plaintiff's Social Security benefits as such.").

In the case at bar, Liberty did not seek reimbursement of the overpayments to Fortelney and Carter by filing an equitable claim for restitution under § 1132(a)(3). The allegations of the Amended Complaint, however, reveal that as to the overpayment of LTD benefits to Carter based upon Chelsea Carter's receipt of retroactive social security benefits, Liberty withheld all LTD benefits owed to Carter to recover the overpayment. The court, agreeing with the district court in Stuart, finds that the withholding of future disability benefits until the overpayment based upon the social security

benefits paid to Chelsea Carter was recouped was permissible and did not violate § 407(a). Stuart, 664 F.Supp. at 625. Moreover, such action was in accordance with the LTD policy and the SSRA executed by Carter. See, Liberty's motion, Ex. 1, GNP–4; Ex. 2 to Liberty's supplement to motion to dismiss.[11] In so finding, the court rejects plaintiffs' arguments urging the court to disallow any offsetting of social security benefits of a policyholder's dependent against the policyholder's long term disability benefits as unlawful and unfair. See, Lamb, 643 F.2d at 112 (The offset of payments received by an insured's "dependents on account of [his] disability does not transgress the policy undergirding the Social Security Act."); see also, Fahringer v. Paul Revere Ins. Co., 317 F.Supp.2d 504, 519 (D.N.J.2003); see, Fortune v. Group Long Term Disability Plan for Employees of Keyspan Corp., 391 Fed.Appx. 74, 79–80 (2nd Cir.2010).

Turning to defendants' actions in recovering the overpayments to Fortelney and Carter based upon their receipt of retroactive social security benefits, the court finds that those actions likewise do not violate § 407(a). Although Liberty required plaintiffs to sign the SSRAs, the court concludes that those agreements are not assignments. While the SSRAs provide that Liberty has a "first lien" on the social security benefits and that the benefits are to be held "in trust," they cannot be construed so as to assign "the right of future payment" of social security benefits to Liberty. And although the SSRAs provide for a "first lien" on the awarded social security benefits, there are no allegations in the Amended Complaint that Liberty ever sought to enforce its "first lien" against plaintiffs. Therefore, none of the funds paid under the Social Security Act were subject to "execution, levy, attachment, garnishment, or other legal process." 42 U.S.C. § 407(a). [12]

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The court also finds that neither the Client Overpayment Assistance Program Authorization nor the Social Security Electronic Repayment Authorization agreements constitute an assignment of "the right of future payment" of social security benefits to the Bassett defendants and IBI. In the former agreement, Fortelney "promise[d]" to "forward a check" to BNA for the "total amount [of social security benefits] received for me." See, Amended Complaint, ¶ 28. This language does not support a finding of an assignment of Fortelney's right to future payment of social security payments. As to the latter agreement, Carter authorized IBI to "[w]ithdraw from my bank account ... Social Security amounts deposited for me and all my dependents and transfer those payments to an account established at Premier Bank." See, id. at ¶ 62. The court likewise concludes that this language does not assign a right to any future payment in social security benefits.

The court rejects plaintiffs' argument that IBI's recoupment of the overpayment to Carter by withdrawing his retroactive social security benefits from his bank account in accordance with the Social Security Electronic Repayment Authorization agreement constitutes "other legal process." In support of their argument, plaintiffs rely upon the Tenth Circuit's ruling in Tom v. First Amer. Credit Union. In that case, an account holder sued a credit union for violation of § 407(a) when it seized or setoff the account holder's funds consisting of social security benefits for payment of a debt owed to the credit union. The credit union argued that an equitable self-help remedy, such as a setoff, was not "other legal process" and was therefore outside the scope of § 407(a). The Tenth Circuit disagreed:

When Congress enacted § 407, it intended to exempt Social Security funds from all creditors, regardless of whether they attempted to reach those funds by way of the court system or by way of self-help remedies. We thus hold that setoff constitutes "other legal process" under § 407 and that the Credit Union violated this section when it seized [the account holder's] Social Security payments.

Tom, 151 F.3d at 1293. After the Tenth Circuit's ruling in Tom, the Supreme Court, in

Washington State Department of Social and Health Services v. Guardianship Estate of Keffeler, 537 U.S. 371, 123 S.Ct. 1017, 154 L.Ed.2d 972 (2003), specifically addressed the term "other legal process" as used in § 407(a). The court determined that such term had a very narrow meaning, and that such process:

should be understood to be process much like the processes of execution, levy, attachment, and garnishment, and at a minimum, would seem to require utilization of some judicial or quasi-judicial mechanism, though not necessarily an elaborate one, by which control over property passes from one person to another in order to discharge or secure discharge of an allegedly existing or anticipated liability.

Keffeler, 537 U.S. at 385, 123 S.Ct. 1017. In light of the Supreme Court's ruling,[13] this court cannot conclude that IBI's withdrawal

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of funds from plaintiff Carter's account pursuant to the Social Security Electronic Repayment Authorization agreement constitutes "other legal process" under § 407(a). There was no judicial or quasi-judicial mechanism utilized to obtain control over Carter's social security benefits. Based upon the ruling in Keffeler, the court likewise rejects plaintiffs' arguments that Liberty's use of the SSRAs and any alleged "threats of legal process" constitute violations of § 407(a).[14]

As none of the alleged actions of defendants challenged by plaintiffs in the Amended Complaint violate § 407(a), the court concludes that plaintiffs cannot state a claim upon which relief may be granted against defendants. The court therefore concludes that the claims of Fortelney, Carter and Chelsea Carter for violation of § 407(a) (Counts I, XI and XIX) are subject to dismissal under Rule 12(b)(6).[15]

B. State Statutory and Common Law Claims

As to the remaining state statutory and common law claims, defendants argue that all of the claims are preempted by ERISA. Although the Amended Complaint fails to mention ERISA, defendants maintain that plaintiffs are in fact seeking additional benefits under the LTD policy, which is a "welfare plan" covered by ERISA. Defendants assert that any attempt by plaintiffs to recover additional benefits under the LTD policy can only be brought under section 502(a)(1)(B) of ERISA, 29 U.S.C. § 1132(a)(1)(B). However, defendants point out that plaintiffs have already received all that they are entitled to under ERISA and that they accordingly have no viable claim under ERISA for additional benefits. In addition, defendants contend that plaintiffs have not exhausted their administrative remedies. Defendants also argue that plaintiffs' claims are preempted by ERISA because they challenge the administration of the LTD policy and the propriety of processing and applying the terms of the LTD policy. Finally, defendants argue that even if the state claims are not preempted by ERISA, the fraud and deceit claims are not alleged with particularity as required by Rule 9(b) and each of the claims are subject to dismissal under Rule 12(b)(6).

Plaintiffs, in response, do not dispute that the LTD policy is an ERISA-covered plan. However, with the exception of their breach of contract claim against Liberty, plaintiffs contend that their state claims are not preempted. [16] According to plaintiffs,

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none of the state law claims "relate to" the LTD policy. Rather, plaintiffs contend that their claims are based on defendants' coercion to obtain unlawful agreements in violation of the Social Security Act and the Oklahoma Workers' Compensation Act. Plaintiffs assert that if the agreements were part of the plan administration, they should have been filed with the Secretary of Labor. Plaintiffs maintain that Liberty did not file them with the Secretary of Labor because they did not relate to administration of the plan. Plaintiffs contend that their claims only "relate to" the LTD policy to the extent that defendants intimidated plaintiffs into signing the agreements so that plaintiffs could obtain their

LTD benefits. As to their OWCA claim, plaintiffs specifically argue that ERISA expressly establishes an exemption for state workers' compensation statutes and the Tenth Circuit has explicitly held that ERISA does not preempt the OWCA. Plaintiffs further argue that the claims of Chelsea Carter, the claims of Carter against IBI, and the claims of Fortelney against the Bassett defendants all escape preemption because Chelsea Carter, IBI and the Bassett defendants are not principal ERISA entities. Further, plaintiffs assert that their fraud and deceit claims are pled with the requisite particularity.[17] Finally, plaintiffs request leave to amend their complaint to add ERISA claims, if the court finds that the state claims are preempted. Plaintiffs contend that they were not required to exhaust their administrative remedies because exhaustion would be futile and inadequate. Further, plaintiffs contend that Liberty has waived any exhaustion requirement.

In reply, defendants contend that plaintiffs' argument that their state claims escape preemption because they relate only to the reimbursement agreements, rather than the LTD policy, is refuted by the express terms of the LTD policy. Defendants point out that the reimbursement agreements are specifically referenced in the LTD policy, are an integral part of offset/reimbursement provisions of the LTD policy, and are a part of the LTD policy and its administration. Defendants contend that the very same reimbursement provisions contained in the reimbursement agreements are contained in the LTD policy. Defendants argue that plaintiffs' state claims indisputably “relate to” the administration of the reimbursement provisions of the LTD policy. In addition, defendants argue that contrary to plaintiffs' assertion, ERISA does not require that the reimbursement agreements be filed with the Secretary of Labor. Defendants maintain that no plan documents or plan descriptions are required to be filed with the Secretary of Labor. Therefore, defendants contend that plaintiffs' argument that the reimbursement agreements are not part of the LTD policy because they were not filed with the Secretary of Labor is ill-founded.

Defendants also contend that Chelsea Carter's claims are preempted by ERISA. They argue that Chelsea Carter is seeking additional LTD policy benefits for her father by challenging the offset/recoupment provisions in the LTD policy. Defendants

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contend that Chelsea Carter has no other claim. They maintain that Liberty never sought any reimbursement from Chelsea Carter or directly targeted her social security benefits. Defendants contend that Chelsea Carter's claims clearly relate to the LTD policy and are therefore preempted. Defendants object to a third amendment of the complaint to add the ERISA claims. Defendants contend that plaintiffs may not assert a claim for additional benefits under the LTD policy for the first time in this civil action. Defendants assert that the LTD policy spells out the required procedure for filing administrative claims, with which plaintiffs did not comply, and that plaintiffs cannot be excused from compliance with the procedure on the basis that defendants dispute plaintiffs' entitlement to the additional benefits. Finally, defendants argue that the court should deny plaintiffs leave to amend to add ERISA claims since plaintiffs have had ample opportunity to assert ERISA claims and elected not to assert them.

The ERISA preemption provision is set forth in 29 U.S.C. § 1144(a) and provides as follows:

[T]he provisions of this subchapter and subchapter III of this chapter shall supersede any and all State laws insofar as they may now or hereafter relate to any employee benefit plan described in section 1003(a) of this title and not exempt under section 1003(b) of this title.

29 U.S.C. § 1144(a).

Before preemption will be found, three requirements must be met. “There must be a

state law, an employee benefit plan, and the state law must 'relate to' the employee benefit plan." Airparts Co., Inc. v. Custom Ben. Services of Austin, Inc., 28 F.3d 1062, 1064 (10th Cir.1994) (quotation omitted). The issue before the court in this case is whether plaintiffs' state claims against defendants "relate to" the LTD policy.[18]

"A law 'relates to' an employee benefit plan, in the normal sense of the phrase, if it has connection with or reference to such a plan." Shaw v. Delta Air Lines, Inc., 463 U.S. 85, 96–97, 103 S.Ct. 2890, 77 L.Ed.2d 490 (1983) (footnote omitted). Hence, even if a state law is not specifically directed toward the regulation of an ERISA plan or affects such a plan only indirectly, it can still be found to "relate to" a plan. Ingersoll–Rand Co. v. McClendon, 498 U.S. 133, 139, 111 S.Ct. 478, 112 L.Ed.2d 474 (1990).

"There is no simple test for determining when a law 'relates to' a plan." Airparts Co., Inc., 28 F.3d at 1064. The Tenth Circuit has recognized four categories of state laws that are preempted by ERISA: (1) laws regulating the type of benefits or terms of ERISA plans; (2) laws creating reporting, disclosure, funding or vesting requirements for such plans; (3) laws providing rules for calculating the amount of benefits to be paid under such plans; and (4) laws and common-law rules providing remedies for misconduct growing out of the administration of such plans. David P. Coldesina, D.D.S., P.C., Emp. Profit Sharing Plan & Trust v. Estate of Simper, 407 F.3d 1126, 1136 (10th Cir.2005).

At the same time, the Tenth Circuit recognizes that ERISA does not preempt all state law claims.

[L]aws of general application—not specifically targeting ERISA plans—that involve traditional areas of state regulation and do not affect "relations among

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the principal ERISA entities—the employer, the plan, the plan fiduciaries, and the beneficiaries"—often are found not to "relate to" an ERISA plan.

Airparts Co., Inc., 28 F.3d at 1065. In addition, ERISA has no bearing on those state laws "which do [ ] not affect the relations among the principal ERISA entities, the employer, the plan, the plan fiduciaries and the beneficiaries as such." Woodworker's Supply, Inc. v. Principal Mut. Life Ins. Co., 170 F.3d 985, 990 (10th Cir.1999) (quotation and internal quotation omitted). "As a corollary, actions that affect the relations between one or more of these plan entities and an outside party similarly escape preemption." Id. (quoting Airparts Co., Inc., 28 F.3d at 1065.)

So while the ERISA preemption provision is "clearly expansive," it is not limitless. N.Y. State Conf. of Blue Cross & Blue Shield Plans v. Travelers Ins. Co., 514 U.S. 645, 655–62, 115 S.Ct. 1671, 131 L.Ed.2d 695 (1995). "Some state actions may affect employee benefits plans in too tenuous, remote, or peripheral a manner to warrant a finding that the law 'relates to' the plan." Shaw, 463 U.S. at 100 n. 21, 103 S.Ct. 2890. "What triggers ERISA preemption is not just any indirect effect on administrative procedures but rather an effect on the primary administrative functions of benefit plans, such as determining an employee's eligibility for a benefit and the amount of that benefit." Airparts Co., Inc., 28 F.3d at 1065. "Indeed, '[a]s long as a state law does not affect the structure, the administration, or the type of benefits provided by an ERISA plan, the mere fact that the [law] has some economic impact on the plan does not require that the [law] be invalidated.' " Estate of Simper, 407 F.3d at 1136 (quoting Airparts Co., Inc.).

I. Claims Against Liberty

With the above principles in mind, the court concludes that plaintiffs' state claims against Liberty for fraud, deceit, conspiracy, breach of contract, unjust enrichment and conversion (Counts III, IV, V, VI, IX and X) are

preempted by ERISA. The claims implicate the terms and administration of the LTD policy and challenge the calculation of the amount of benefits to be paid from the LTD policy. The claims also seek to remedy misconduct growing out of the administration of the LTD policy. Moreover, the claims, as alleged, affect the relations among the principal ERISA entities. The court opines that the state claims alleged against Liberty directly "relate to" the LTD policy, which is indisputably an ERISA-covered plan. Consequently, the court finds that the state claims are preempted.

Although plaintiffs argue that their state claims are not preempted because they relate to the reimbursement agreements (the SSRAs and Agreement Concerning Benefits) and not the LTD policy, the court disagrees. As pointed out by defendants, the reimbursement agreements are specifically referenced in the LTD policy. The LTD policy provides that the LTD benefits will be reduced by an estimate of the "Other Income Benefits" (social security and workers' compensation benefits) unless the policyholder "signs a reimbursement agreement under which, in part, the [policyholder] agrees to repay Liberty for any overpayment resulting from the award or receipt of Other Income Benefits." See, Ex. 1 to Liberty's motion, Section 4, LTD–24. Moreover, the reimbursement provisions contained in the LTD policy are also mentioned in the reimbursement agreements. See, Ex. 1 to Liberty's motion, Section 4, GNP–4. The court thus concludes that the reimbursement agreements are a part of the LTD policy and its administration.

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In so concluding, the court rejects plaintiffs' argument that the reimbursement agreements are not part of the LTD policy because they were not filed with the Secretary of Labor. Section 1021(b) of Title 29 of the United States Code does not require that the agreements be filed.[19] Since the reimbursement agreements are part of the terms of the LTD policy and its administration, and plaintiffs' state claims against Liberty relate to the terms and administration of the LTD policy (and seek a remedy for misconduct growing out of the administration of the LTD policy), the court concludes that the claims are preempted. See, Settles v. Golden Rule Ins. Co., 927 F.2d 505, 509 (10th Cir.1991) (The Tenth Circuit "has found that common law tort and breach of contract claims are preempted by ERISA if the factual basis of the cause of action involves an employee benefit plan.")

In addition, the court finds that the state law claims against Liberty for fraud, deceit, conspiracy, breach of contract, unjust enrichment and conversion, also challenge the calculation of the amount of plaintiffs' benefits. Specifically, with respect to the tort claims, plaintiffs allege that:

> Liberty also made material misrepresentations regarding the amount of the alleged overpayments ... Even assuming Liberty could legally request and require such overpayments, which it could not, Liberty overstated the amount by its own terms by understating the amount it owed under the policy after Class Members received Social Security and Workers' Compensation benefits.

See, Amended Complaint, ¶ 116 (Count III—fraud claim).

> Liberty also willfully deceived the Liberty Plaintiffs and Subclasses regarding the amount of the alleged overpayments Plaintiffs and the Class owed. Even assuming Liberty could legally request and require such overpayments, which it could not, Liberty overstated the amount by its own terms by understating the amount it owed under the policy after Liberty Plaintiffs and Subclasses received Social Security and Workers' Compensation benefits.

See, Amended Complaint, ¶ 122 (Count IV—deceit claim).

> Liberty, IBI and the Bassett Defendants acted in combination to commit the unlawful acts described above.

See, Amended Complaint, ¶ 128 (Count V—conspiracy claim).

Liberty's calculation of the overpayments allegedly owed by Fortelney, Stoup, Carter and members of the Liberty/SS Subclass, Liberty/SS Payee Subclass, and Liberty/WC Subclass ... were grossly overstated. Liberty understated the amount it owed under the policies after Liberty Plaintiffs and Subclasses received Social Security and Workers' Compensation benefits.

See, Amended Complaint, ¶ 151 (Count IX—unjust enrichment claim).

Defendants wrongfully exerted dominion over the property of all Plaintiffs and Subclasses, specifically their Social Security and Workers' Compensation benefits.

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See, Amended Complaint, ¶ 155 (Count X—conversion).

As to the breach of contract claim against, the Amended Complaint alleges:

Liberty further breached their contracts by demanding Liberty Plaintiffs and Subclasses repay it more than their contracts required.

See, Amended Complaint, ¶ 135 (Count VI—breach of contract).

In sum, the court concludes based upon these referenced allegations in the Amended Complaint that plaintiffs' state tort and breach of contract claims (Counts III–VI, IX, X) are preempted by ERISA because they challenge the calculation of the amount of benefits owed to plaintiffs. See, Revells v. Metropolitan Life Ins. Co., 261 F.Supp.2d 1359 (M.D.Ala.2003) (state law claims of breach of contract and bad faith refusal to pay benefits based on defendants' reduction of disability insurance benefits resulting from the policy's social security set-off provision preempted by ERISA).

As to plaintiff Stoup's claim against Liberty under the Oklahoma Workers' Compensation Act, specifically, 85 O.S. § 48 (Count II),[20] the court likewise finds that the claim is preempted. The court rejects plaintiffs' argument that the OWCA claim escapes preemption by virtue of 29 U.S.C. § 1003(b)(3). That section exempts from ERISA "any employee benefit plan if ... such plan is maintained solely for the purpose of complying with applicable workmen's compensation laws...." 29 U.S.C. § 1003(b)(3). The LTD policy is not a "plan" that is maintained for the purpose of complying with the workers' compensation laws. In their briefing, plaintiffs nonetheless argue that the Tenth Circuit has explicitly held that ERISA does not preempt the OWCA. In Contract Services Employee Trust v. Davis, 55 F.3d 533 (10th Cir.1995), the Tenth Circuit, following the First and Ninth Circuits, held that ERISA does not preempt the Oklahoma workers' compensation law. Id. at 536. The provisions at issue in Davis were 85 O.S. §§ 61–64 which require employers to either obtain workers' compensation insurance or establish a self-insured plan. The plans established pursuant to these provisions would be exempt from ERISA under § 1003(b)(3). In the First Circuit case, Combined Management, Inc. v. Superintendent of Bureau of Ins. of State of Maine, 22 F.3d 1, 4 (1st Cir.1994), followed by the Tenth Circuit, the court stated that "[l]aws which relate only to welfare benefits plans exempt from ERISA's coverage [ ] fit safely under the umbrella of [§ 1003(b)(3)]'s exemption." (Emphasis added). The court, however, citing to District of Columbia v. Greater Washington Bd. of Trade, 506 U.S. 125, 131–132, 113 S.Ct. 580, 121 L.Ed.2d 513 (1992), further stated that "some workers compensation laws might 'relate to' ERISA covered benefit plans, instead of, and in addition to plans exempt under [§ 1003(b)(3)] and thus fall under the broad sweep of ERISA's preemption clause." Combined Management, Inc., 22 F.3d at 4. In this case, the provision of the OWCA at issue is 85 O.S. § 48. That section can relate to both ERISA-covered benefit plans and those exempt under ERISA. The court therefore concludes that the Tenth Circuit's

decision in Davis does not warrant a conclusion that plaintiff Stoup's claim under

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§ 48 escapes ERISA preemption under § 1003(b)(3).

Plaintiffs further argue that plaintiff Stoup's § 48 claim against Liberty is not preempted because the "gravamen of this case is the unlawful collection scheme designed by the Defendants to fill their coffers." See, plaintiffs' omnibus response (doc. no. 73), p. 17. Although plaintiff Stoup is challenging the Agreement Concerning Benefits which Liberty required him to sign, this agreement is a reimbursement agreement referred to in the LTD policy. Plaintiff Stoup also attacks the reimbursement provisions set forth in the LTD policy. Consequently, plaintiff Stoup's § 48 claim relates to the LTD policy in that it challenges the terms and administration of the LTD policy. The court therefore concludes that the § 48 claim is preempted by ERISA.

As previously noted, plaintiffs state that they wish to dismiss their claims without prejudice for violation of the Massachusetts Unfair Trade Practices Act, Mass. Gen. Laws Ch. 93A § 2 (Count VII) and 36 O.S. § 902 (Count VIII—Excessive Premiums). Liberty, however, urges the court to dismiss the claims with prejudice because they are preempted by ERISA. The court concludes that the claims are preempted by ERISA because they challenge the administration of the plan. Consequently, the court concludes that claims should be dismissed on the basis of ERISA preemption. The dismissal will be without prejudice—but leave to amend will be denied because plaintiffs clearly cannot satisfy the exhaustion requirement.

Plaintiffs further argue that the state claims of Chelsea Carter are not preempted because she is not a principal ERISA entity. Plaintiffs rely upon the language in Woodworker's Supply, Inc. v. Principal Mut. Life Ins. Co., and Airparts Co., Inc. v. Custom Ben. of Austin, Inc., wherein the Tenth Circuit stated that "actions that affect the relations between one or more of these plan entities and an outside party [ ] escape preemption." Woodworker's Supply, Inc., 170 F.3d at 990; Airparts Co., Inc., 28 F.3d at 1065. The court, however, concludes that plaintiff Chelsea's claims of unjust enrichment and conversion (Counts IX and X) and violation of the Massachusetts Unfair Trade Practices Act, Mass. Gen. Laws Ch. 93A § 2 (Count VII) are preempted. In Count IX of the Amended Complaint relating to the claim of unjust enrichment, plaintiffs allege:

Liberty's LTD disability policy is also illegal and violates public policy because it calls Social Security benefits paid to dependents "Other Income," and it purports to allow Liberty to recoup and offset Social Security benefits paid to its policyholders' dependents. Social Security benefits paid to dependents are for the sole benefit and use of the dependent and are not to be used as income of the representative payee. Liberty has been unlawfully enriched by its illegal insurance policy and subsequent agreements it induced its policyholders to sign....

Liberty has been unlawfully enriched in the amount of the Social Security benefits awarded to the dependents of its policyholders through direct recoupment and offsetting the benefits otherwise owed to its policyholders in the amount of dependent benefits. Social Security benefits paid to dependents are for the sole benefit and use of the dependent and should not be used to reduce Liberty's obligations under its LTD policies.

See, Amended Complaint, ¶¶ 152–153.

Chelsea Carter's unjust enrichment claim cannot be characterized as "affect[ing] the relations of one or more of [the] plan entities and an outside party." Woodworker's Supply, Inc., 170 F.3d at 990. Rather, the unjust enrichment claim

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affects the relations between the LTD policy and Carter, the policyholder. Chelsea Carter is challenging the offset/recoupment provisions of the LTD policy which were applied to her father. Her claim clearly relates to the terms and administration of the LTD policy. The court therefore concludes that the claim is preempted by ERISA. The fact that Chelsea Carter has no remedy under ERISA does not preclude the preemption of her claims. Cannon v. Group Health Service of Oklahoma, Inc., 77 F.3d 1270, 1274 (10th Cir.1996).

The court likewise concludes that plaintiff Chelsea Carter's conversion claim (Count X) and her claim for violation of Massachusetts Unfair Trade Practices Act, Mass. Gen. Law Ch. 93A § 2 (Count VII) are preempted by ERISA. They clearly relate to the administration of the LTD policy and the calculation of the benefit formula by Liberty. Indeed, as to her conversion claim, Chelsea Carter avers that Liberty wrongfully exerted dominion over her social security benefits. According to the Amended Complaint, "Liberty has taken Chelsea's past due benefits from Social Security by withholding all benefits owed to Carter that he would have otherwise been paid ... Liberty offsets Carter's LTD benefit[s] by the amount of benefits Chelsea receives." In addition, as to her statutory claim, Chelsea Carter alleges that "Liberty's acts, practices and conduct, as alleged herein, are unfair to Chelsea Carter." As Chelsea Carter's claims involve the terms and administration of the LTD policy and the calculation of benefits under it, the court finds that the claims relate to the LTD policy. Consequently, the court finds the claims are preempted by ERISA. [21]

In sum, the court concludes that plaintiffs' state statutory and common law claims against Liberty (Counts II–X) are preempted by ERISA and therefore may not be maintained. Thus, the court finds plaintiffs' state statutory and common law claims against Liberty are subject to dismissal based upon ERISA preemption.

II. Claims Against the Bassett Defendants and IBI

The court finds that Fortelney's state claims against the Bassett defendants for fraud, deceit, breach of contract, breach of fiduciary duty and negligence (Counts XII, XIII, XV, XVI and XVII) are not preempted by ERISA. The court reaches the same conclusion as to Carter's claims against IBI for fraud, deceit, breach of fiduciary duty and negligence (Counts XX, XXI, XXIII, and XXIV). Unlike the claims against Liberty, the court concludes that Fortelney's claims against the Bassett defendants and Carter's claims against IBI do not affect the structure, administration or type of benefits to be provided by the LTD policy. Nor do they seek to remedy misconduct growing out of the administration of the LTD policy. In addition, unlike the claims against Liberty, the court concludes that Fortelney's claims against the Bassett defendants and Carter's claims against IBI are not seeking additional benefits under the LTD policy. "[M]erely because [plaintiff's] damages would be based upon the amount of potential plan benefits does not implicate the administration of the plan, and is not consequential enough to connect the action with, or relate the action to, the plan." Hospice of Metro Denver, Inc. v. Group Health Ins., Inc., 944 F.2d 752, 755 (10th Cir.1991).

The fraud and deceit claims brought by Fortelney and Carter involve misrepresentations

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purportedly made to plaintiffs by defendants in order to induce plaintiffs to engage the law firms for the purpose of securing the social security benefits and to execute certain agreements in regard to those benefits. Plaintiffs specifically allege that the Bassett defendants misrepresented that they would act in Fortelney's best interests. They also allege that IBI misrepresented to Carter that he was required to apply for social security benefits. Fortelney's breach of contract claim relates to the specific agreements signed by Fortelney when he engaged the Bassett defendants to represent him. Plaintiffs allege that these agreements were breached when the Bassett defendants failed to solely represent Fortelney and failed to act in his best interests.

The breach of fiduciary duty and negligence claims alleged by Fortelney and Carter concern alleged breaches of duty arising out of the attorney—client relationships between plaintiffs and defendants. Plaintiffs allege that the Bassett defendants and IBI breached their duties by violating several rules of professional conduct, including rules relating to conflicts of interests. The court concludes that the claims of fraud, deceit, breach of contract, breach of fiduciary duty and negligence, are laws of general application—not specifically targeting an ERISA plan—that involve traditional areas of state regulation and do not affect the relations among the principal ERISA entities. See, Airparts Co., Inc., 28 F.3d at 1066 (10th Cir.1994); see also, Pacificare of Okla., Inc. v. Burrage, 59 F.3d 151, 155 (10th Cir.1995) (medical malpractice claim against HMO through vicarious liability was not preempted by ERISA); Gruber v. Bendos, 2005 WL 2065234 *3 (D.Md. August 23, 2005) (participant's legal malpractice claim against attorney who represented participant in challenging insurance company's decision to deny disability benefits not preempted by ERISA).

Defendants also challenge Fortelney and Carter's fraud and deceit claims under Rule 9(b), Fed.R.Civ.P. Upon review, the court concludes that the fraud and deceit claims are not pled with particularity as required by Rule 9(b). The Amended Complaint fails to "set forth the time, place, and contents of the false representation[s], the identity of the party making the false statements and the consequences thereof." Koch, 203 F.3d at 1236. In other words, the Amended Complaint does not provide " 'the who, what, when, where, and how' " for the claims. Caprin, 99 Fed.Appx. at 158 (quoting DiLeo, 901 F.2d at 627).

As an example, IBI, in its motion, challenges the alleged misrepresentation that Carter was required to apply for social security benefits. The court concludes that more particularity about this statement is required. In paragraph 64 of the Amended Complaint, plaintiffs allege that "[a]n IBI representative told Carter that he had to apply for Social Security benefits in order to receive his disability benefits under the Liberty policy." See, Amended Complaint, ¶ 64. Although the Amended Complaint refers in that same paragraph to a letter sent by IBI to Carter on July 30, 2008, it does not allege that the purported misrepresentation by the IBI representative was made in that July 30th letter. Id. If IBI allegedly represented to Carter "prior" to the signing of an reimbursement agreement [22] that he was required to apply for social security benefits, plaintiffs may be able to show that IBI's statement to Carter was false. Indeed,

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the LTD policy allowed a policyholder to have his LTD benefits reduced by Liberty's estimation of the amount of social security benefits without having to apply for social security benefits. See, Ex. 1 to Liberty's motion, LTD–24.[23] However, if plaintiffs chose not to have the social security benefits estimated and signed the reimbursement agreements, then they were required to apply for social security benefits. See, Ex. 1 to Liberty's motion, LTD–24) (policyholder must "provide[ ] satisfactory proof of application for Other Income Benefits"); Ex. 2 to Liberty's supplement to motion to dismiss ("I agree to apply for Social Security Benefits within 45 days of Liberty Life's written request and provide proof of such application.") Therefore, if the IBI representative made the alleged statement after Carter elected to not to have his LTD benefits reduced by estimated social security benefits and signed the reimbursement agreement required by the LTD policy, the statement would be true and Carter would not be able to establish his fraud claim or deceit claim.

In addition, IBI challenges the alleged misrepresentation that IBI told Carter that "[he] had to send [his] Social Security lump sum payments to IBI and/or Liberty" and "[he] must pay [his] Social Security benefits to Liberty." See, Amended Complaint, ¶¶ 208, 214 and ¶¶ 69, 73. Plaintiffs may also be able to show that these alleged statements were false. Although LTD policy and the reimbursement agreements require the policyholders to repay Liberty in full

for the overpayments, the LTD policy and reimbursement agreement also provide that Liberty may withhold future benefits until the overpayment is recovered in full. The LTD policy provided that even the minimum monthly benefit otherwise payable could be applied toward satisfying the overpayment. See, Ex. 1 to Liberty's motion, LTD–1. Indeed, in regard to the overpayment based upon Chelsea Carter's receipt of retroactive social security benefits, Liberty reduced Carter's benefits by the amount Chelsea Carter received. See, Amended Complaint, ¶ 83. In addition, plaintiffs did not have to pay the overpayment from their social security payments. Instead, the payments could be paid by other assets. Although Liberty "strongly suggested" that Carter set aside his retroactive social security benefit payment, see, Amended Complaint, ¶ 67, plaintiffs have not alleged that Liberty actually required Carter to repay the overpayment from his social security benefits. Furthermore, Liberty advised Carter that it would "work with IBI in regards to collecting this overpayment." Id. ¶¶ 68, 72.

The court therefore concludes that Fortelney and Carter's fraud and deceit claims should be dismissed without prejudice for failure to comply with Rule 9(b). The court, however, will grant plaintiffs leave to amend to allege the fraud and deceit claims with particularity.

As to the claim alleged against the Bassett defendants for breach of contract and as to the claims of negligence and breach of fiduciary duty alleged against the Bassett defendants and IBI, which the court has found not to be preempted, the court concludes that the claims survive dismissal under Rule 12(b)(6).

The court notes that IBI has specifically challenged Carter's negligence and breach of fiduciary duty claims on the

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basis that Carter cannot point to a breach of duty arising from IBI's agreement to represent Carter before the Social Security Administration. The court, however, finds that Carter's claims are not premised upon IBI's representation of him before the Social Security Administration, but rather, the claims are based upon IBI's representation of Carter in repaying the alleged overpayment obligations to Liberty. Although the Amended Complaint does not allege an agreement between Carter and IBI to assist Carter in repaying the alleged overpayment obligations, the allegations, taken as true, show that IBI was in fact assisting Carter in the repayment. It was providing legal advice to Carter and the claims of negligence and breach of fiduciary duty are based upon IBI's representation in regard to the repayment of the overpayment obligations. The court concludes that Carter's claims of negligence and breach of fiduciary against IBI, as alleged, do state a claim upon which relief can be granted and these claims, as stated, survive dismissal under Rule 12(b)(6).

As to Fortelney and Carter's claims of conspiracy (Count XIV and Count XXII), the court finds that the claims fail to state a claim for relief to the extent they are based upon "unlawful acts" consisting of violations of § 407(a). Under Oklahoma law, a civil conspiracy itself does not create liability. An unlawful purpose or use of unlawful means is required. Brock v. Thompson, 948 P.2d 279, 294 (Okla.1997). The court has found in this order that defendants did not violate § 407(a). Therefore, plaintiffs cannot base their conspiracy claims on alleged violations of § 407(a). To the extent the conspiracy claims are based upon the alleged "unlawful acts" of Liberty, such as the alleged fraud and deceit, the court finds that the claims are preempted by ERISA. The court concludes that such claims implicate the terms and the administration of the LTD policy and the calculation of benefits by Liberty. To the extent that the conspiracy claims are based only upon the alleged "unlawful acts" of the Bassett defendants and IBI, the court does not find that the claim is preempted. The court further concludes that those claims survive dismissal under Rule 12(b)(6).

The final state claim alleged against the Bassett defendants and IBI is conversion (Count

XIV and Count XXV). The court has previously concluded in this order that the Bassett defendants and IBI did not violate § 407(a) in their conduct regarding the repayment of plaintiffs' overpayment obligations to Liberty. None of the actions taken by these defendants are sufficient to state a claim for relief under § 407(a). To the extent that plaintiffs' conversion claim is based upon defendants' purported violations of § 407(a), the court concludes that such claim is subject to dismissal under Rule 12(b)(6) because plaintiffs cannot show any violations of § 407(a). To the extent that plaintiffs' conversion claim is based upon funds being sent to defendants to assist plaintiffs in meeting the alleged overpayment obligations under the LTD policy and the SSRAs, the court finds that plaintiffs' claim is preempted by ERISA. Such a claim implicates the terms of the LTD policy and the calculation of benefits by Liberty. They challenge whether the amounts paid to defendants and sent to Liberty were owed under the LTD policy and SSRAs. Although the claim is against the Bassett defendants and IBI rather than Liberty, these claims clearly relate to the LTD policy and are preempted by ERISA.

III. Exhaustion of Administrative Remedies

In their briefing, plaintiffs request that if the court concludes that ERISA

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preempts their state claims, the court grant plaintiffs an opportunity to amend their complaint to add claims under ERISA. As found in this order, the court concludes that plaintiffs' claims against Liberty are preempted by ERISA.[24] Liberty argues that plaintiffs should not be granted leave to amend their complaint because the amendment would be futile in that plaintiffs have not exhausted their administrative remedies in regard to any ERISA claim.

ERISA contains no explicit exhaustion requirement. Nonetheless, the Tenth Circuit has determined that exhaustion of administrative remedies is an implicit prerequisite to seeking judicial relief. McGraw v. Prudential Ins. Co., 137 F.3d 1253, 1263 (10th Cir.1998). This requirement "derives from the exhaustion doctrine permeating all judicial review of administrative agency action, and aligns with ERISA's overall structure of placing primary responsibility for claim resolution on fund trustees." Id. (citations omitted). Any other procedure would permit "premature judicial interference" and "would impede those internal processes which result in a completed record of decision making for a court to review." Id. Courts have eschewed exhaustion under two limited circumstances: first, when resort to administrative remedies would be futile; or second, when the remedy provided is inadequate. Id.

Plaintiffs contend that exhaustion would be futile and inadequate because Liberty has disputed that plaintiffs are entitled to their social security and workers' compensation benefits. In order to satisfy the futility exception to the exhaustion doctrine, a plaintiff must establish that "it is certain that [his] claim will be denied on appeal, not merely that [he] doubts that an appeal will result in a different decision." Rando v. Standard Ins. Co., 1999 WL 317497, *4 (10th Cir. May 20, 1999) (quoting Lindemann v. Mobil Oil Corp., 79 F.3d 647, 650 (7th Cir.1996)). Plaintiffs' claim of futility is based only on supposition. They merely claim that because Liberty disputes entitlement to the benefits, the remedy is futile. However, success of a claim of futility requires a "clear and positive showing of futility." Rando, 1999 WL 317497 at *4; see also, Getting v. Fortis Benefits Ins. Co., 5 Fed.Appx. 833 (10th Cir.2001) (conclusory statement that appeal would have been futile not sufficient to excuse exhaustion of administrative remedies).[25] The court concludes that plaintiffs' bare allegations of futility are not sufficient to support a conclusion that exhaustion of administrative remedies is not warranted. Contentious claims—especially claims that portend expensive litigation that might spawn even more litigation of the same genre—get resolved administratively all the

time. Plaintiffs' bare averment of inadequacy of remedy is not sufficient to excuse exhaustion.

In their briefing, plaintiffs also argue that the exhaustion requirement has been waived by Liberty. According to plaintiffs, Liberty failed to give any notice of their appeal rights or review rights after they took their social security and workers' compensation benefits. Because of a failure to give notice, plaintiffs contend that Liberty waived the exhaustion requirement.

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The court is unpersuaded by plaintiffs' waiver argument. The claim requirement is set forth in the LTD policy. There is no allegation that plaintiffs did not possess the LTD policy prior to filing suit. The court concludes that plaintiffs were given notice of their rights to file a claim and therefore Liberty did not waive enforcement of the exhaustion requirement.

Because the court concludes that plaintiffs have failed to meet their burden to show that exhaustion of their administrative remedies would be futile or that the remedy would be inadequate, and because they have failed to show that Liberty waived the exhaustion requirement, the court finds that another amendment to the complaint to allege the ERISA claims would be futile. The court therefore denies plaintiffs' request to amend the complaint to allege ERISA claims against Liberty. Foman v. Davis, 371 U.S. 178, 182, 83 S.Ct. 227, 9 L.Ed.2d 222 (1962) (district court may withhold leave to amend based upon "futility of the amendment.")

IV. Recap of Court's Rulings as to Named Plaintiffs' Claims

In light of the court's rulings in this order, the court finds as follows:

(1) Liberty's motion in regard to Stoup's state statutory and common law claims (Counts II, III, IV, VI, VII, VIII, IX and X) should be granted and Stoup's statutory and common law claims against Liberty are dismissed without prejudice as preempted by ERISA. As leave to amend to add ERISA claims has been denied, Stoup has no pending claims against Liberty and Stoup is no longer a party to this action.

(2) Liberty's motion in regard to Chelsea Carter's claims (Counts I, VII, IX and X) should be granted. Chelsea Carter's federal statutory claim against Liberty for violation of the Social Security Act, 42 U.S.C. § 407 (Count I), is dismissed under Rule 12(b)(6) for failure to state a claim upon which relief can be granted. Chelsea Carter's state statutory and common law claims against Liberty for violation of Massachusetts Unfair Trade Practices Act, Mass. Gen. Laws Ch. 93A § 2, unjust enrichment, and conversion (Counts VII, IX and X) are dismissed as preempted by ERISA.

(3) IBI's motion in regard to Chelsea Carter's federal statutory claim for violation of the Social Security Act, 42 U.S.C. § 407 (Count XIX) should be granted. Chelsea Carter's claim against IBI is dismissed under Rule 12(b)(6) for failure to state a claim upon which relief can be granted.

(4) As Chelsea Carter has no pending claims against Liberty and no pending claim against IBI, Chelsea Carter is no longer a party to this action.

(5) Liberty's motion in regard to Carter's claims (Counts I, III, IV, V, VI, VII, VIII, IX and X) should be granted. Carter's federal statutory claim against Liberty for violation of the Social Security Act, 42 U.S.C. § 407 (Count I) is dismissed under Rule 12(b)(6) for failure to state a claim upon which relief can be granted. Carter's state statutory and common law claims against Liberty (Counts III, IV, V, VI, VII, IX and X) are dismissed without prejudice as preempted by ERISA. As leave to amend to add ERISA claims has been denied, Carter has no pending claims against Liberty.

(6) IBI's motion in regard to Carter's claims (Counts XIX–XXV) should be granted in part and denied in part. Carter's federal statutory claim against IBI for violation of the Social Security Act, 42 U.S.C. § 407 (Count XIX) is

dismissed under Rule 12(b)(6) for failure to state a claim upon which relief can be granted. Carter's fraud and deceit claims against IBI (Counts XX and XXI) are dismissed without prejudice under Rule 9(b) with

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leave to amend to state the claims with particularity. Carter's conspiracy claim (Count XXII) is dismissed under Rule 12(b)(6) for failure to state a claim upon which relief can be granted to the extent it is based upon a violation of § 407(a) and is dismissed as preempted by ERISA to the extent it is based upon unlawful acts of Liberty. Carter's conversion claim (Count XXV) is dismissed under Rule 12(b)(6) to the extent it is based upon a violation of § 407(a) and is dismissed as preempted by ERISA to the extent it is based upon funds being sent to IBI to assist Carter in meeting the alleged overpayment obligation under the LTD policy and the Social Security Reimbursement Agreement.

Carter's breach of fiduciary duty claim and negligence claims (Counts XXIII and XXIV), and Carter's conspiracy claim (Count XXII) to the extent it is based upon the unlawful acts of IBI, remain pending.

(7) Liberty's motion in regard to Fortelney's claims (Counts I, III, IV, V, VI, VII, VIII, IX and X) should be granted. Fortelney's federal statutory claim against Liberty for violation of the Social Security Act, 42 U.S.C. § 407 (Count I) is dismissed under Rule 12(b)(6) for failure to state a claim upon which relief can be granted. Fortelney's state statutory and common law claims against Liberty (Counts III, IV, V, VI, VII, IX and X) are dismissed without prejudice as preempted by ERISA. As leave to amend to add ERISA claims has been denied, Fortelney has no pending claims against Liberty.

(8) The Bassett defendants' motion in regard to Fortelney's claims (Counts XI–XVIII) should be granted in part and denied in part. Fortelney's federal statutory claim against the Bassett defendants for violation of the Social Security Act, 42 U.S.C. § 407 (Count XI) is dismissed under Rule 12(b)(6) for failure to state a claim upon which relief can be granted. Fortelney's fraud and deceit claims against the Bassett defendants (Counts XII and XIII) are dismissed without prejudice under Rule 9(b) with leave to amend to state the claims with particularity. Fortelney's conspiracy claim (Count XIV) is dismissed under Rule 12(b)(6) for failure to state a claim upon which relief can be granted to the extent it is based upon a violation of § 407(a) and is dismissed as preempted by ERISA to the extent it is based upon unlawful acts of Liberty. Fortelney's conversion claim (Count XVIII) is dismissed under Rule 12(b)(6) to the extent it is based upon a violation of § 407(a) and is dismissed as preempted by ERISA to the extent it is based upon funds being sent to the Bassett defendants to assist Fortelney in meeting the alleged overpayment obligation under the LTD policy and the Social Security Reimbursement Agreement.

Fortelney's breach of contract, breach of fiduciary duty and negligence claims (Counts XV, XVI and XVII) and Fortelney's conspiracy claim (Count XIV) to the extent it is based upon the unlawful acts of the Bassett defendants remain pending.

V. Class Action Allegations Against Liberty

As stated, the Amended Complaint includes class action allegations against defendants, including Liberty. No class certification motion has been filed and thus no class or subclass has been certified. Despite this fact, the court may and has proceeded with ruling on Liberty's motion to dismiss. See, Manual for Complex Litigation (Fourth) § 21.133 (“The court may rule on motions pursuant to Rule 12, Rule 56, or other threshold issues before deciding on certification”).[26] Such ruling, however,

[790 F.Supp.2d 1361]

binds only the named plaintiffs. Id. Nonetheless, because the motion to dismiss has been resolved in Liberty's favor vis-a-vis all of the named plaintiffs (leaving no claims remaining against

Liberty by any of the named plaintiffs), and because leave to amend to add ERISA claims has been denied, the court concludes that the class action allegations against Liberty should be and are stricken from the Amended Complaint as essentially surplusage. Consequently, no claims or allegations remain pending against Liberty in this action.

Conclusion

Based upon the foregoing,

Defendant Liberty Life Assurance Company of Boston's Motion to Dismiss Plaintiffs' First Amended Class Action Complaint (doc. no. 54) is **GRANTED.** The named plaintiffs' request for leave to amend the Amended Complaint to allege ERISA claims against defendant, Liberty Life Assurance Company of Boston, is **DENIED.** The class action allegations against defendant, Liberty Life Assurance Company of Boston, are **STRICKEN** from the Amended Complaint.

Defendants Bassett Law Firm LLC, Greta Bassett, and John R. Nelson's Motion to Dismiss Plaintiffs' First Amended Complaint (doc. no. 56) and Defendant Integrated Benefits, Inc.'s Motion to Dismiss Plaintiffs' First Amended Class Action Complaint (doc. no. 74) are **GRANTED in part** and **DENIED in part.**

In light of the court's ruling in this order, plaintiffs Brandon Stoup and Chelsea Carter have no pending claims and they are no longer parties to this action.

Plaintiffs, Larry Fortelney and David Carter, are granted leave to file a Second Amended Complaint stating with particularity their fraud and deceit claims within 20 days from the date of this order. Failure to comply may result in dismissal of the fraud and deceit claims with prejudice and this action shall proceed only as to the claims of plaintiff, Larry Fortelney, individually and on behalf of all others similarly situated, against defendants, Bassett Law Firm LLC, Greta Bassett, and John R. Nelson, for breach of contract, breach of fiduciary duty and negligence and conspiracy and as to the claims of plaintiff, David Carter, individually and on behalf of all others similarly situated, against defendant, Integrated Benefits, Inc., for breach of fiduciary duty, negligence and conspiracy.

Notes:

[1] As set forth below, defendant, Bassett Law Firm LLC, assisted plaintiff, Larry Fortelney, in obtaining social security benefits. IBI did the same for plaintiff, David Carter and his daughter, plaintiff, Chelsea Carter. These defendants also were involved in assisting plaintiffs, Larry Fortelney and David Carter, with their alleged "overpayment obligations" to Liberty. See, Amended Complaint, ¶ 4.

[2] Plaintiffs' Amended Complaint omits some language from the paragraphs cited from the SSRA. The court has included the omitted language from the SSRA since the SSRA is referred to in the Amended Complaint, Liberty has provided the SSRA with its motion and the parties do not dispute its authenticity. In evaluating a motion to dismiss, the court "may consider documents referred to in the complaint if the documents are central to the plaintiff[s'] claim[s] and the parties do not dispute the documents' authenticity." Smith v. United States, 561 F.3d 1090, 1098 (10th Cir.2009), cert. denied, —— U.S. ——, 130 S.Ct. 1142, 175 L.Ed.2d 973 (2010).

[3] Defendant, Bassett Law Firm, LLC, has its main office in Columbia, Missouri. Plaintiffs alleged, on information and belief, that no member of the firm is licensed in Oklahoma. See, Amended Complaint, ¶ 16.

[4] IBI is a Missouri corporation. Plaintiffs allege, on information and belief, that no attorney at IBI was licensed to practice law in Oklahoma. See, Amended Complaint, ¶ 20.

[5] The Amended Complaint also alleges facts relating to a Mark Smith. See, Amended Complaint, ¶¶ 51–59. However, Mr. Smith is not

listed in the caption or named in the Amended Complaint as a plaintiff. No claims are alleged on his behalf. The allegations with respect to Mark Smith will be disregarded.

[6] As previously noted, in evaluating a motion to dismiss, the court "may consider documents referred to in the complaint if the documents are central to the plaintiff[s'] claim[s] and the parties do not dispute the documents' authenticity." Smith, 561 F.3d at 1098.

[7] Section 407(a) provides in pertinent part:

> The right of any person to any future payment under this subchapter shall not be transferable or assignable, at law or in equity, and none of the moneys paid or payable or rights existing under this subchapter shall be subject to execution, levy, attachment, garnishment, or other legal process....

42 U.S.C. § 407(a).

[8] The LTD policy, as hereinafter discussed, is an employee welfare benefit plan under ERISA. Offsetting other income received as social security benefits against long term disability benefits is not prohibited by ERISA. Godwin v. Sun Life Assur. Co. of Canada, 980 F.2d 323, 327 (5th Cir.1992) (validity of social security and workers' compensation offsets against disability benefits is well established), citing Alessi v. Raybestos–Manhattan, Inc., 451 U.S. 504, 514–515, 101 S.Ct. 1895, 68 L.Ed.2d 402 (1981) (integration of employee benefits with other sources of income available to employees is permissible.)

[9] In Lamb, the court also found that the offset of payments received by a claimant's dependent on account of a claimant's disability "does not transgress the policy undergirding the Social Security Act, 42 U.S.C. § 402," which provides disability benefits to dependent children.

[10] Other courts have allowed the recoupment of an overpayment caused by a participant's receipt of social security benefits by retaining the future monthly LTD benefits until the overpayment is recovered in full. See, DeFrancesco v. Nationwide Mut. Ins. Co., 2006 WL 923716 *2 (D.Conn. April 7, 2006) (citing cases); see also, 467 F.3d 1031, 1038 (7th Cir.2006) (recoupment of overpayments from future monthly benefits "fosters the integrity of a written plan and ensures the availability of funds for other participants.")

[11] Although the LTD policy provided that the "Monthly Benefit payable will not be less than the Minimum Monthly Benefit shown in the Schedule of Benefits," it also provided that if an overpayment was due to Liberty, "the Minimum Monthly Benefit otherwise payable under this provision will be applied toward satisfying the overpayment." See, Ex 1 to Liberty's motion, LTD–1.

[12] In their briefing, plaintiffs, citing to In re Handel, 57,0 F.3d 140–146 (3rd Cir.2009), assert that a lien constitutes "other legal process" under section 407(a). The court finds the facts in this case distinguishable from Handel. In Handel, a law firm sought to enforce a charging attorney lien to collect fees owed from a client. The Third Circuit concluded that the "alleged lien falls squarely within the definition of 'other legal process.' " Id. In so doing, the court found that the laws cited by the law firm establishing charging liens envisioned the utilization of the courts to enforce the claims of liability. In this case, Liberty did not seek to enforce the "first lien" and there is no citation of authority which envisions the utilization of courts to enforce the "first lien."

[13] The court also concludes that the Supreme Court's decision in Philpott v. Essex County Welfare Bd., 409 U.S. 413, 93 S.Ct. 590, 34 L.Ed.2d 608 (1973) does not support a finding that IBI's actions or any of the other defendants' actions violated § 407(a). In Philpott, the State of New Jersey sought to attach a beneficiary's social security benefits as reimbursement for the costs of the beneficiary's care and maintenance. In so doing, the state used the judicial system. See, Philpott, 409 U.S. at 415, 93 S.Ct. 590 ("Respondent sued to reach the bank account"). None of the allegations in

the Amended Complaint establish that any of the defendants utilized the judicial system to obtain plaintiffs' social security benefits or sought in any way to attach the social security benefits.

FN14. See, Wojchowski v. Daines, 498 F.3d 99, 107–110 (2nd Cir.2007) (holding that the Second Circuit's prior expansive definition of "legal process" which included the use of express or implied threats of process was no longer good law after the Supreme Court's decision in Keffeler).

[15] As additional authority in support of their arguments regarding the § 407(a) claims, plaintiffs rely upon an unpublished state court order issued on January 10, 2011 by the District Court of Seminole County, State of Oklahoma, in David L. Griffin v. American Fidelity Assurance Corporation, CJ–2010–3. See, (doc. no. 83). The court finds the authority to be non-binding on the issue of whether defendants violated § 407(a) and also finds the authority to be unpersuasive.

[16] Plaintiffs assert that their breach of contract claim against Liberty was alleged in the alternative. They maintain that if the court does not find their state claims for fraud, deceit, conspiracy, conversion, unjust enrichment and violation of the Oklahoma Workers Compensation Act are preempted, they will dismiss the breach of contract claim. Plaintiffs also request the opportunity to amend their complaint and assert the breach of contract claim and other relief under ERISA.

[17] In their briefing, plaintiffs state that they wish to dismiss their claims against Liberty for violation of Massachusetts Unfair Trade Practices Act, Mass. Gen. Laws Ch. 93A § 2 (Count VII) and violation of 36 O.S. § 902—Excessive Premiums (Count VIII) without prejudice. Defendants object to the dismissal without prejudice. They contend that the claims should be dismissed with prejudice as they are preempted. The court concludes as hereinafter discussed that the claims should be dismissed as preempted by ERISA.

[18] It is undisputed that plaintiffs have alleged state law claims against defendants. The LTD policy is undisputedly a "welfare plan." See, 29 U.S.C. § 1002(1) (a welfare plan is a plan that provides "benefits in the event of sickness, accident, disability....") And a welfare plan is an employee benefit plan. 29 U.S.C. § 1002(3).

[19] Section 1021(b) provides:

The administrator shall, in accordance with section 1024(a) of this title, file with the Secretary—

(1) the annual report containing the information required by section 1023 of this title; and

(2) terminal and supplementary reports as required by subsection (c) of this section.

29 U.S.C. § 1021(b).

[20] Section 48 provides in pertinent part:

Claims for compensation or benefits due under the Workers' Compensation Act shall not be assigned ... and shall be exempt from all claims of creditors and from levy, execution or attachment or other remedy for recovery or collection of a debt, which exemption may not be waived.

85 O.S. § 48.

[21] Plaintiffs also rely upon the unpublished state order in Griffin in regard to whether Chelsea Carter's conversion claim is preempted by ERISA. The court finds the case to be nonbinding and unpersuasive.

[22] The Amended Complaint alleges that Carter signed the SSRA on August 8, 2008. See, Amended Complaint, ¶ 65.

[23] Even if social security benefits were estimated, the policyholder could still apply for social security benefits, and in the event Liberty overestimated the amount payable to the policyholder, Liberty agreed to reimburse the

policyholder for such amount, upon the receipt of proof of the amount of social security benefits awarded or denied. See, Ex. 1 to Liberty's motion, LTD–24.

[24] The court has also found certain claims against the Bassett defendants and IBI to be preempted by ERISA. The court, however, does not conclude that plaintiffs have requested to amend their complaint to add any ERISA claims against the Bassett defendants and IBI. Plaintiffs have not shown in their papers that they would have a viable ERISA claim against these defendants.

[25] Unpublished decisions cited for persuasive value pursuant to 10th Cir. R. 32.1.

FN26. See also, 5 Moore's Federal Practice, § 23.81[2] (3d ed. 2011) and cases cited therein.

BINDER & BINDER, P.C., Plaintiff,
v.
MICHAEL K. ASTRUE, Commissioner of the Social Security Administration, Defendant.
CV-11-0467 (SJF)
UNITED STATES DISTRICT COURT EASTERN DISTRICT OF NEW YORK
Dated: January 25, 2012

ORDER

FEUERSTEIN, J.

Binder & Binder, P.C. ("plaintiff") commenced this action against Michael K. Astrue ("defendant"), Commissioner of the Social Security Administration ("SSA"), seeking to recover attorney's fees relating to its representation of a claimant for social security disability insurance ("DI") benefits pursuant to Section 206 of the Social Security Act, 42 U.S.C. § 406. The parties now cross-move pursuant to Rule 56 of the Federal Rules of Civil Procedure for summary judgment. For the reasons set forth below, plaintiff's motion is granted in part and defendant's cross motion is denied.

I. BACKGROUND

A. Factual Background

The following facts are undisputed, unless otherwise indicated:

On or about August 9, 2007, Gordon P. Landwirth ("Landwirth") retained plaintiff to represent him with respect to his application for DI benefits and executed an agreement entitled,

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"fees for Representation before the Social Security Administration" ("the Fee Agreement"). (Complaint [Compl.], f5, Ex. A). Under the Fee Agreement, inter alia, if Landwirth was successful on his claim for DI benefits:

> "at the initial stage, the reconsideration stage, or an initial administrative law judge hearing, a fee agreement will be submitted for approval to the [SSA]. Under the fee agreement, the fees shall be the lesser of: a. twenty-five percent (25%) of the past due benefits awarded to [Landwirth] * * *, OR b. the maximum amount set by the Commissioner, pursuant to Section 406(a)(2)(A). This amount is currently five thousand three hundred dollars ($5,300.00), but is subject to adjustment by the Commissioner."

(Compl., Ex. A). However, if Landwirth was successful on his claim only following a review by the Appeals Council, the Fee Agreement provided that "the fee petition system will be used," pursuant to which "the fees charged by [plaintiff] will be twenty-five percent of all past-due benefits awarded." (Id.) The Fee Agreement further provided, inter alia, that if it were invalidated by the SSA "for any reason," plaintiff "will use the fee petition method." (Id.)

By decision dated November 13, 2009, following an Appeals Council remand, Administrative Law Judge Mark Hecht ("the ALJ") found Landwirth to be disabled as of November 1, 2005 and entitled to DI benefits. (T. 1-3, 6-12). By order dated November 13, 2009, the ALJ approved the Fee Agreement, "subject to the condition that the claim results in past-due benefits." (T. 4-5).

On or about December 9, 2009, the SSA paid plaintiff a total of five thousand nine hundred seventeen dollars ($5,917.00), i.e., six thousand dollars ($6,000.00) minus a statutory assessment of eighty-three dollars ($83.00) imposed pursuant to 42 U.S.C. § 406(d), for the legal services it rendered to Landwirth during the SSA proceedings. (T. 13).

On March 20, 2010, the SSA's Office of Central Operations ("OCO") advised Landwirth,

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inter alia: (1) that he was awarded past-due benefits for the period between August 2006 through October 2009 in the total amount of sixty-five thousand five hundred eighty-eight dollars ($65,588.00); (2) that he would be receiving monthly benefits in the amount of one thousand six hundred sixty-two dollars ($1,662.00), as well as checks in the amount of (a) one thousand seven hundred seventy-two dollars and seventy cents ($1,772.70) for money due him through December 2009 and (b) sixty-one thousand three hundred sixty dollars and forty cents ($61,360.40) "because of an additional lump-sum payment;" (3) that the Fee Agreement between him and plaintiff had been approved by the SSA; and (4) that six thousand dollars ($6,000.00) had therefore been withheld from the past-due benefits award to pay plaintiff pursuant to the Fee Agreement and that the balance of the past-due benefits award would then be forwarded to Landwirth. (T. 14-16).

By order dated April 21, 2010, upon review of the Fee Agreement, Mark S. Sochaczewsjy ("Chief ALJ"), the Regional Chief ALJ for the SSA, invalidated the Fee Agreement on the basis that it did "not meet the statutory requirements of Sections 206(a)(2)(A) of the Social Security Act as amended by Section 5106(a) of the Omnibus Budget Reconciliation Act of 1990."[1] (T. 18). In a letter to plaintiff dated that same day, the Chief ALJ explained that:

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> "the two-tier fee structure set forth in the [fee] agreement is invalid * * * [because it] states that the maximum fee of $5,300.00 applies only for representation before the [SSA]. Once the case is appealed [to] the Appeals Council level, the maximum will not [sic] longer apply. * * * Since the case was not favorable [to Landwirth] prior to the that [sic] appeal, the fee agreement is invalid under Section 206(a)(2)(A)(ii) of the Social Security Act, as the requirements set forth by that statute were not satisfied."

(T. 17). Plaintiff was advised that it was "entitled to request a [legal] fee through the petition process;" that "[a]ll papers must be submitted to the New York Hearing Office if [it] wish[ed] to charge and collect a fee in this case;" and that the Chief ALJ's order was not subject to further review. (T. 17).

By letter to the ALJ and petition, both dated July 8, 2010 and received by the SSA's Office of Disability Adjudication and Review ("ODAR") on July 22, 2010, plaintiff submitted a "Petition to Obtain Approval of a Fee" to the SSA, seeking a legal fee pursuant to 42 U.S.C. § 406(a) in the amount of eight thousand dollars ($8,000.00). (T. 33-41). In the letter to the ALJ, plaintiff noted, inter alia, "that 25% of the past due benefits awarded [Landwirth] * * * is $16,397.00. Although [Landwirth] agreed to pay 25%, [plaintiff] [was] reducing [its] fee to $8,000.00." (T. 33).

On July 16, 2010, Landwirth filed a voluntary petition for relief under Chapter 7 of the United States Bankruptcy Code, 11 U.S.C. § 101, et seq., in the United States Bankruptcy Court for the Southern District of New York ("the bankruptcy court"). (T. 21-29). Pursuant to the "Notice of Chapter 7 Bankruptcy Case, Meeting of Creditors, & Deadlines" ("Chapter 7 Notice") issued by the bankruptcy court, potential creditors of Landwirth were notified, inter alia, that if they "believe [d] that [Landwirth] [was] not entitled to receive a discharge under Bankruptcy Code §§ 727(a) or that a debt owed to [them] [was] not dischargeable under Bankruptcy Code §§

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523(a)(2), (4), or (6), [they] must start a lawsuit by filing a complaint in the bankruptcy clerk's

office by [October 12, 2010]." (T. 21-22). "Schedule F - Creditors Holding Unsecured Nonpriority Claims" ("Schedule F") designated plaintiff as a creditor of Landwirth with respect to a disputed claim in an unknown amount, but did not provide plaintiff's address. (T. 25, 27). The Certificate of Notice indicates that plaintiff was not sent a copy of the Chapter 7 Notice. (T. 29). Plaintiff alleges that it, therefore, did not receive notification of Landwirth's Chapter 7 proceeding in time to file a timely objection to Landwirth's discharge, i.e., that Landwirth's debt to plaintiff was not dischargeable under Section 523(a)(2), (4) or (6) of the Bankruptcy Code. (Compl., ¶ 11).

On July 26, 2010, the SSA's ODAR issued an "Authorization to Charge and Collect Fee," authorizing plaintiff to charge and collect a fee in the amount of eight thousand dollars ($8,000.00) for services it provided to Landwirth in the SSA proceedings and advising plaintiff that the fee would be paid directly to it from Landwirth's past-due benefits check, but that if the check did not cover the fee, payment of the balance due was "a matter for [plaintiff] and [Landwirth] to settle."[2] (T. 19). Plaintiff alleges that it is entitled to payment of two thousand dollars ($2,000.00) since it was only paid six thousand dollars ($6,000.00) of the eight thousand dollar ($8,000.00) legal fee certified by the SSA. (Compl., ¶ 13).

On October 26, 2010, the bankruptcy court entered a "Discharge of Debtor Order of Final Decree" ("the bankruptcy order"), releasing Landwirth from all dischargeable debts , i.e., most debts existing on the date the bankruptcy case was filed, and closing the Chapter 7 proceeding.

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(T. 30). On the "Explanation of Bankruptcy Discharge in a Chapter 7 Case" annexed to the bankruptcy order, it is noted that certain types of debt are generally not discharged in the case, including, inter alia, "Some debts which were not properly listed by the debtor." (T. 31).

On December 19, 2010, the SSA's OCO advised plaintiff, pursuant to its "Hearings, Appeals and Litigation Law Manual" ("HALLEX"), that it had received plaintiff's July 8, 2010 "petition requesting a fee for the services [plaintiff] performed for * * * Landwirth," but that since Landwirth had filed a bankruptcy petition, the SSA could not act on plaintiff's fee petition absent authorization from the bankruptcy court. (T. 32). The SSA requested plaintiff to notify it, or to have Landwirth notify it, of the outcome of the bankruptcy proceeding. (T. 32).

B. Procedural Background

On January 31, 2011, plaintiff commenced this action seeking to recover from the SSA the remaining two thousand dollars ($2,000.00) of its certified legal fee under Section 206 of the Social Security Act, 42 U.S.C. § 406(a), plus interest.

The parties cross-move pursuant to Rule 56 of the Federal Rules of Civil Procedure for summary judgment.

II. DISCUSSION

A. Standard of Review

Summary judgment should not be granted unless "the pleadings, the discovery and disclosure materials on file, and any affidavits show that there is no genuine issue as to any material fact and that the movant is entitled to judgment as a matter of law." Fed. R. Civ. P.

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56(c). In ruling on a summary judgment motion, the district court must first "determine whether there is a genuine dispute as to a material fact, raising an issue for trial" McCarthy v. Dun & Bradstreet Corp., 482 F.3d 184, 202 (2d Cir. 2007) (internal quotations and citations omitted); see Ricci v. DeStefano, 557 U.S. 557, 129 S.Ct. 2658, 2677, 174 L.Ed.2d 490 (2009) (holding that "[o]n a motion for summary judgment, facts must be viewed in the light most favorable to the nonmoving party only if there is a 'genuine'

dispute as to those facts." (Emphasis added) (internal quotations and citation omitted)). "A fact is material if it 'might affect the outcome of the suit under governing law.'" Spinelli v. City of New York, 579 F.3d 160, 166 (2d Cir. 2009) (quoting Anderson v. Liberty Lobby. Inc., 477 U.S. 242, 248, 106 S. Ct. 2505, 91 L. Ed. 2d 202 (1986)). "Where the undisputed facts reveal that there is an absence of sufficient proof as to one essential element of a claim, any factual disputes with respect to other elements become immaterial and cannot defeat a motion for summary judgment." Chandok v. Klessig, 632 F.3d 803, 812 (2d Cir. 2011): see also Celotex Corp. v. Catrett, 477 U.S. 317, 322-23, 106 S.Ct. 2548, 91 L.Ed.2d 265 (1986) (holding that summary judgment is appropriate when the non-moving party has no evidentiary support for an essential element for which it bears the burden of proof).

If the district court determines that there is a genuine dispute as to a material fact, the court must then "resolve all ambiguities, and credit all factual inferences that could rationally be drawn, in favor of the party opposing summary judgment," Spinelli, 579 F.3d at 166 (internal quotations and citation omitted); see also Pucino v. Verizon Wireless Communications. Inc., 618 F.3d 112, 117 (2d Cir. 2010), to determine whether there is a genuine issue for trial. See Ricci. 557 U.S. 557, 129 S.Ct. at 2677. A genuine issue exists for summary judgment purposes "where the evidence is such that a reasonable jury could decide in the non-movant's favor." Beyer v.

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Count v of Nassau, 524 F.3d 160, 163 (2d Cir. 2008) (citing Guilbert v. Gardner, 480 F.3d 140, 145 (2d Cir. 2007)); see also United Transp. Union v. National R.R. Passenger Corp., 588 F.3d 805, 809 (2d Cir. 2009). "Where the record taken as a whole could not lead a rational trier of fact to find for the nonmoving party, there is no genuine issue for trial." Ricci, 557 U.S. 557, 129 S.Ct. at 2677 (quoting Matsushita Elec. Industrial Co.. Ltd. v. Zenith Radio Corp., 475 U.S. 574, 587, 106 S.Ct. 1348, 89 L.Ed.2d 538 (1986)).

"The moving party bears the initial burden of demonstrating the absence of a genuine issue of material fact," F.D.I.C. v. Great American Ins. Co., 607 F.3d 288, 292 (2d Cir. 2010) (quotations and citation omitted), after which the burden shifts to the nonmoving party to "come forward with specific evidence demonstrating the existence of a genuine dispute of material fact." Brown v. Eli Lilly & Co., 654 F.3d 347, 358 (2d Cir. 2011); see also Spinelli, 579 F.3d at 166. Thus, the nonmoving party can only defeat summary judgment "by coming forward with evidence that would be sufficient, if all reasonable inferences were drawn in [its] favor, to establish the existence of a factual question that must be resolved at trial. Spinelli, 579 F.3d at 166 (internal quotations and citations omitted); see also Celotex Corp., 477 U.S. at 323, 106 S.Ct. 2548. "The mere existence of a scintilla of evidence in support of the [non-movant's] position will be insufficient; there must be evidence on which the jury could reasonably find for the [non-movant]." Hayut v. State Univ. of N.Y., 352 F.3d 733, 743 (2d Cir. 2003) (alterations in original). Moreover, the nonmoving party "may not rely on conclusory allegations or unsubstantiated speculation" to defeat summary judgment. Brown, 654 F.3d at 358. Since there is no dispute as to any material fact, summary judgment is appropriate in this action.

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B. Statutory Duties

A request to charge a fee for time spent representing a claimant in a proceeding before the SSA is made pursuant to 42 U.S.C. § 406(a). That statute provides, in relevant part:

> "(1) The Commissioner of Social Security may, by rule and regulation, prescribe the maximum fees which may be charged for services performed in connection with any claim

> before the Commissioner of Social Security under this subchapter, and any agreement in violation of such rules and regulations shall be void. Except as provided in paragraph (2)(A), whenever the Commissioner of Social Security, in any claim before the Commissioner for benefits under this subchapter, makes a determination favorable to the claimant, the Commissioner shall, if the claimant was represented by an attorney in connection with such claim, fix (in accordance with the regulations prescribed pursuant to the preceding sentence) a reasonable fee to compensate such attorney for the services performed by him in connection with such claim. * * * (4) Subject to subsection (d) of this section, if the claimant is determined to be entitled to past-due benefits under this subchapter and the person representing the claimant is an attorney, the Commissioner of Social Security shall, notwithstanding section 405(i) of this title, certify for payment out of such past-due benefits * * * to such attorney an amount equal to so much of the maximum fee as does not exceed 25 percent of such past-due benefits * * *."

42 U.S.C. § 406(a) (emphasis added).

In accordance with 42 U.S.C. § 406(a), the Commissioner of Social Security promulgated, inter alia, 20 C.F.R. § 404.1720. That regulation, in effect at the time plaintiff submitted its petition in July 2010, provided, in relevant part:

> "(a) General. A representative may charge and receive a fee for his or her services as a representative only as provided in paragraph (b) of this section. (b) Charging and receiving a fee. (1) The representative must file a written request with [the SSA] before he or she may charge or receive a fee for his or her services. (2) [The SSA] decide[s] the amount of the fee, if any, a representative may charge or receive. (3) Subject to paragraph (e) of this section, a representative must not charge or receive any fee unless [the SSA] ha[s]

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> authorized it, and a representative must not charge or receive any fee that is more than the amount [the SSA] authorize[s]. (4) If [the] representative is an attorney * * *, and [the claimant] [is] entitled to past-due benefits, * * * [the SSA] will pay the authorized fee, or a part of the authorized fee, directly to the representative out of the past-due benefits, subject to the limitations described in § 404.1730(b)(1). * * *

(emphasis added).

Thus, under 42 U.S.C. § 406(a) and 20 C.F.R. § 404.1720, defendant has a duty, inter alia: (1) to fix a reasonable fee to compensate plaintiff for the services performed by it in connection with Landwirth's claim for DI benefits, see 42 U.S.C. § 406(a)(1); 20 C.F.R. § 404.1720(b); (2) to certify for payment out of the past-due benefits awarded to Landwirth "an amount equal to so much of the maximum fee as does not exceed 25 percent of such past-due benefits," 42 U.S.C. § 406(a)(4); and (3) to pay the authorized fee directly to plaintiff out of the

past-due benefits award, see 20 C.F.R. § 404.1720(b).

C. Basis of Jurisdiction

1. 28 U.S.C. § 1331

Section 205(g) of the Social Security Act, 42 U.S.C. § 405(g), provides for judicial review of "any final decision of the Commissioner of Social Security made after a hearing * * *." However, that section is limited to judicial review of decisions involving a party to the hearing, e.g., the claimant in the social security proceeding or the SSA itself, and does not provide a basis for jurisdiction in cases, such as this, where the representative of the claimant in a social security proceeding seeks recovery of a legal fee pursuant to 42 U.S.C. § 406(a). See Binder & Binder PC v. Barnhart ("Binder II"), 481 F.3d 141, 149 (2d Cir. 2007) (holding that because Binder &

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Binder PC, the representative of the claimant in a SSA proceeding, was not a party in the proceedings before the SSA, it cannot avail itself of section 405(g)); see also Delott v. Astrue, No. 08-CV-3952, 2011 WL 703560, at * 5 (E.D.N.Y. Feb. 18, 2011) (holding that because plaintiff, the claimants' attorney, was not a party to any of the social security decisions, the Court did not have subject matter jurisdiction under 42 U.S.C. § 405(g)). Accordingly, any claim for recovery of legal fees under 42 U.S.C. § 406(a) cannot arise under 42 U.S.C. § 405(g).

Section 205(h) of the Social Security Act, 42 U.S.C. § 405(h), provides, in relevant part, that "[n]o findings of fact or decision of the Commissioner of Social Security shall be reviewed by any person, tribunal, or governmental agency except as herein provided. No action against * * * the Commissioner of Social Security * * * shall be brought under section 1331 or 1346 of Title 28 to recover on any claim arising under [42 U.S.C. § 405(g)]." (emphasis added). The Second Circuit has held that:

> "[n]ormally, Section 405(h) channels all challenges that 'arise under' the Act through the proper administrative proceedings by forbidding federal suits that have not been administratively reviewed first. * * * Thus, * * *, federal question jurisdiction does not generally lie under section 28 U.S.C. § 1331 for suits brought under the Social Security Act, even if they raise constitutional questions. * * * Judicial review is available to a plaintiff under 28 U.S.C. § 1331, however, where * * * there are no alternative means to review a federal claim arising under the Social Security Act. * * *"

Binder II, 481 F.3d at 149 (citations omitted); see also Binder & Binder PC v. Barnhart ("Binder I"), 399 F.3d 128, 130-31 (2d Cir. 2005) (holding that although Section 405(h) typically bars suits brought under 28 U.S.C. § 1331, judicial review is available when there is no alternative since it may be presumed "that Congress did not intend to foreclose all avenues of judicial review." (emphasis in original)). Accordingly, the Second Circuit has held that a representative

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seeking fees under 42 U.S.C. § 406, "may invoke federal question jurisdiction under 28 U.S.C. § 1331 because, were such jurisdiction unavailable, it would be unable to obtain any judicial review of its claims under the [Social Security] Act." Binder II, 481 F.3d at 150; see also Buchanan v. Apfel, 249 F.3d 485, 490 (6th Cir. 2001) (holding that 42 U.S.C. § 405(h) does not preclude a claim by an attorney representing claimants in social security proceedings challenging the SSA's method for determining the amount of fees upon statutory or constitutional grounds because, inter alia, the attorney was not a party to the SSA hearings and

there "is no clear and convincing evidence that Congress intended to deny a judicial forum for such a claim.")

Accordingly, this Court has jurisdiction over this matter under 28 U.S.C. § 1331.[3]

2. 28 U.S.C. § 1361

In addition, this Court has subject matter jurisdiction over this action under the mandamus statute, 28 U.S.C. § 1361. That statute provides that "[t]he district courts shall have original jurisdiction of any action in the nature of mandamus to compel an officer or employee of the United States or any agency thereof to perform a duty owed to the plaintiff."

"[M]andamus is an extraordinary remedy," Miller v. French, 530 U.S. 327, 339, 120 S.Ct. 2246, 147 L.Ed.2d 326 (2000); see S.E.C. v. Rajaratnam, 622 F.3d 159, 169 (2d Cir. 2010), that may only be granted where: (1) the petitioner has no other adequate means to attain the relief

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sought; (2) the petitioner shows a "clear and indisputable right to the issuance of the writ," Miller, 530 U.S. at 339, 120 S.Ct. 2246 (internal quotations and citation omitted); and (3) the court, in the exercise of its discretion, determines that the writ is appropriate under the circumstances. In re City of New York, 607 F.3d 923, 932-33 (2d Cir. 2010); see also Cheney v. United States District Court for District of Columbia, 542 U.S. 367, 380-81, 124 S.Ct. 2576, 159 L.Ed.2d 459 (2004). A writ of mandamus "provide[s] a remedy for a petitioner only if he has exhausted all other avenues of relief and only if the defendant owes him a clear nondiscretionary duty." Heckler v. Ringer, 466 U.S. 602, 626, 104 S.Ct. 2013, 80 L.Ed.2d 622 (1984) (citations omitted); see also Escaler v. United States Citizenship and Immigration Services, 582 F.3d 288, 292 (2d Cir. 2009).

a. Nondiscretionary Duty

The Second Circuit has held that there is "no authority for the SSA to interpret and apply bankruptcy law or to enforce the orders of the Bankruptcy Court, and * * *, in the absence of such authority, the SSA's unambiguous and limited duty [is] to certify for payment to [the representative seeking a fee under 42 U.S.C. § 406] [its] reasonable fee," Binder II. 481 F.3d at 152 (emphasis added).[4] The Second Circuit also held: "The Social Security Act by its terms does not authorize the SSA to enforce discharges in bankruptcy or make any determination as to

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attorneys' fees other than in accordance with its statutory authority to fix the fees of claimant's attorneys and to withhold and transmit the fees so fixed. The plain language of § 406(a)(4) admits of no exceptions in this regard." Id at 151 (emphasis added). According to the Circuit, "the SSA lack[s] authority to deviate from the procedure outlined in § 406(a)(4) of the [Social Security] Act." Id at 152 n. 3.

Defendant fulfilled its duty to fix a reasonable fee under Section 406(a)(1) on July 26, 2010, when it determined plaintiff's reasonable fee to be eight thousand dollars ($8,000.00). Defendant's determination that plaintiff was entitled to a fee in the amount of eight thousand dollars ($8,000.00) was proper, notwithstanding the pendency of the bankruptcy proceeding, since it had an "unambiguous" statutory duty to fix a reasonable fee for plaintiff's services under 42 U.S.C. § 406(a)(1). See Binder IL 481 F.3d at 152. In determining plaintiff's reasonable fee, defendant recognized the amount of work completed by plaintiff and determined that plaintiff was entitled to payment for that work in the amount of eight thousand dollars ($8,000.00). See Id. at 151. "Absent a showing that the portion of the total past-due benefits to which [the plaintiff] is entitled is an unreasonable attorneys' fee, * * *, the SSA had a statutory duty under the [Social Security] Act to pay [the plaintiff] the certified fee." Id. (emphasis added). Accordingly, since there is no showing that an eight thousand dollar ($8,000.00) fee to plaintiff is unreasonable,

defendant had a clear and nondiscretionary duty, with which it failed to comply without authority, to withhold the full amount of certified fees from the past-due benefits award to Landwirth and to pay that amount to plaintiff.

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b. Adequate Remedy

Moreover, there is no other adequate remedy available to plaintiff to seek the remainder of its authorized legal fee. By erroneously paying Landwirth past-due benefits that the SSA had a statutory duty to withhold as payment to plaintiff for its fee under 42 U.S.C. § 406(a), there resulted an overpayment of past-due benefits to Landwirth. See 20 C.F.R. § 404.501(a)(8) ("The provisions for adjustment [of an overpayment as set forth in Section 404(b)] * * * apply in cases where through error: * * * A payment of past due benefits is made to an individual and such payment had not been reduced by the amount of attorney's fees payable directly to an attorney under section 206 of the [Social Security] Act.") As set forth more fully below, 42 U.S.C. § 404(a) requires the SSA, not plaintiff, to seek to recoup any overpayment of a past-due benefits award from the claimant.

c. Appropriateness of Mandamus

Since, inter alia, defendant had an unambiguous and nondiscretionary duty under the Social Security Act, 42 U.S.C. § 406(a), to withhold from the past-due benefits awarded to Landwirth the amount of plaintiff's reasonable fee, which it determined to be eight thousand dollars ($8,000.00), and to then pay that amount directly to plaintiff; it failed to perform that statutory duty; and there are no other adequate means by which plaintiff can obtain the remainder of the fees due it, a writ of mandamus under 28 U.S.C. § 1361, compelling defendant to pay plaintiff the remaining two thousand dollars ($2,000.00) of the certified legal fee, is appropriate.

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D. Sovereign Immunity

Defendant argues, nonetheless, that the doctrine of sovereign immunity shields it from liability for paying the certified legal fee to plaintiff out of general social security funds.

"Sovereign immunity is the privilege of the sovereign not to be sued without its consent." Virginia Office for Protection and Advocacy v. Stewart, 131 S. Ct. 1632, 1637, 179 L.Ed.2d 675 (2011). "Under settled principles of sovereign immunity, the United States, as sovereign, is immune from suit, save as it consents to be sued... and the terms of its consent to be sued in any court define that court's jurisdiction to entertain the suit." United States v. Dalm, 494 U.S. 596, 609, 110 S. Ct. 1361, 108 L.Ed.2d 548 (1990) (internal quotations and citations omitted); see also Adeleke v. United States, 355 F.3d 144, 150 (2d Cir. 2004) (holding that the United States "may not be sued without its consent and that the existence of consent is a prerequisite for jurisdiction." (quotations and citation omitted)). Sovereign immunity is a jurisdictional bar, see Lunney v. U.S., 319 F.3d 550, 554 (2d Cir. 2003), which, absent a waiver, shields the federal government, its agencies and its officers acting in their official capacity from suits seeking monetary damages. Department of Army v. Blue Fox, Inc., 525 U.S. 255, 260, 119 S.Ct. 687, 142 L.Ed.2d 718 (1999) (quoting F.D.I.C. v. Meyer, 510 U.S. 471, 475, 114 S.Ct. 996, 127 L.Ed.2d 308 (1994V): see County of Suffolk. N.Y. v. Sebelius, 605 F.3d 135, 140 (2d Cir. 2010) (holding that absent an "unequivocally expressed" statutory waiver, the United States, its agencies and its officers acting in their official capacity are immune from suit based on the principle of sovereign immunity).

Although the Second Circuit has not directly addressed the issue of whether 42 U.S.C. § 406(a) constitutes a waiver of sovereign immunity, the two (2) circuit courts that have addressed

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the issue have held that 42 U.S.C. § 406(a) does not constitute a waiver of sovereign immunity. See In re Handel, 57,0 F.3d 140 (3d Cir. 2009);

Pittman v. Sullivan, 911 F.2d 42, 46 (8th Cir. 1990); Russell v. Sullivan, 887 F.2d 170, 172 (8th Cir. 1989). In so holding, the Third Circuit rejected the suggestion that "under § 406, the federal government has a direct obligation to counsel for a Social Security claimant for the amount of any attorney's fee determination" and held that 42 U.S.C. § 406 "[d]oes not create a federal promise to pay counsel independently of the private obligation [of the claimant]," In re Handel, 570 F.3d at 144; and the Eight Circuit held, inter alia, that fee awards under Section 406 are not judicially reviewable and, therefore, the court had no authority (1) to order the Secretary of Health and Human Services to pay the authorized fee or to recoup the amount from the claimant and pay it to the claimant's representative, Pittman, 911 F.2d at 46, or (2) to order the Secretary to pay the claimant's representative the balance remaining on its fee award out of general social security funds, id.; see also Russell, 887 F.2d at 172.

Although the Second Circuit has not expressly addressed the issue, it appears from its holding in Binder II that it would not follow the holdings of the Third and Eighth Circuits. Specifically, as noted above, the Second Circuit has held, seemingly contrary to those circuit courts, that a representative seeking fees under 42 U.S.C. § 406(a) may seek judicial review under 28 U.S.C. § 1331, other than review of the amount of fees determined to be reasonable, Binder II. 481 F.3d at 150, and that the SSA has an "unambiguous and limited duty" under 42 U.S.C. § 406(a)(4) to certify a reasonable fee for payment, to withhold that amount from any past-due benefits award and to then pay that amount directly to the representative, Id., 481 F.3d at 152; and has further indicated that the SSA "lack[s] authority to deviate from the procedure

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outlined in § 406(a)(4) of the [Social Security] Act," Id. at 152 n. 3. Moreover, in Binder II, the Second Circuit refused to consider, and thereby implicitly rejected, the SSA's sovereign immunity defense on the basis that its "conclusion that the SSA had a duty to pay [the plaintiff] the certified fee dispel[ed] the need for [it] to address th[at] defense." See, e.g. Binder II, 481 F.3d at 152 n. 4. Accordingly, in this Circuit, unlike the Third and Eighth Circuits, sovereign immunity does not shield the SSA from fulfilling its statutory obligation to a representative for a social security claimant, such as plaintiff, to certify a reasonable fee pursuant to 42 U.S.C. § 406(a), to withhold that amount from any past-due benefits award and then to pay that amount directly to the representative.

Although Binder II is distinguishable from this case insofar as in that case the SSA was seeking to recoup money it had already paid to the plaintiff-representative from the claimant's past-due benefits award, that factor does not extinguish or otherwise alter the SSA's "unambiguous and limited duty" under 42 U.S.C. § 406(a) to certify a reasonable fee, withhold the amount of the certified fee from any past-due benefits award and pay that amount directly to the representative, which the Second Circuit found dispelled the need for it to address the sovereign immunity defense. Accordingly, the fact that in this case the SSA has failed to perform its statutory duty to withhold the authorized legal fee from the past-due benefits award to Landwirth, and has already erroneously paid the entire amount of past-due benefits to Landwirth, does not excuse it from performing its additional unambiguous and nondiscretionary duty under the Social Security Act, 42 U.S.C. § 406(a), to pay the full amount of certified legal fees, i.e., eight thousand dollars ($8,000.00), directly to plaintiff.

Moreover, I respectfully believe that the Third Circuit's interpretation of a similar claim

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seeking to impose upon the federal government "a direct obligation to counsel for a social security claimant for the amount of any attorney's fee determination," In re Handel, 570 F.3d at 144, was overly broad. Clearly, 42 U.S.C. § 406(a) does not impose upon the SSA a "direct obligation to counsel for a social security

claimant" to pay the amount of any attorney's fee determination where, for example, the past-due benefits payable to the claimant are less than the amount of certified attorney's fees. In such circumstances, the SSA is clearly not liable to the claimant's representative to pay the difference from general social security funds. However, plaintiff's argument is properly construed more narrowly, i.e., that since the SSA has a statutory duty to certify a reasonable fee to plaintiff, to withhold such certified amount from the past-due benefits award to the claimant and to then pay that amount from the past-due benefits award, its failure to perform its statutory duty to withhold that amount from the past-due benefits paid to the claimant does not excuse it from its duty to pay the full amount of certified fees to the claimant's representative. Viewed in this light, a plaintiff seeking payment from the SSA of attorney's fees that have previously been certified as reasonable under 42 U.S.C. § 406(a) is seeking only to compel the SSA to perform a statutory duty under the Social Security Act which it failed to perform; it is not seeking monetary damages based upon any direct obligation on the part of the SSA to pay attorney's fees.

Moreover, although the Eighth Circuit conclusorily held that 42 U.S.C. § 406(a) cannot be construed as a waiver of sovereign immunity, Russell, 887 F.2d at 172; see also Pittman, 911 F.2d at 46 (citing Russell), it cited only the opinion of the United States District Court for the District of Delaware in Roberts v. Schweiker, 655 F. Supp. 1105 (D. Del. 1987), in support of that conclusion. The Delaware district court, in turn, relied upon the general proposition set forth

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by the Supreme Court in Ruckelshaus v. Sierra Club, 463 U.S. 680, 103 S. Ct. 3274, 77 L.Ed.2d 938 (1983), that "[i]n the absence of * * * a waiver [of sovereign immunity], the court is powerless to award attorney's fees against the United States." Roberts, 655 F. Supp. at 1110.

Ruckelshaus, however, involved an application by unsuccessful parties in an action seeking review of the promulgation of standards limiting emission of sulfur dioxide by coal-burning power plants by the Environmental Protection Agency ("EPA") for attorney's fees incurred by them pursuant to Section 307(f) of the Clean Air Act, 42 U.S.C. § 7607(f), which permits attorney's fees to be awarded when "such an award is appropriate." 463 U.S. at 682, 103 S. Ct. 3274. The issue before the Supreme Court was whether it is "appropriate" to award attorney's fees to an unsuccessful party under that statute.[5] Id. In holding that unsuccessful parties are not entitled to an award of attorney's fees under that statute, the Supreme Court held that "[e]xcept to the extent it has waived its immunity, the Government is immune from claims for attorney's fees," 463 U.S. at 685, 103 S. Ct. 3274, and that the United States had not waived its sovereign immunity from claims for attorney's fees by unsuccessful parties under that statute. Id. at 686, 103 S. Ct. 3274. That case is clearly distinguishable from the instant case because, inter alia, in that case, any award of attorney's fees was discretionary with the court, see 42 U.S.C. § 7607(f) ("[t]he court may award costs of litigation (including reasonable attorney * * * fees) whenever it determines that such award is appropriate." (emphasis added)), whereas in this case, the SSA has a nondiscretionary statutory duty to determine a reasonable attorney's fees,

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withhold that amount from any past-due benefits award to Landwirth and then pay that amount directly to plaintiff. Moreover, as noted above, plaintiff was not a party to the SSA proceedings and, therefore, is not asserting a claim for attorney's fees relative to its success in the underlying SSA proceedings. Rather, plaintiff is merely seeking, in essence, to compel defendant to perform its statutory and nondiscretionary duties under 42 U.S.C. § 406(a).

Moreover, the Delaware district court also found that the attorney who represented the claimant during the SSA proceedings must look

to the claimant, who received the entire past-due benefits award, including the certified legal fee, to recover his fee. Roberts. 655 F. Supp. at 1111. However, that holding is contrary to 42 U.S.C. § 404(a), which requires the SSA to seek the recoup any overpayment of past-due benefits from a claimant. Following the reasoning of that district court, an attorney who represented a claimant who received an overpayment of past-due benefits including the amount of the certified legal fee could seek to recover the fee from the claimant at the same time that the SSA seeks to recoup the overpayment under 42 U.S.C. § 404(a), resulting in a double reduction of the benefits received by the claimant. Such a result is contrary to the remedial and beneficent purpose of the Social Security Act. See McBrayer v. Secretary of Health & Human Services, 712 F.2d 795, 798-99 (2d Cir. 1983) (recognizing that the Social Security Act is remedial in purpose); Cutler v. Weinberger, 516 F.2d 1282, 1285 (2d Cir. 1975) (holding that the Social Security Act is remedial or beneficent in purpose). Accordingly, I find the Eighth Circuit's holding that sovereign immunity protects the SSA from claims pursuant to 42 U.S.C. § 406(a), seeking to recover legal fees that have erroneously been paid to the claimant, to be unpersuasive and contrary to both the statutory scheme and purpose of the Social Security Act.

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E. Appropriations Clause

The Appropriations Clause of the United States Constitution provides: "No Money shall be drawn from the Treasury, but in Consequence of Appropriations made by Law." U.S. Const, art. I, § 9, cl. 7. The Supreme Court has interpreted the Appropriations Clause to mean that "[m]oney may be paid out [of the federal Treasury] only through an appropriation made by law; in other words, the payment of money from the Treasury must be authorized by a statute." Office of Personnel Management v. Richmond, 496 U.S. 414, 424, 110 S. Ct. 2465, 110 L. Ed.2d 387 (1990).

Defendant contends that since the past-due benefits award has already been paid to Landwirth, the Appropriations Clause bars plaintiff's claim because payment can only be made from general Social Security funds, which is not contemplated by 42 U.S.C. § 406(a).

As previously noted, 42 U.S.C. § 406(a)(4) provides, in relevant part, that "the Commissioner of Social Security shall, notwithstanding [the SSA's duty to certify for payment and to pay DI benefits to a successful claimant pursuant to] section 405(i) of this title [[6]], certify for payment out of [any] past-due benefits [award]" a reasonable fee to an attorney representing the claimant in the social security proceeding. (Emphasis added). Pursuant to 42 U.S.C. § 401(h), DI benefits awarded to a claimant "shall be made only from the Federal Disability

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Insurance Trust Fund ["FDITF"] [established by 42 U.S.C. § 401(b)]." Thus, the Social Security Act expressly authorizes the payment of past-due DI benefits, from which the payment of legal fees under 42 U.S.C. § 406(a) are to be made, from the FDITF.[7]

Landwirth was awarded past-due DI benefits in the amount of sixty-five thousand five hundred eighty-eight dollars ($65,588.00) for the period between August 2006 through October 2009, as well as an additional one thousand seven hundred seventy-two dollars and seventy cents ($1,772.70) as payment of benefits through December 2009, for a total past-due benefits award of sixty-seven thousand three hundred sixty dollars and seventy cents ($67,360.70). 42 U.S.C. § 401(h) expressly authorized that amount to be paid from the FDITF. Pursuant to 42 U.S.C. §§ 405(i) and 406(a)(4), respectively, the SSA was required to pay Landwirth his past-due benefits and plaintiff its reasonable fee, determined by the SSA to be eight thousand dollars ($8,000.00), from the sixty-seven thousand three hundred sixty dollars and seventy cents ($67,360.70) amount drawn from the FDITF. Therefore, the SSA was only

authorized to pay Landwirth past-due benefits in the amount of fifty-nine thousand three hundred sixty dollars and seventy cents ($59,360.70) from the funds drawn from the FDITF. Defendant's payment to plaintiff of sixty-

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three thousand one hundred thirty-three dollars and ten cents ($63,133.10)[8] , thus, resulted in an overpayment of past-due benefits to Landwirth in the amount of three thousand seven hundred seventy-two dollars and forty cents ($3,772.40). It is the amount of that overpayment, not the amount of legal fees defendant was required to pay to plaintiff under 42 U.S.C. § 406(a), that was not authorized by the Social Security Act.

Furthermore, 42 U.S.C. § 404(a) requires the SSA, with certain exceptions not relevant here[9] , to seek to recoup any overpayment of benefits paid to a claimant. See also 20 C.F.R. § 404.502. Specifically, that statute provides, in relevant part:

> "Whenever the Commissioner of Social Security finds that more * * * than the correct amount of payment has been made to any person under this subchapter, proper adjustment or recovery shall be made, under regulations prescribed by the Commissioner of Social Security, as follows: (A) * * * the Commissioner of Social Security shall decrease any payment under this subchapter to which such overpaid person is entitled, or shall require such overpaid person or his estate to refund the amount in excess of the correct amount, * * *, or shall obtain recovery by means of reduction in tax refunds based on notice to the Secretary of Treasury as permitted under section 3720A of Title 31, or shall apply any combination of the foregoing. * * *."

(Emphasis added).

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As noted above, by erroneously paying Landwirth past-due benefits, inter alia, that the SSA had an unambiguous and nondiscretionary duty under 42 U.S.C. § 406(a) to withhold from payment to Landwirth and to pay directly to plaintiff, there resulted an overpayment of benefits to Landwirth, see 20 C.F.R. § 404.501(a)(8), which the SSA has a statutory duty under 42 U.S.C. § 404(a) to seek to recoup.[10] In other words, the Social Security Act requires defendant, not plaintiff, to seek to recoup the unauthorized overpayment of funds from the FDITF to Landwirth from Landwirth. See 42 U.S.C. § 404(b) and 20 C.F.R. § 404.502.[11]

In sum: (1) defendant had an unambiguous and nondiscretionary duty under the Social Security Act, which it failed to perform, (a) to withhold plaintiff's certified fee, which it determined to be eight thousand dollars ($8,000.00), from the past-due benefits award paid from the FDITF to Landwirth, and (b) to then pay the full certified amount directly to plaintiff and only the remainder of the award to Landwirth as past-due benefits; (2) it was defendant's overpayment to Landwirth of more than the amount of the past-due benefits award less plaintiff's certified fee, not any payment to plaintiff of its reasonable fee, that is not statutorily authorized; and (3) defendant is, therefore, required to comply with its statutory duties under the Social Security Act by: (a) paying plaintiff the difference between the amount of fees defendant

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determined to be reasonable and the amount of attorney's fees it previously paid to plaintiff, i.e., two thousand dollars ($2,000.00), from the FDITF and (b) seeking to recoup its overpayment of past-due benefits from Landwirth or waiving recoupment under the circumstances set forth in 42 U.S.C. § 404(b).[12] Therefore, so much of plaintiff's motion as seeks

summary judgment on its claim seeking, in essence, to compel defendant to perform its statutory obligation under 42 U.S.C. § 406(a)(4) to pay it the remainder of fees which it certified to be reasonable and which it failed to withhold from the past-due benefits paid to Landwirth in contravention of its statutory duty is granted and defendant is directed to comply with its statutory obligations: (a) to pay plaintiff the remaining amount of its certified legal fees, i.e., two thousand dollars ($2,000.00), pursuant to 42 U.S.C. § 406(a)(4), and (b) to seek to recoup its overpayment of past-due benefits to Landwirth from Landwirth pursuant to 42 U.S.C. § 404(a), or to waive such recoupment pursuant to 42 U.S.C. § 404(b).

F. Interest

However, plaintiff's claim for prejudgment interest is denied. "In the absence of express congressional consent to the award of interest separate from a general waiver of immunity to suit, the United States is immune from an interest award." Library of Congress v. Shaw, 478 U.S. 310, 311, 106 S. Ct. 2957, 92 L.Ed.2d 250 (1986), superceded by statute, Civil Rights Act of 1991, Pub. L. No. 102-166, 105 Stat. 1079; see also Palmieri v. Allstate Ins. Co., 445 F.3d 179,

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193 (2d Cir. 2006); Ikelionwu v. United States, 150 F.3d 233, 239 (2d Cir. 1998). "A statutory waiver of this 'no-interest rule' must be construed strictly in favor of the sovereign." Andrulonis v. United States, 26 F.3d 1224, 1231 (2d Cir. 1994); see also Shaw, 478 U.S. at 318-19, 106 S. Ct. 2957 (holding that "[t?he no-interest rule provides an added gloss of strictness upon the[] usual rules [that waivers of sovereign immunity must be construed strictly in favor of the sovereign and not be enlarged 'beyond what the language requires']."")

Since there is no indication in the Social Security Act, or otherwise, that Congress intended to waive the United States's sovereign immunity for interest on fee awards made pursuant to 42 U.S.C. § 406(a), plaintiff's claim for interest is denied.

III. CONCLUSION

So much of plaintiff's motion as seeks summary judgment on its claim seeking, in essence, to compel defendant to comply with its statutory duty under 42 U.S.C. § 406(a)(4) to, inter alia, pay the full amount of its certified attorney's fee is granted and defendant is directed to comply with its statutory duties: (a) to pay to plaintiff the amount of two thousand dollars ($2,000.00), i.e., the difference between the amount of fees defendant certified to be reasonable under 42 U.S.C. § 406(a) and the amount of fees it previously paid to plaintiff, and (b) to seek to recoup its overpayment of past-due benefits to Landwirth from Landwirth pursuant to 42 U.S.C. § 404(a) or waive such recoupment pursuant to 42 U.S.C. § 404(b), and plaintiff's motion is otherwise denied. Defendant's cross motion for summary judgment dismissing the complaint is denied. The Clerk of the Court is directed: (1) to enter judgment compelling defendant to comply with its statutory duties pursuant to 42 U.S.C. §§ 406(a)(4) and 404, respectively, by: (a)

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paying plaintiff its outstanding certified legal fee in the amount of two thousand dollars ($2,000.00) and (b) seeking to recoup its overpayment of past-due benefits from Landwirth pursuant to 42 U.S.C. § 404(a), or waiving such recoupment under 42 U.S.C. § 404(b); and (2) to close this case.

SO ORDERED.

_____

SANDRA J. FEUERSTEIN
United States District Judge

Dated: January 25, 2012
Central Islip, New York

Notes:

[1.] 42 U.S.C. § 406(a)(2)(A) provides, in relevant part, that "in the case of a claim of entitlement to past-due benefits under this subchapter, if- (i) an agreement between the claimant and another person regarding any fee to be recovered by such person to compensate such person for services with respect to the claim is presented in writing to the Commissioner of Social Security prior to the time of the Commissioner's determination regarding the claim, (ii) the fee specified in the agreement does not exceed the lesser of - (I) 25 percent of the total amount of such past-due benefits * * *, or (II) $4,000[], and (iii) the determination is favorable to the claimant, then the Commissioner of Social Security shall approve the agreement at the time of the favorable determination, and (subject to paragraph (3)) the fee specified in the agreement shall be the maximum fee. * * *

[2.] It is undisputed that the past-due benefits paid to Landwirth covered the amount of the certified legal fee.

[3.] Although 42 U.S.C. § 406(a)(3) and 20 C.F.R. § 404.1720(d), which govern the SSA's review of the amount which would otherwise be the maximum fee under Section 406(a), provide, in relevant part, that the SSA's determination of that amount shall not be "subject to further review," those provisions are inapplicable to this case because plaintiff is not seeking judicial review of the SSA's fee determination, i.e., the amount of the fee. Rather, plaintiff is seeking to compel defendant to pay the remainder of the eight thousand dollar ($8,000.00) amount that it has already determined to be a reasonable fee.

[4.] To the extent that the SSA's HALLEX is to the contrary, HALLEX is merely an internal agency guidebook which lacks the force of law and does not alter statutory duties. See. e.g. DeChirico v. Callahan, 134 F.3d 1177, 1184 (2d Cir. 1998): see also Davenport v. Astrue, 417 Fed. Appx. 544, 547 (7th Cir. Mar. 30, 2011); Lockwood v. Commissioner of Social Security Administration, 616 F.3d 1068, 1072 (9th Cir. 2010); Melvin v. Astrue, 602 F.Supp.2d 694, 704 (E.D.N.C. 2009).

[5.] The Supreme Court also noted that sixteen (16) other federal statutes contained identical provisions permitting attorney's fees to be awarded when "appropriate," Id. at 682 n. 1, 103 S. Ct. 3274, and, thus, that's its holding was equally applicable to those statutes. The Social Security Act is not one of those statutes.

[6.] 42 U.S.C. § 405(i) provides, in relevant part, that "[u]pon final decision of the Commissioner of Social Security * * * that any person is entitled to any payment or payments under [Title II of the Social Security Act], the Commissioner of Social Security shall certify to the Managing Trustee * * * the amount of such payment or payments * * * and the Managing Trustee, through the Fiscal Service of the Department of Treasury, * * * shall make payment in accordance with the certification of the Commissioner of Social Security. * * * The Managing Trustee shall not be held personally liable for any payment or payments made in accordance with a certification by the Commissioner of Social Security."

[7.] Further, 42 U.S.C. § 406(d) provides for an assessment to be imposed upon an attorney entitled to a fee under Section 406(a)(4), calculated in accordance therewith. 42 U.S.C. § 406(d)(5) provides, in relevant part, that such assessments collected by the Commissioner of Social Security shall be credited, inter alia, to the FDITF. "The assessments authorized under [Section 406(d)] shall be collected and available for obligation only to the extent and in the amount provided in advance in appropriations Acts. Amounts so appropriated are authorized to remain available until expended, for administrative expenses in carrying out [Title II of the Social Security Act] and related laws." 42 U.S.C. § 406(d)(6). Thus, the administrative expenses incurred by the SSA in performing its statutory obligations under 42 U.S.C. § 406 are payable out of the FDITF from the assessments collected pursuant to that statute.

[8.] Pursuant to the SSA's March 20, 2010 notice to Landwirth, sent after it had already paid plaintiff six thousand dollars ($6,000.00) of its legal fees, (T. 13), Landwirth received two (2) checks for past-due benefits, i.e. a check in the amount of one thousand seven hundred seventy-two dollars and seventy cents ($1,772.70) for benefits due him to December 2009 and an "additional lump sum payment" of sixty-one thousand three hundred sixty dollars and forty cents ($61,360.40). (T. 14-16). Thus, Landwirth received past-due benefits in the total amount of sixty-three thousand one hundred thirty-three dollars and ten cents ($63,133.10).

[9.] 42 U.S.C. § 404(b) provides, in relevant part, that "[i]n any case in which more than the correct

amount of payment has been made, there shall be no adjustment of payments to, or recovery by the United States from, any person who is without fault if such adjustment or recovery would defeat the purpose of this subchapter or would be against equity and good conscience. * * *." 20 C.F.R. § 404.506 provides the procedure for waiver of adjustment and recovery of any overpayment amount pursuant to 42 U.S.C. § 404(b).

[10.] Defendant does not contend that it ever determined that any adjustment or recovery of the overpayment from Landwirth would defeat the purpose of Title II of the Social Security Act or would be against equity and good conscience. See 42 U.S.C. § 404(b).

[11.] Whether or not defendant can successfully recoup the overpayment from Landwirth as a result, inter alia, of the bankruptcy discharge is not before this Court, particularly absent any indication that defendant has sought to recoup the overpayment from Landwirth to date. In any event, the Social Security Act specifically contemplates situations in which the SSA's right to recoup an overpayment of past-due benefits may be waived. See 42 U.S.C. § 404(b). Moreover, in light of this determination, it is unnecessary to consider whether any debt owed by Landwirth to plaintiff was dischargeable or, in fact, discharged in bankruptcy.

[12.] I make no determination as to whether Landwirth's debt to the SSA for the overpayment of past-due benefits was nondischargeable under Section 523 of the Bankruptcy Code or was in fact discharged in bankruptcy. That determination is for the bankruptcy court in the first instance.

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848 F.Supp.2d 230
BINDER & BINDER, P.C., Plaintiff,
v.
Michael K. ASTRUE, Commissioner of the Social Security Administration, Defendant.
No. CV–11–0467 (SJF).
United States District Court,
E.D. New York.
Jan. 25, 2012.

[848 F.Supp.2d 232]

Jeffrey Herzberg, Smithtown, NY, for Plaintiff.

Vincent Lipari, United States Attorneys Office, Central Islip, NY, for Defendant.

ORDER
FEUERSTEIN, District Judge.

Binder & Binder, P.C. ("plaintiff") commenced this action against Michael K. Astrue

[848 F.Supp.2d 233]

("defendant"), Commissioner of the Social Security Administration ("SSA"), seeking to recover attorney's fees relating to its representation of a claimant for social security disability insurance ("DI") benefits pursuant to Section 206 of the Social Security Act, 42 U.S.C. § 406. The parties now cross-move pursuant to Rule 56 of the Federal Rules of Civil Procedure for summary judgment. For the reasons set forth below, plaintiff's motion is granted in part and defendant's cross motion is denied.

I. BACKGROUND

A. Factual Background

The following facts are undisputed, unless otherwise indicated:

On or about August 9, 2007, Gordon P. Landwirth ("Landwirth") retained plaintiff to represent him with respect to his application for DI benefits and executed an agreement entitled, "Fees for Representation before the Social Security Administration" ("the Fee Agreement"). (Complaint [Compl.], ¶ 5, Ex. A). Under the Fee Agreement, inter alia, if Landwirth was successful on his claim for DI benefits:

> "at the initial stage, the reconsideration stage, or an initial administrative law judge hearing, a fee agreement will be submitted for approval to the [SSA]. Under the fee agreement, the fees shall be the lesser of: a. twenty-five percent (25%) of the past due benefits awarded to [Landwirth] * * *, OR b. the maximum amount set by the Commissioner, pursuant to Section 406(a)(2)(A). This amount is currently five thousand three hundred dollars ($5,300.00), but is subject to adjustment by the Commissioner."

(Compl., Ex. A). However, if Landwirth was successful on his claim only following a review by the Appeals Council, the Fee Agreement provided that "the fee petition system will be used," pursuant to which "the fees charged by [plaintiff] will be twenty-five percent of all past-due benefits awarded." (Id.) The Fee Agreement further provided, inter alia, that if it were invalidated by the SSA "for any reason," plaintiff "will use the fee petition method." (Id.)

By decision dated November 13, 2009, following an Appeals Council remand, Administrative Law Judge Mark Hecht ("the ALJ") found Landwirth to be disabled as of November 1, 2005 and entitled to DI benefits. (T. 1–3, 6–12). By order dated November 13, 2009, the ALJ approved the Fee Agreement, "subject to the condition that the claim results in past-due benefits." (T. 4–5).

On or about December 9, 2009, the SSA paid plaintiff a total of five thousand nine hundred seventeen dollars ($5,917.00), i.e., six thousand dollars ($6,000.00) minus a statutory assessment of eighty-three dollars ($83.00) imposed pursuant to 42 U.S.C. § 406(d), for the legal services it rendered to Landwirth during the SSA proceedings. (T. 13).

On March 20, 2010, the SSA's Office of Central Operations ("OCO") advised Landwirth, inter alia: (1) that he was awarded past-due benefits for the period between August 2006 through October 2009 in the total amount of sixty-five thousand five hundred eighty-eight dollars ($65,588.00); (2) that he would be receiving monthly benefits in the amount of one thousand six hundred sixty-two dollars ($1,662.00), as well as checks in the amount of (a) one thousand seven hundred seventy-two dollars and seventy cents ($1,772.70) for money due him through December 2009 and (b) sixty-one thousand three hundred sixty dollars and forty cents ($61,360.40) "because of an additional lump-sum payment;" (3) that the Fee Agreement between him

[848 F.Supp.2d 234]

and plaintiff had been approved by the SSA; and (4) that six thousand dollars ($6,000.00) had therefore been withheld from the past-due benefits award to pay plaintiff pursuant to the Fee Agreement and that the balance of the past-due benefits award would then be forwarded to Landwirth. (T. 14–16).

By order dated April 21, 2010, upon review of the Fee Agreement, Mark S. Sochaczewsjy ("Chief ALJ"), the Regional Chief ALJ for the SSA, invalidated the Fee Agreement on the basis that it did "not meet the statutory requirements of Sections 206(a)(2)(A) of the Social Security Act as amended by Section 5106(a) of the Omnibus Budget Reconciliation Act of 1990." [1] (T. 18). In a letter to plaintiff dated that same day, the Chief ALJ explained that:

"the two-tier fee structure set forth in the [fee] agreement is invalid * * * [because it] states that the maximum fee of $5,300.00 applies only for representation before the [SSA]. Once the case is appealed [to] the Appeals Council level, the maximum will not [sic] longer apply. * * * Since the case was not favorable [to Landwirth] prior to the that [sic] appeal, the fee agreement is invalid under Section 206(a)(2)(A)(ii) of the Social Security Act, as the requirements set forth by that statute were not satisfied." (T. 17). Plaintiff was advised that it was "entitled to request a [legal] fee through the petition process;" that "[a]ll papers must be submitted to the New York Hearing Office if [it] wish[ed] to charge and collect a fee in this case;" and that the Chief ALJ's order was not subject to further review. (T. 17).

By letter to the ALJ and petition, both dated July 8, 2010 and received by the SSA's Office of Disability Adjudication and Review ("ODAR") on July 22, 2010, plaintiff submitted a "Petition to Obtain Approval of a Fee" to the SSA, seeking a legal fee pursuant to 42 U.S.C. § 406(a) in the amount of eight thousand dollars ($8,000.00). (T. 33–41). In the letter to the ALJ, plaintiff noted, inter alia, "that 25% of the past due benefits awarded [Landwirth] * * * is $16,397.00. Although [Landwirth] agreed to pay 25%, [plaintiff] [was] reducing [its] fee to $8,000.00." (T. 33).

On July 16, 2010, Landwirth filed a voluntary petition for relief under Chapter 7 of the United States Bankruptcy Code, 11 U.S.C. § 101, et seq., in the United States Bankruptcy Court for the Southern District of New York ("the bankruptcy court"). (T. 21–29). Pursuant to the "Notice of Chapter 7 Bankruptcy Case, Meeting of Creditors, & Deadlines" ("Chapter 7 Notice") issued by the bankruptcy court, potential creditors of Landwirth were notified, inter alia, that if they "believe[d] that [Landwirth] [was] not entitled to receive a discharge under Bankruptcy Code §§ 727(a)or that a debt owed to [them] [was] not dischargeable under Bankruptcy Code §§ 523(a)(2), (4), or (6), [they] must start a lawsuit by filing a complaint in the

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bankruptcy clerk's office by [October 12, 2010].” (T. 21–22). “Schedule F–Creditors Holding Unsecured Nonpriority Claims” (“Schedule F”) designated plaintiff as a creditor of Landwirth with respect to a disputed claim in an unknown amount, but did not provide plaintiff's address. (T. 25, 27). The Certificate of Notice indicates that plaintiff was not sent a copy of the Chapter 7 Notice. (T. 29). Plaintiff alleges that it, therefore, did not receive notification of Landwirth's Chapter 7 proceeding in time to file a timely objection to Landwirth's discharge, i.e., that Landwirth's debt to plaintiff was not dischargeable under Section 523(a)(2), (4) or (6) of the Bankruptcy Code. (Compl., ¶ 11).

On July 26, 2010, the SSA's ODAR issued an “Authorization to Charge and Collect Fee,” authorizing plaintiff to charge and collect a fee in the amount of eight thousand dollars ($8,000.00) for services it provided to Landwirth in the SSA proceedings and advising plaintiff that the fee would be paid directly to it from Landwirth's past-due benefits check, but that if the check did not cover the fee, payment of the balance due was “a matter for [plaintiff] and [Landwirth] to settle.” [2] (T. 19). Plaintiff alleges that it is entitled to payment of two thousand dollars ($2,000.00) since it was only paid six thousand dollars ($6,000.00) of the eight thousand dollar ($8,000.00) legal fee certified by the SSA. (Compl., ¶ 13).

On October 26, 2010, the bankruptcy court entered a “Discharge of Debtor Order of Final Decree” (“the bankruptcy order”), releasing Landwirth from all dischargeable debts, i.e., most debts existing on the date the bankruptcy case was filed, and closing the Chapter 7 proceeding. (T. 30). On the “Explanation of Bankruptcy Discharge in a Chapter 7 Case” annexed to the bankruptcy order, it is noted that certain types of debt are generally not discharged in the case, including, inter alia, “Some debts which were not properly listed by the debtor.” (T. 31).

On December 19, 2010, the SSA's OCO advised plaintiff, pursuant to its “Hearings, Appeals and Litigation Law Manual” (“HALLEX”), that it had received plaintiff's July 8, 2010 “petition requesting a fee for the services [plaintiff] performed for * * * Landwirth,” but that since Landwirth had filed a bankruptcy petition, the SSA could not act on plaintiff's fee petition absent authorization from the bankruptcy court. (T. 32). The SSA requested plaintiff to notify it, or to have Landwirth notify it, of the outcome of the bankruptcy proceeding. (T. 32).

B. Procedural Background

On January 31, 2011, plaintiff commenced this action seeking to recover from the SSA the remaining two thousand dollars ($2,000.00) of its certified legal fee under Section 206 of the Social Security Act, 42 U.S.C. § 406(a), plus interest.

The parties cross-move pursuant to Rule 56 of the Federal Rules of Civil Procedure for summary judgment.

II. DISCUSSION

A. Standard of Review

Summary judgment should not be granted unless “the pleadings, the discovery and disclosure materials on file, and any affidavits show that there is no genuine issue as to any material fact and that the movant is entitled to judgment as a matter of law.” Fed.R.Civ.P. 56(c). In ruling on a summary

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judgment motion, the district court must first “determine whether there is a genuine dispute as to a material fact, raising an issue for trial” McCarthy v. Dun & Bradstreet Corp., 482 F.3d 184, 202 (2d Cir.2007) (internal quotations and citations omitted); see Ricci v. DeStefano, 557 U.S. 557, 129 S.Ct. 2658, 2677, 174 L.Ed.2d 490 (2009) (holding that “[o]n a motion for summary judgment, facts must be viewed in the light most favorable to the nonmoving party

only if there is a 'genuine' dispute as to those facts." (Emphasis added) (internal quotations and citation omitted)). "A fact is material if it 'might affect the outcome of the suit under governing law.' " Spinelli v. City of New York, 579 F.3d 160, 166 (2d Cir.2009) (quoting Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 248, 106 S.Ct. 2505, 91 L.Ed.2d 202 (1986)). "Where the undisputed facts reveal that there is an absence of sufficient proof as to one essential element of a claim, any factual disputes with respect to other elements become immaterial and cannot defeat a motion for summary judgment." Chandok v. Klessig, 632 F.3d 803, 812 (2d Cir.2011); see also Celotex Corp. v. Catrett, 477 U.S. 317, 322–23, 106 S.Ct. 2548, 91 L.Ed.2d 265 (1986) (holding that summary judgment is appropriate when the non-moving party has no evidentiary support for an essential element for which it bears the burden of proof).

If the district court determines that there is a genuine dispute as to a material fact, the court must then "resolve all ambiguities, and credit all factual inferences that could rationally be drawn, in favor of the party opposing summary judgment," Spinelli, 579 F.3d at 166 (internal quotations and citation omitted); see also Pucino v. Verizon Wireless Communications, Inc., 618 F.3d 112, 117 (2d Cir.2010), to determine whether there is a genuine issue for trial. See Ricci, 557 U.S. 557, 129 S.Ct. at 2677. A genuine issue exists for summary judgment purposes "where the evidence is such that a reasonable jury could decide in the non-movant's favor." Beyer v. County of Nassau, 524 F.3d 160, 163 (2d Cir.2008) (citing Guilbert v. Gardner, 480 F.3d 140, 145 (2d Cir.2007)); see also United Transp. Union v. National R.R. Passenger Corp., 588 F.3d 805, 809 (2d Cir.2009). "Where the record taken as a whole could not lead a rational trier of fact to find for the nonmoving party, there is no genuine issue for trial." Ricci, 557 U.S. 557, 129 S.Ct. at 2677 (quoting Matsushita Elec. Industrial Co., Ltd. v. Zenith Radio Corp., 475 U.S. 574, 587, 106 S.Ct. 1348, 89 L.Ed.2d 538 (1986)).

"The moving party bears the initial burden of demonstrating the absence of a genuine issue of material fact," F.D.I.C. v. Great American Ins. Co., 607 F.3d 288, 292 (2d Cir.2010) (quotations and citation omitted), after which the burden shifts to the nonmoving party to "come forward with specific evidence demonstrating the existence of a genuine dispute of material fact." Brown v. Eli Lilly & Co., 654 F.3d 347, 358 (2d Cir.2011); see also Spinelli, 579 F.3d at 166. Thus, the nonmoving party can only defeat summary judgment "by coming forward with evidence that would be sufficient, if all reasonable inferences were drawn in [its] favor, to establish the existence of" a factual question that must be resolved at trial. Spinelli, 579 F.3d at 166 (internal quotations and citations omitted); see also Celotex Corp., 477 U.S. at 323, 106 S.Ct. 2548. "The mere existence of a scintilla of evidence in support of the [non-movant's] position will be insufficient; there must be evidence on which the jury could reasonably find for the [non-movant]." Hayut v. State Univ. of N.Y., 352 F.3d 733, 743 (2d Cir.2003) (alterations in original). Moreover, the non-moving party "may not rely on conclusory allegations or unsubstantiated speculation"

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to defeat summary judgment. Brown, 654 F.3d at 358.

Since there is no dispute as to any material fact, summary judgment is appropriate in this action.

B. Statutory Duties

A request to charge a fee for time spent representing a claimant in a proceeding before the SSA is made pursuant to 42 U.S.C. § 406(a). That statute provides, in relevant part:

"(1) The Commissioner of Social Security may, by rule and regulation, prescribe the maximum fees which may be charged for services performed in connection with any claim before the Commissioner of Social Security under this subchapter, and any agreement in violation of such rules and regulations shall be void. Except as provided in paragraph (2)(A),

whenever the Commissioner of Social Security, in any claim before the Commissioner for benefits under this subchapter, makes a determination favorable to the claimant, the Commissioner shall, if the claimant was represented by an attorney in connection with such claim, fix (in accordance with the regulations prescribed pursuant to the preceding sentence) a reasonable fee to compensate such attorney for the services performed by him in connection with such claim.

* * *

(4) Subject to subsection (d) of this section, if the claimant is determined to be entitled to past-due benefits under this subchapter and the person representing the claimant is an attorney, the Commissioner of Social Security shall, notwithstanding section 405(i) of this title, certify for payment out of such past-due benefits * * * to such attorney an amount equal to so much of the maximum fee as does not exceed 25 percent of such past-due benefits * * *."

42 U.S.C. § 406(a) (emphasis added).

In accordance with 42 U.S.C. § 406(a), the Commissioner of Social Security promulgated, inter alia,20 C.F.R. § 404.1720. That regulation, in effect at the time plaintiff submitted its petition in July 2010, provided, in relevant part:

"(a) General. A representative may charge and receive a fee for his or her services as a representative only as provided in paragraph (b) of this section.

(b) Charging and receiving a fee. (1) The representative must file a written request with [the SSA] before he or she may charge or receive a fee for his or her services. (2) [The SSA] decide[s] the amount of the fee, if any, a representative may charge or receive. (3) Subject to paragraph (e) of this section, a representative must not charge or receive any fee unless [the SSA] ha[s] authorized it, and a representative must not charge or receive any fee that is more than the amount [the SSA] authorize[s]. (4) If [the] representative is an attorney * * *, and [the claimant] [is] entitled to past-due benefits, * * * [the SSA] will pay the authorized fee, or a part of the authorized fee, directly to the representative out of the past-due benefits, subject to the limitations described in § 404.1730(b)(1).* * *.

(emphasis added).

Thus, under 42 U.S.C. § 406(a) and 20 C.F.R. § 404.1720, defendant has a duty, inter alia: (1) to fix a reasonable fee to compensate plaintiff for the services performed by it in connection with Landwirth's claim for DI benefits, see42 U.S.C. § 406(a)(1); 20 C.F.R. § 404.1720(b); (2) to certify for payment out of the past-due benefits awarded to Landwirth "an amount equal to so much of the maximum fee as does not exceed 25 percent of such past-

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due benefits," 42 U.S.C. § 406(a)(4); and (3) to pay the authorized fee directly to plaintiff out of the past-due benefits award, see20 C.F.R. § 404.1720(b).

C. Basis of Jurisdiction1. 28 U.S.C. § 1331

Section 205(g) of the Social Security Act, 42 U.S.C. § 405(g), provides for judicial review of "any final decision of the Commissioner of Social Security made after a hearing * * *." However, that section is limited to judicial review of decisions involving a party to the hearing, e.g., the claimant in the social security proceeding or the SSA itself, and does not provide a basis for jurisdiction in cases, such as this, where the representative of the claimant in a social security proceeding seeks recovery of a legal fee pursuant to 42 U.S.C. § 406(a). See Binder & Binder PC v. Barnhart ("Binder II"), 481 F.3d 141, 149 (2d Cir.2007) (holding that because Binder & Binder PC, the representative of the claimant in a SSA proceeding, was not a party in the proceedings before the SSA, it cannot avail itself of section 405(g)); see also Delott v. Astrue, No. 08–CV–3952, 2011 WL

703560, at *5 (E.D.N.Y. Feb. 18, 2011) (holding that because plaintiff, the claimants' attorney, was not a party to any of the social security decisions, the Court did not have subject matter jurisdiction under 42 U.S.C. § 405(g)). Accordingly, any claim for recovery of legal fees under 42 U.S.C. § 406(a) cannot arise under 42 U.S.C. § 405(g).

Section 205(h) of the Social Security Act, 42 U.S.C. § 405(h), provides, in relevant part, that "[n]o findings of fact or decision of the Commissioner of Social Security shall be reviewed by any person, tribunal, or governmental agency except as herein provided. No action against * * * the Commissioner of Social Security * * * shall be brought under section 1331 or 1346 of Title 28 to recover on any claim arising under [42 U.S.C. § 405(g)]." (emphasis added). The Second Circuit has held that:

"[n]ormally, Section 405(h) channels all challenges that 'arise under' the Act through the proper administrative proceedings by forbidding federal suits that have not been administratively reviewed first. * * * Thus, * * *, federal question jurisdiction does not generally lie under section 28 U.S.C. § 1331 for suits brought under the Social Security Act, even if they raise constitutional questions. * * *

Judicial review is available to a plaintiff under 28 U.S.C. § 1331, however, where * * * there are no alternative means to review a federal claim arising under the Social Security Act. * * * "

Binder II, 481 F.3d at 149 (citations omitted); see also Binder & Binder PC v. Barnhart ("Binder I") 399 F.3d 128, 130–31 (2d Cir.2005) (holding that although Section 405(h) typically bars suits brought under 28 U.S.C. § 1331, judicial review is available when there is no alternative since it may be presumed "that Congress did not intend to foreclose all avenues of judicial review." (emphasis in original)). Accordingly, the Second Circuit has held that a representative seeking fees under 42 U.S.C. § 406, "may invoke federal question jurisdiction under 28 U.S.C. § 1331 because, were such jurisdiction unavailable, it would be unable to obtain any judicial review of its claims under the [Social Security] Act." Binder II, 481 F.3d at 150;see also Buchanan v. Apfel, 249 F.3d 485, 490 (6th Cir.2001) (holding that 42 U.S.C. § 405(h) does not preclude a claim by an attorney representing claimants in social security proceedings challenging the SSA's method for determining the amount of fees upon statutory or constitutional grounds because, inter alia, the attorney was not a

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party to the SSA hearings and there "is no clear and convincing evidence that Congress intended to deny a judicial forum for such a claim.")

Accordingly, this Court has jurisdiction over this matter under 28 U.S.C. § 1331.[3]

2. 28 U.S.C. § 1361

In addition, this Court has subject matter jurisdiction over this action under the mandamus statute, 28 U.S.C. § 1361. That statute provides that "[t]he district courts shall have original jurisdiction of any action in the nature of mandamus to compel an officer or employee of the United States or any agency thereof to perform a duty owed to the plaintiff."

"[M]andamus is an extraordinary remedy," Miller v. French, 530 U.S. 327, 339, 120 S.Ct. 2246, 147 L.Ed.2d 326 (2000); see S.E.C. v. Rajaratnam, 622 F.3d 159, 169 (2d Cir.2010), that may only be granted where: (1) the petitioner has no other adequate means to attain the relief sought; (2) the petitioner shows a "clear and indisputable right to the issuance of the writ," Miller, 530 U.S. at 339, 120 S.Ct. 2246 (internal quotations and citation omitted); and (3) the court, in the exercise of its discretion, determines that the writ is appropriate under the circumstances. In re City of New York, 607 F.3d 923, 932–33 (2d Cir.2010); see also Cheney v. United States District Court for District of Columbia, 542 U.S. 367, 380–81, 124 S.Ct.

2576, 159 L.Ed.2d 459 (2004). A writ of mandamus "provide[s] a remedy for a petitioner only if he has exhausted all other avenues of relief and only if the defendant owes him a clear nondiscretionary duty." Heckler v. Ringer, 466 U.S. 602, 626, 104 S.Ct. 2013, 80 L.Ed.2d 622 (1984) (citations omitted); see also Escaler v. United States Citizenship and Immigration Services, 582 F.3d 288, 292 (2d Cir.2009).

a. Nondiscretionary Duty

The Second Circuit has held that there is "no authority for the SSA to interpret and apply bankruptcy law or to enforce the orders of the Bankruptcy Court, and * * *, in the absence of such authority, the SSA's unambiguous and limited duty [is] to certify for payment to [the representative seeking a fee under 42 U.S.C. § 406] [its] reasonable fee," Binder II, 481 F.3d at 152 (emphasis added).[4] The Second Circuit also held: "The Social Security Act by its terms does not authorize the SSA to enforce discharges in bankruptcy or make any determination as to attorneys' fees other than in accordance with its statutory authority to fix the fees of claimant's attorneys and to withhold and transmit the fees so fixed. The plain language of § 406(a)(4) admits of no exceptions in this regard." Id. at 151 (emphasis added). According to the Circuit, "the SSA lack[s]

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authority to deviate from the procedure outlined in § 406(a)(4) of the [Social Security] Act." Id. at 152 n. 3.

Defendant fulfilled its duty to fix a reasonable fee under Section 406(a)(1) on July 26, 2010, when it determined plaintiff's reasonable fee to be eight thousand dollars ($8,000.00). Defendant's determination that plaintiff was entitled to a fee in the amount of eight thousand dollars ($8,000.00) was proper, notwithstanding the pendency of the bankruptcy proceeding, since it had an "unambiguous" statutory duty to fix a reasonable fee for plaintiff's services under 42 U.S.C. § 406(a)(1). See Binder II, 481 F.3d at 152. In determining plaintiff's reasonable fee, defendant recognized the amount of work completed by plaintiff and determined that plaintiff was entitled to payment for that work in the amount of eight thousand dollars ($8,000.00). See Id. at 151. "Absent a showing that the portion of the total past-due benefits to which [the plaintiff] is entitled is an unreasonable attorneys' fee, * * *, the SSA had a statutory duty under the [Social Security] Act to pay [the plaintiff] the certified fee." Id. (emphasis added). Accordingly, since there is no showing that an eight thousand dollar ($8,000.00) fee to plaintiff is unreasonable, defendant had a clear and nondiscretionary duty, with which it failed to comply without authority, to withhold the full amount of certified fees from the past-due benefits award to Landwirth and to pay that amount to plaintiff.

b. Adequate Remedy

Moreover, there is no other adequate remedy available to plaintiff to seek the remainder of its authorized legal fee. By erroneously paying Landwirth past-due benefits that the SSA had a statutory duty to withhold as payment to plaintiff for its fee under 42 U.S.C. § 406(a), there resulted an overpayment of past-due benefits to Landwirth. See20 C.F.R. § 404.501(a)(8) ("The provisions for adjustment [of an overpayment as set forth in Section 404(b)] * * * apply in cases where through error: * * * A payment of past due benefits is made to an individual and such payment had not been reduced by the amount of attorney's fees payable directly to an attorney under section 206 of the [Social Security] Act.") As set forth more fully below, 42 U.S.C. § 404(a) requires the SSA, not plaintiff, to seek to recoup any overpayment of a past-due benefits award from the claimant.

c. Appropriateness of Mandamus

Since, inter alia, defendant had an unambiguous and nondiscretionary duty under the Social Security Act, 42 U.S.C. § 406(a), to withhold from the past-due benefits awarded to Landwirth the amount of plaintiff's reasonable fee, which it determined to be eight thousand

dollars ($8,000.00), and to then pay that amount directly to plaintiff; it failed to perform that statutory duty; and there are no other adequate means by which plaintiff can obtain the remainder of the fees due it, a writ of mandamus under 28 U.S.C. § 1361, compelling defendant to pay plaintiff the remaining two thousand dollars ($2,000.00) of the certified legal fee, is appropriate.

D. Sovereign Immunity

Defendant argues, nonetheless, that the doctrine of sovereign immunity shields it from liability for paying the certified legal fee to plaintiff out of general social security funds.

"Sovereign immunity is the privilege of the sovereign not to be sued without its consent." Virginia Office for Protection and Advocacy v. Stewart, —— U.S. ——, 131 S.Ct. 1632, 1637, 179 L.Ed.2d 675 (2011). "Under settled principles of sovereign immunity, the United States, as sovereign,

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is immune from suit, save as it consents to be sued ... and the terms of its consent to be sued in any court define that court's jurisdiction to entertain the suit." United States v. Dalm, 494 U.S. 596, 609, 110 S.Ct. 1361, 108 L.Ed.2d 548 (1990) (internal quotations and citations omitted); see also Adeleke v. United States, 355 F.3d 144, 150 (2d Cir.2004) (holding that the United States "may not be sued without its consent and that the existence of consent is a prerequisite for jurisdiction." (quotations and citation omitted)). Sovereign immunity is a jurisdictional bar, see Lunney v. U.S., 319 F.3d 550, 554 (2d Cir.2003), which, absent a waiver, shields the federal government, its agencies and its officers acting in their official capacity from suits seeking monetary damages. Department of Army v. Blue Fox, Inc., 525 U.S. 255, 260, 119 S.Ct. 687, 142 L.Ed.2d 718 (1999) (quoting F.D.I.C. v. Meyer, 510 U.S. 471, 475, 114 S.Ct. 996, 127 L.Ed.2d 308 (1994)); see County of Suffolk, N.Y. v. Sebelius, 605 F.3d 135, 140 (2d Cir.2010) (holding that absent an "unequivocally expressed" statutory waiver, the United States, its agencies and its officers acting in their official capacity are immune from suit based on the principle of sovereign immunity).

Although the Second Circuit has not directly addressed the issue of whether 42 U.S.C. § 406(a) constitutes a waiver of sovereign immunity, the two (2) circuit courts that have addressed the issue have held that 42 U.S.C. § 406(a) does not constitute a waiver of sovereign immunity. See In re Handel, 570 F.3d 140 (3d Cir.2009); Pittman v. Sullivan, 911 F.2d 42, 46 (8th Cir.1990); Russell v. Sullivan, 887 F.2d 170, 172 (8th Cir.1989). In so holding, the Third Circuit rejected the suggestion that "under § 406, the federal government has a direct obligation to counsel for a Social Security claimant for the amount of any attorney's fee determination" and held that 42 U.S.C. § 406 "[d]oes not create a federal promise to pay counsel independently of the private obligation [of the claimant]," In re Handel, 570 F.3d at 144; and the Eight Circuit held, inter alia, that fee awards under Section 406 are not judicially reviewable and, therefore, the court had no authority (1) to order the Secretary of Health and Human Services to pay the authorized fee or to recoup the amount from the claimant and pay it to the claimant's representative, Pittman, 911 F.2d at 46, or (2) to order the Secretary to pay the claimant's representative the balance remaining on its fee award out of general social security funds, id.; see also Russell, 887 F.2d at 172.

Although the Second Circuit has not expressly addressed the issue, it appears from its holding in Binder II that it would not follow the holdings of the Third and Eighth Circuits. Specifically, as noted above, the Second Circuit has held, seemingly contrary to those circuit courts, that a representative seeking fees under 42 U.S.C. § 406(a) may seek judicial review under 28 U.S.C. § 1331, other than review of the amount of fees determined to be reasonable, Binder II, 481 F.3d at 150, and that the SSA has an "unambiguous and limited duty" under 42 U.S.C. § 406(a)(4) to certify a reasonable fee for payment, to withhold that amount from any past-

due benefits award and to then pay that amount directly to the representative, Id., 481 F.3d at 152; and has further indicated that the SSA "lack[s] authority to deviate from the procedure outlined in § 406(a)(4) of the [Social Security] Act," Id. at 152 n. 3. Moreover, in Binder II the Second Circuit refused to consider, and thereby implicitly rejected, the SSA's sovereign immunity defense on the basis that its "conclusion that the SSA had a duty to pay [the plaintiff] the certified fee dispel[led] the need for [it]

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to address th[at] defense." See, e.g. Binder II, 481 F.3d at 152 n. 4. Accordingly, in this Circuit, unlike the Third and Eighth Circuits, sovereign immunity does not shield the SSA from fulfilling its statutory obligation to a representative for a social security claimant, such as plaintiff, to certify a reasonable fee pursuant to 42 U.S.C. § 406(a), to withhold that amount from any past-due benefits award and then to pay that amount directly to the representative.

Although Binder II is distinguishable from this case insofar as in that case the SSA was seeking to recoup money it had already paid to the plaintiff-representative from the claimant's past-due benefits award, that factor does not extinguish or otherwise alter the SSA's "unambiguous and limited duty" under 42 U.S.C. § 406(a) to certify a reasonable fee, withhold the amount of the certified fee from any past-due benefits award and pay that amount directly to the representative, which the Second Circuit found dispelled the need for it to address the sovereign immunity defense. Accordingly, the fact that in this case the SSA has failed to perform its statutory duty to withhold the authorized legal fee from the past-due benefits award to Landwirth, and has already erroneously paid the entire amount of past-due benefits to Landwirth, does not excuse it from performing its additional unambiguous and nondiscretionary duty under the Social Security Act, 42 U.S.C. § 406(a), to pay the full amount of certified legal fees, i.e., eight thousand dollars ($8,000.00), directly to plaintiff.

Moreover, I respectfully believe that the Third Circuit's interpretation of a similar claim as seeking to impose upon the federal government "a direct obligation to counsel for a social security claimant for the amount of any attorney's fee determination," In re Handel, 570 F.3d at 144, was overly broad. Clearly, 42 U.S.C. § 406(a) does not impose upon the SSA a "direct obligation to counsel for a social security claimant" to pay the amount of any attorney's fee determination where, for example, the past-due benefits payable to the claimant are less than the amount of certified attorney's fees. In such circumstances, the SSA is clearly not liable to the claimant's representative to pay the difference from general social security funds. However, plaintiff's argument is properly construed more narrowly, i.e., that since the SSA has a statutory duty to certify a reasonable fee to plaintiff, to withhold such certified amount from the past-due benefits award to the claimant and to then pay that amount from the past-due benefits award, its failure to perform its statutory duty to withhold that amount from the past-due benefits paid to the claimant does not excuse it from its duty to pay the full amount of certified fees to the claimant's representative. Viewed in this light, a plaintiff seeking payment from the SSA of attorney's fees that have previously been certified as reasonable under 42 U.S.C. § 406(a) is seeking only to compel the SSA to perform a statutory duty under the Social Security Act which it failed to perform; it is not seeking monetary damages based upon any direct obligation on the part of the SSA to pay attorney's fees.

Moreover, although the Eighth Circuit conclusorily held that 42 U.S.C. § 406(a) cannot be construed as a waiver of sovereign immunity, Russell, 887 F.2d at 172;see also Pittman, 911 F.2d at 46 (citing Russell), it cited only the opinion of the United States District Court for the District of Delaware in Roberts v. Schweiker, 655 F.Supp. 1105 (D.Del.1987), in support of that conclusion. The Delaware district

court, in turn, relied upon the general proposition set forth by the Supreme Court in

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Ruckelshaus v. Sierra Club, 463 U.S. 680, 103 S.Ct. 3274, 77 L.Ed.2d 938 (1983), that "[i]n the absence of * * * a waiver [of sovereign immunity], the court is powerless to award attorney's fees against the United States." Roberts, 655 F.Supp. at 1110.

Ruckelshaus, however, involved an application by unsuccessful parties in an action seeking review of the promulgation of standards limiting emission of sulfur dioxide by coal-burning power plants by the Environmental Protection Agency ("EPA") for attorney's fees incurred by them pursuant to Section 307(f) of the Clean Air Act, 42 U.S.C. § 7607(f), which permits attorney's fees to be awarded when "such an award is appropriate." 463 U.S. at 682, 103 S.Ct. 3274. The issue before the Supreme Court was whether it is "appropriate" to award attorney's fees to an unsuccessful party under that statute.[5]Id. In holding that unsuccessful parties are not entitled to an award of attorney's fees under that statute, the Supreme Court held that "[e]xcept to the extent it has waived its immunity, the Government is immune from claims for attorney's fees," 463 U.S. at 685, 103 S.Ct. 3274, and that the United States had not waived its sovereign immunity from claims for attorney's fees by unsuccessful parties under that statute. Id. at 686, 103 S.Ct. 3274. That case is clearly distinguishable from the instant case because, inter alia, in that case, any award of attorney's fees was discretionary with the court, see42 U.S.C. § 7607(f) ("[t]he court may award costs of litigation (including reasonable attorney * * * fees) whenever it determines that such award is appropriate." (emphasis added)), whereas in this case, the SSA has a nondiscretionary statutory duty to determine a reasonable attorney's fees, withhold that amount from any past-due benefits award to Landwirth and then pay that amount directly to plaintiff. Moreover, as noted above, plaintiff was not a party to the SSA proceedings and, therefore, is not asserting a claim for attorney's fees relative to its success in the underlying SSA proceedings. Rather, plaintiff is merely seeking, in essence, to compel defendant to perform its statutory and nondiscretionary duties under 42 U.S.C. § 406(a).

Moreover, the Delaware district court also found that the attorney who represented the claimant during the SSA proceedings must look to the claimant, who received the entire past-due benefits award, including the certified legal fee, to recover his fee. Roberts, 655 F.Supp. at 1111. However, that holding is contrary to 42 U.S.C. § 404(a), which requires the SSA to seek the recoup any overpayment of past-due benefits from a claimant. Following the reasoning of that district court, an attorney who represented a claimant who received an overpayment of past-due benefits including the amount of the certified legal fee could seek to recover the fee from the claimant at the same time that the SSA seeks to recoup the overpayment under 42 U.S.C. § 404(a), resulting in a double reduction of the benefits received by the claimant. Such a result is contrary to the remedial and beneficent purpose of the Social Security Act. See McBrayer v. Secretary of Health & Human Services, 712 F.2d 795, 798–99 (2d Cir.1983) (recognizing that the Social Security Act is remedial in purpose); Cutler v. Weinberger, 516 F.2d 1282, 1285 (2d Cir.1975) (holding that the Social Security Act is remedial or beneficent in purpose). Accordingly, I find the Eighth Circuit's holding that sovereign

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immunity protects the SSA from claims pursuant to 42 U.S.C. § 406(a), seeking to recover legal fees that have erroneously been paid to the claimant, to be unpersuasive and contrary to both the statutory scheme and purpose of the Social Security Act.

E. Appropriations Clause

The Appropriations Clause of the United States Constitution provides: "No Money shall be drawn from the Treasury, but in Consequence of Appropriations made by Law." U.S. Const.

art. I, § 9, cl. 7. The Supreme Court has interpreted the Appropriations Clause to mean that "[m]oney may be paid out [of the federal Treasury] only through an appropriation made by law; in other words, the payment of money from the Treasury must be authorized by a statute." Office of Personnel Management v. Richmond, 496 U.S. 414, 424, 110 S.Ct. 2465, 110 L.Ed.2d 387 (1990).

Defendant contends that since the past-due benefits award has already been paid to Landwirth, the Appropriations Clause bars plaintiff's claim because payment can only be made from general Social Security funds, which is not contemplated by 42 U.S.C. § 406(a).

As previously noted, 42 U.S.C. § 406(a)(4) provides, in relevant part, that "the Commissioner of Social Security shall, notwithstanding [the SSA's duty to certify for payment and to pay DI benefits to a successful claimant pursuant to] section 405(i) of this title[[6]], certify for payment out of [any] past-due benefits [award]" a reasonable fee to an attorney representing the claimant in the social security proceeding. (Emphasis added). Pursuant to 42 U.S.C. § 401(h), DI benefits awarded to a claimant "shall be made only from the Federal Disability Insurance Trust Fund ["FDITF"] [established by 42 U.S.C. § 401(b)]." Thus, the Social Security Act expressly authorizes the payment of past-due DI benefits, from which the payment of legal fees under 42 U.S.C. § 406(a) are to be made, from the FDITF.[7]

Landwirth was awarded past-due DI benefits in the amount of sixty-five thousand five hundred eighty-eight dollars ($65,588.00) for the period between August 2006 through October 2009, as well as an additional one thousand seven hundred

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seventy-two dollars and seventy cents ($1,772.70) as payment of benefits through December 2009, for a total past-due benefits award of sixty-seven thousand three hundred sixty dollars and seventy cents ($67,360.70). 42 U.S.C. § 401(h) expressly authorized that amount to be paid from the FDITF. Pursuant to 42 U.S.C. §§ 405(i) and 406(a)(4), respectively, the SSA was required to pay Landwirth his past-due benefits and plaintiff its reasonable fee, determined by the SSA to be eight thousand dollars ($8,000.00), from the sixty-seven thousand three hundred sixty dollars and seventy cents ($67,360.70) amount drawn from the FDITF. Therefore, the SSA was only authorized to pay Landwirth past-due benefits in the amount of fifty-nine thousand three hundred sixty dollars and seventy cents ($59,360.70) from the funds drawn from the FDITF. Defendant's payment to plaintiff of sixty-three thousand one hundred thirty-three dollars and ten cents ($63,133.10) [8], thus, resulted in an overpayment of past-due benefits to Landwirth in the amount of three thousand seven hundred seventy-two dollars and forty cents ($3,772.40). It is the amount of that overpayment, not the amount of legal fees defendant was required to pay to plaintiff under 42 U.S.C. § 406(a), that was not authorized by the Social Security Act.

Furthermore, 42 U.S.C. § 404(a) requires the SSA, with certain exceptions not relevant here [9], to seek to recoup any overpayment of benefits paid to a claimant. See also20 C.F.R. § 404.502. Specifically, that statute provides, in relevant part:

"Whenever the Commissioner of Social Security finds that more * * * than the correct amount of payment has been made to any person under this subchapter, proper adjustment or recovery shall be made, under regulations prescribed by the Commissioner of Social Security, as follows: (A) * * * the Commissioner of Social Security shall decrease any payment under this subchapter to which such overpaid person is entitled, or shall require such overpaid person or his estate to refund the amount in excess of the correct amount, * * *, or shall obtain recovery by means of reduction in tax refunds based on notice to the Secretary of Treasury as permitted under section 3720A of Title 31, or shall apply any combination of the foregoing. * * *." (Emphasis added).

As noted above, by erroneously paying Landwirth past-due benefits, inter alia, that the SSA had an unambiguous and

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nondiscretionary duty under 42 U.S.C. § 406(a) to withhold from payment to Landwirth and to pay directly to plaintiff, there resulted an overpayment of benefits to Landwirth, see20 C.F.R. § 404.501(a)(8), which the SSA has a statutory duty under 42 U.S.C. § 404(a) to seek to recoup.[10] In other words, the Social Security Act requires defendant, not plaintiff, to seek to recoup the unauthorized overpayment of funds from the FDITF to Landwirth from Landwirth. See42 U.S.C. § 404(b) and 20 C.F.R. § 404.502.[11]

In sum: (1) defendant had an unambiguous and nondiscretionary duty under the Social Security Act, which it failed to perform, (a) to withhold plaintiff's certified fee, which it determined to be eight thousand dollars ($8,000.00), from the past-due benefits award paid from the FDITF to Landwirth, and (b) to then pay the full certified amount directly to plaintiff and only the remainder of the award to Landwirth as past-due benefits; (2) it was defendant's overpayment to Landwirth of more than the amount of the past-due benefits award less plaintiff's certified fee, not any payment to plaintiff of its reasonable fee, that is not statutorily authorized; and (3) defendant is, therefore, required to comply with its statutory duties under the Social Security Act by: (a) paying plaintiff the difference between the amount of fees defendant determined to be reasonable and the amount of attorney's fees it previously paid to plaintiff, i.e., two thousand dollars ($2,000.00), from the FDITF and (b) seeking to recoup its overpayment of past-due benefits from Landwirth or waiving recoupment under the circumstances set forth in 42 U.S.C. § 404(b). [12] Therefore, so much of plaintiff s motion as seeks summary judgment on its claim seeking, in essence, to compel defendant to perform its statutory obligation under 42 U.S.C. § 406(a)(4) to pay it the remainder of fees which it certified to be reasonable and which it failed to withhold from the past-due benefits paid to Landwirth in contravention of its statutory duty is granted and defendant is directed to comply with its statutory obligations: (a) to pay plaintiff the remaining amount of its certified legal fees, i.e., two thousand dollars ($2,000.00), pursuant to 42 U.S.C. § 406(a)(4), and (b) to seek to recoup its overpayment of past-due benefits to Landwirth from Landwirth pursuant to 42 U.S.C. § 404(a), or to waive such recoupment pursuant to 42 U.S.C. § 404(b).

F. Interest

However, plaintiff's claim for prejudgment interest is denied. “In the

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absence of express congressional consent to the award of interest separate from a general waiver of immunity to suit, the United States is immune from an interest award.” Library of Congress v. Shaw, 478 U.S. 310, 311, 106 S.Ct. 2957, 92 L.Ed.2d 250 (1986), superceded by statute, Civil Rights Act of 1991, Pub. L. No. 102–166, 105 Stat. 1079; see also Palmieri v. Allstate Ins. Co., 445 F.3d 179 (2d Cir.2006); Ikelionwu v. United States, 150 F.3d 233, 239 (2d Cir.1998). “A statutory waiver of this ‘no-interest rule’ must be construed strictly in favor of the sovereign.” Andrulonis v. United States, 26 F.3d 1224, 1231 (2d Cir.1994); see also Shaw, 478 U.S. at 318–19, 106 S.Ct. 2957 (holding that “[t]he no-interest rule provides an added gloss of strictness upon the[ ] usual rules [that waivers of sovereign immunity must be construed strictly in favor of the sovereign and not be enlarged ‘beyond what the language requires'].”)

Since there is no indication in the Social Security Act, or otherwise, that Congress intended to waive the United States's sovereign immunity for interest on fee awards made pursuant to 42 U.S.C. § 406(a), plaintiff's claim for interest is denied.

III. CONCLUSION

So much of plaintiff's motion as seeks summary judgment on its claim seeking, in

essence, to compel defendant to comply with its statutory duty under 42 U.S.C. § 406(a)(4) to, inter alia, pay the full amount of its certified attorney's fee is granted and defendant is directed to comply with its statutory duties: (a) to pay to plaintiff the amount of two thousand dollars ($2,000.00), i.e., the difference between the amount of fees defendant certified to be reasonable under 42 U.S.C. § 406(a) and the amount of fees it previously paid to plaintiff, and (b) to seek to recoup its overpayment of past-due benefits to Landwirth from Landwirth pursuant to 42 U.S.C. § 404(a) or waive such recoupment pursuant to 42 U.S.C. § 404(b), and plaintiff's motion is otherwise denied. Defendant's cross motion for summary judgment dismissing the complaint is denied. The Clerk of the Court is directed: (1) to enter judgment compelling defendant to comply with its statutory duties pursuant to 42 U.S.C. §§ 406(a)(4) and 404, respectively, by: (a) paying plaintiff its outstanding certified legal fee in the amount of two thousand dollars ($2,000.00) and (b) seeking to recoup its overpayment of past-due benefits from Landwirth pursuant to 42 U.S.C. § 404(a), or waiving such recoupment under 42 U.S.C. § 404(b); and (2) to close this case.

SO ORDERED.

Notes:

[1].42 U.S.C. § 406(a)(2)(A) provides, in relevant part, that "in the case of a claim of entitlement to past-due benefits under this subchapter, if (i) an agreement between the claimant and another person regarding any fee to be recovered by such person to compensate such person for services with respect to the claim is presented in writing to the Commissioner of Social Security prior to the time of the Commissioner's determination regarding the claim, (ii) the fee specified in the agreement does not exceed the lesser of—(I) 25 percent of the total amount of such past—due benefits * * *, or (II) $4,000[ ], and (iii) the determination is favorable to the claimant, then the Commissioner of Social Security shall approve the agreement at the time of the favorable determination, and (subject to paragraph (3)) the fee specified in the agreement shall be the maximum fee. * * *

[2] It is undisputed that the past-due benefits paid to Landwirth covered the amount of the certified legal fee.

[3] Although 42 U.S.C. § 406(a)(3) and 20 C.F.R. § 404.1720(d), which govern the SSA's review of the amount which would otherwise be the maximum fee under Section 406(a), provide, in relevant part, that the SSA's determination of that amount shall not be "subject to further review," those provisions are inapplicable to this case because plaintiff is not seeking judicial review of the SSA's fee determination, i.e., the amount of the fee. Rather, plaintiff is seeking to compel defendant to pay the remainder of the eight thousand dollar ($8,000.00) amount that it has already determined to be a reasonable fee.

[4] To the extent that the SSA's HALLEX is to the contrary, HALLEX is merely an internal agency guidebook which lacks the force of law and does not alter statutory duties. See, e.g. DeChirico v. Callahan, 134 F.3d 1177, 1184 (2d Cir.1998); see also Davenport v. Astrue, 417 Fed.Appx. 544, 547 (7th Cir.2011); Lockwood v. Commissioner of Social Security Administration, 616 F.3d 1068, 1072 (9th Cir.2010); Melvin v. Astrue, 602 F.Supp.2d 694, 704 (E.D.N.C.2009).

[5] The Supreme Court also noted that sixteen (16) other federal statutes contained identical provisions permitting attorney's fees to be awarded when "appropriate," Id. at 682 n. 1, 103 S.Ct. 3274, and, thus, that's its holding was equally applicable to those statutes. The Social Security Act is not one of those statutes.

[6].42 U.S.C. § 405(i) provides, in relevant part, that "[u]pon final decision of the Commissioner of Social Security * * * that any person is entitled to any payment or payments under [Title II of the Social Security Act], the

Commissioner of Social Security shall certify to the Managing Trustee * * * the amount of such payment or payments * * * and the Managing Trustee, through the Fiscal Service of the Department of Treasury, * * * shall make payment in accordance with the certification of the Commissioner of Social Security. * * * The Managing Trustee shall not be held personally liable for any payment or payments made in accordance with a certification by the Commissioner of Social Security."

[7] Further, 42 U.S.C. § 406(d) provides for an assessment to be imposed upon an attorney entitled to a fee under Section 406(a)(4), calculated in accordance therewith. 42 U.S.C. § 406(d)(5) provides, in relevant part, that such assessments collected by the Commissioner of Social Security shall be credited, inter alia, to the FDITF. "The assessments authorized under [Section 406(d)] shall be collected and available for obligation only to the extent and in the amount provided in advance in appropriations Acts. Amounts so appropriated are authorized to remain available until expended, for administrative expenses in carrying out [Title II of the Social Security Act] and related laws." 42 U.S.C. § 406(d)(6). Thus, the administrative expenses incurred by the SSA in performing its statutory obligations under 42 U.S.C. § 406 are payable out of the FDITF from the assessments collected pursuant to that statute.

[8] Pursuant to the SSA's March 20, 2010 notice to Landwirth, sent after it had already paid plaintiff six thousand dollars ($6,000.00) of its legal fees, (T. 13), Landwirth received two (2) checks for past-due benefits, i.e. a check in the amount of one thousand seven hundred seventy-two dollars and seventy cents ($1,772.70) for benefits due him to December 2009 and an "additional lump sum payment" of sixty-one thousand three hundred sixty dollars and forty cents ($61,360.40). (T. 14–16). Thus, Landwirth received past-due benefits in the total amount of sixty-three thousand one hundred thirty-three dollars and ten cents ($63,133.10).

[9].42 U.S.C. § 404(b) provides, in relevant part, that "[i]n any case in which more than the correct amount of payment has been made, there shall be no adjustment of payments to, or recovery by the United States from, any person who is without fault if such adjustment or recovery would defeat the purpose of this subchapter or would be against equity and good conscience. * * *." 20 C.F.R. § 404.506 provides the procedure for waiver of adjustment and recovery of any overpayment amount pursuant to 42 U.S.C. § 404(b).

[10] Defendant does not contend that it ever determined that any adjustment or recovery of the overpayment from Landwirth would defeat the purpose of Title II of the Social Security Act or would be against equity and good conscience. See42 U.S.C. § 404(b).

[11] Whether or not defendant can successfully recoup the overpayment from Landwirth as a result, inter alia, of the bankruptcy discharge is not before this Court, particularly absent any indication that defendant has sought to recoup the overpayment from Landwirth to date. In any event, the Social Security Act specifically contemplates situations in which the SSA's right to recoup an overpayment of past-due benefits may be waived. See42 U.S.C. § 404(b). Moreover, in light of this determination, it is unnecessary to consider whether any debt owed by Landwirth to plaintiff was dischargeable or, in fact, discharged in bankruptcy.

[12] I make no determination as to whether Landwirth's debt to the SSA for the overpayment of past-due benefits was nondischargeable under Section 523 of the Bankruptcy Code or was in fact discharged in bankruptcy. That determination is for the bankruptcy court in the first instance.