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U.S. Bankruptcy Court
District of New Jersey

UNITED STATES BANKRUPTCY COURT
DISTRICT OF NEW JERSEY

In Re: **CHECKMATE COMMUNICATIONS, LLC,** Debtor.	Case No.: 20-21872 Chapter: 11 Hearing Date: September 27, 2022 Judge: John K. Sherwood
CHECKMATE COMMUNICATIONS, LLC, Plaintiff/Counter-Defendant, vs. **FRANKOSKI CONSTRUCTION COMPANY,** Defendant/Counterclaimant.	Adv. Pro. No.: 21-01241

DECISION AND ORDER PARTIALLY GRANTING FRANKOSKI CONSTRUCTION COMPANY'S MOTION FOR SUMMARY JUDGMENT

The relief set forth on the following pages, numbered two (2) through eleven (11), is hereby **ORDERED**.

DATED: November 14, 2022

Honorable John K. Sherwood
United States Bankruptcy Court

INTRODUCTION

In this adversary proceeding, Checkmate Communications, LLC ("Debtor") seeks payment for electrical work it performed between filing its bankruptcy petition and its rejection of a subcontractor agreement ("Subcontract") with Frankoski Construction Company ("Frankoski"). The Debtor also seeks to recover retainage amounts that Frankoski withheld from the Debtor's payments. Frankoski does not dispute that it owes the Debtor money but seeks to offset the amount owed by the damages it incurred from the Debtor's rejection of the Subcontract through the defense of recoupment. Because both the money owed to the Debtor and Frankoski's rejection damages arose from the same integrated transaction, Frankoski can recoup its damages. Thus, Frankoski's motion for summary judgment will be granted in part.

JURISDICTION

This Court has jurisdiction over this adversary proceeding pursuant to 28 U.S.C. §§ 1334(b), 157(a), and the Standing Order of Reference from the United States District Court for the District of New Jersey. This matter is a core proceeding pursuant 28 U.S.C. §§ 157(b)(2)(A), (E) and (O). Venue is proper under 28 U.S.C. §§ 1408 and 1409(a).

FINDINGS OF FACT AND CONCLUSIONS OF LAW

On February 19, 2020, Frankoski and the Debtor entered into the Subcontract where Frankoski agreed to pay the Debtor $1,295,272 for electrical work and the installation of a fire alarm system for Frankoski's construction project at the Maplewood Bus Operations Control Center for New Jersey Transit. The Subcontract price was later adjusted to $1,308,745. [ECF No. 27-8, ¶¶ 1-2]. The Subcontract required the Debtor to complete the work in a "continuous and

timely fashion." [ECF No. 27-2, ¶ 4]. Pursuant to the Subcontract, Frankoski withheld retainage from the payments it made to the Debtor. Frankoski would disburse the retainage to the Debtor "upon final acceptance of the work by [New Jersey Transit]." [ECF No. 27-2, ¶ 8].

On October 21, 2020, the Debtor filed its Chapter 11 bankruptcy petition. The Debtor continued work under the Subcontract until February 24, 2021. [ECF Nos. 27-1, ¶ 9]. The Debtor rejected the executory contract with Frankoski on February 25, 2021. [ECF No. 29-3, ¶ 8]. On April 1, 2021, the Court entered an Order approving the Debtor's decision to reject the Subcontract. [ECF No. 27-8, ¶ 10].

The parties are not in complete agreement over the amount Frankoski owes the Debtor. As of February 24, 2021, the Debtor had submitted three payment applications to Frankoski which Frankoski has not paid. On January 14, Frankoski approved, but did not pay, the Debtor's application for $28,616. On February 1, Frankoski approved, but did not pay, the Debtor's application for $38,218.50. Frankoski did not approve or pay the Debtor's application for $32,650 submitted on February 22. [ECF No. 28-3, ¶¶ 8-11]. Frankoski disputes the amount of the last payment application because New Jersey Transit marked it down to $19,700. [ECF No. 30-13, ¶¶ 8-12]. As of February 24, the Debtor claims the retainage balance was $71,693.40.[1] [ECF No. 28-3, ¶ 12]. Frankoski claims the retainage balance was $70,548 at the time of rejection. [ECF No. 30-13, ¶ 12]. Additionally, there appears to be some confusion over the total amount due to the Debtor. Adding the retainage and payment applications submitted by the Debtor, Frankoski would owe the Debtor $171,177.90, which is also the amount the Debtor asks

[1] The retainage balance contains deferred compensation from Debtor's prepetition and postpetition work. [ECF No. 28-3, ¶ 12].

for in its complaint. [*See* ECF No. 1, ¶ 9]. However, in its summary judgment brief, the Debtor claims Frankoski owes $167,943.00.

Frankoski alleges it incurred at least $185,145.38 in damages due to the Debtor's rejection of the Subcontract. [ECF No. 27-1, ¶ 16]. In response to the Debtor's complaint, Frankoski filed an answer and counterclaim asserting that it is entitled to offset the money it owes the Debtor with the expenses it incurred because of the Debtor's breach of the Subcontract. Frankoski's calculation of damages is summarized in the chart below.

	Damage Amount	***Frankoski's Explanation for Damage Amount***
	$44,000.00	Damages due to the termination of the Subcontract, re-procurement of the Subcontract, and delays
	$13,994.75	Money paid to Mulvey Electric, Inc. to complete a portion of Debtor's work on an expedited basis
	$3,750.00	Claims Frankoski received from Debtor's subcontractors
	$882,070.00	Money paid to Woljchik Electric to correct Debtor's defective work and complete the project
Total Expenses which Frankoski incurred due to Debtor's rejection of the Subcontract	$943,814.75	
	$(758,669.37)	Unpaid balance of the Subcontract with Debtor at the time of rejection
TOTAL DAMAGES	$185,145.38	Difference between total sum expended by Frankoski following Debtor's rejection and the unpaid balance of the Subcontract with Debtor

[ECF No. 27-1].

On May 28, 2022, the Debtor filed a summary judgment motion, which it withdrew. [ECF No. 28-5, ¶¶ 5-6]. On August 25, after the parties engaged in discovery, Frankoski filed its

summary judgment motion. [ECF No. 27]. On September 3, the Debtor filed its cross-motion for summary judgment. [ECF No. 28].

Fed. R. Bankr. P. 7056 incorporates Fed. R. Civ. P. 56. Under Fed. R. Civ. P. 56, summary judgment should be granted "if the movant shows that there is no genuine dispute as to any material fact and the movant is entitled to judgment as a matter of law." A Court must grant summary judgment if the movant shows there is no evidence to support the non-moving party's case. *Celotex Corp. v. Catrett*, 477 U.S. 317, 325 (1986). Where the record could not lead a "rational trier of fact" to rule in favor of the nonmoving party, summary judgment is appropriate. *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 587 (1986).

After the filing of a petition, a Chapter 11 debtor-in-possession may assume or reject an executory contract any time before the confirmation of a plan. 11 U.S.C. § 365(d)(2). The purpose of this section is to give the debtor-in-possession time to determine whether the executory contract is beneficial for the business's reorganization. *In re Univ. Med. Ctr.*, 973 F.2d 1065, 1075 (3d Cir. 1992). The Bankruptcy Code is silent about the duties of the parties to an agreement during the period between the filing of a bankruptcy petition and the rejection or assumption of an executory contract. Courts hold that, during the period between the filing of a petition and the rejection or assumption of a contract, executory contracts are not enforceable against the debtor-in-possession. *See id., N.L.R.B. v. Bildisco & Bildisco*, 465 U.S. 513, 532 (1984). If a debtor-in-possession receives benefits under the terms of a contract prior to rejection, it must pay the counterparty to the executory contract for the value of the goods or services it received. *Bildisco & Bildisco*, 465 U.S. at 531-32. It is not clear what happens when the debtor-in-possession provides goods or services to the contract counterparty before the contract is

rejected, as is the case here. However, it is logical that if the debtor-in-possession has to pay for what it receives, it should also be paid for what it provides. *See U.S. on Behalf of U.S. Postal Serv. v. Dewey Freight Sys., Inc.*, 31 F.3d 620, 624 (8th Cir. 1994); *In re Monarch Cap. Corp.*, 163 B.R. 899, 907 (Bankr. D. Mass. 1994).

Generally, once a debtor-in-possession rejects an executory contract, courts will deem it breached "immediately before the date of the filing of the petition," 11 U.S.C. § 365(g)(1), and the debtor-in-possession's counterparty to the contract will have a prepetition unsecured claim for breach of contract damages. 11 U.S.C. § 502(g). Based on these bankruptcy principles, the Debtor argues it had the right to continue performing under the Subcontract and Frankoski was obligated to pay the Debtor for work completed postpetition and the entire retainage balance. Debtor contends it should be paid the amounts due in full, while Frankoski's rejection claim should be treated as an unsecured claim, as provided in 11 U.S.C. §§ 502(g) and 365(g)(1).

Debtor finds support for this argument in *Dewey Freight*. In *Dewey Freight*, the United States Postal Service contracted with a carrier for trucking services. The carrier filed for Chapter 11 bankruptcy but continued to haul mail for several months before it determined it could no longer perform under the terms of the contract. The United States Postal Service sought to recoup its rejection damages from the money it owed the carrier, but the Eighth Circuit would not allow the United States Postal Service to use the defense of recoupment. *Dewey Freight Sys., Inc.*, 31 F.3d at 625. The Court was persuaded by the United States Supreme Court's holding in *Bildisco & Bildisco* that executory contracts are enforceable by a debtor-in-possession post-petition. *Id.* And, the court noted that recoupment frustrates the purpose behind 11 U.S.C. §§ 365(g)(1) and 502(g) providing that rejection of an executory contract gives rise to a prepetition

unsecured claim against a debtor-in-possession. *Id.* Perhaps most importantly, the Eighth Circuit cited to the fundamental purposes of reorganization – to prevent liquidations, preserve jobs and prevent misuse of economic resources – and suggested that giving a debtor-in-possession reasonable time to evaluate its contracts while it could enforce them was consistent with these purposes. *Id.*

Counsel to the Debtor effectively summed up the reasoning in *Dewey Freight* and applied it to the situation here as follows:

> . . . a ruling that recoupment applies to reduce an estate's claim for post-bankruptcy services would essentially eviscerate the opportunity the bankruptcy code gives a debtor-in-possession to continue to perform and provide services under an executory contract up until the time it is either assumed or rejected. Obviously, at the time the DIP filed bankruptcy, it was unsure as to whether it made viable business sense for the estate to assume or reject the Frankoski Contract. Of course, it would be easy to predict that if the DIP rejected the Contract, Frankoski would have a rejection claim. If Frankoski is entitled to reduce its obligation by the amount of its rejection claim, then the DIP would be working on a contingency basis – it would get paid only if it assumed the Contract and not be paid if it rejected the Contract. This cannot be what is intended by the bankruptcy code.

[ECF No. 29, p. 9].

Though the Debtor's argument and the decision in *Dewey Freight* seem well-reasoned, they are inconsistent with decisions of the Third Circuit Court of Appeals which are controlling here. The recoupment doctrine is a defense available to a creditor against a debtor's claim. *Lee v. Schweiker*, 739 F.2d 870, 875 (3d Cir.1984). Recoupment allows for offsetting prepetition claims of a creditor against postpetition claims of a debtor against the creditor if those claims arose from the same transaction. *See In re Flagstaff Realty Associates*, 60 F.3d 1031, 1035 (3d Cir. 1995) (the Third Circuit allowed postpetition money owed to a debtor-landlord to be recouped against

prepetition obligations owed by the landlord); *In re Revel AC Inc.*, 909 F.3d 597, 603-04 (3d Cir. 2018) (the Third Circuit allowed a commercial tenant to offset the damages it incurred following a landlord-debtor's nonperformance under a lease against the amount it owed in rent regardless of whether the rent or recoupment amounts arose before or after the bankruptcy petition). The defense of recoupment is unaffected by the usual limitations imposed on creditors when a debtor files for bankruptcy; it is unaffected by the priority distribution scheme and serves as an exception to the automatic stay. *See In re Flagstaff Realty Associates*, 60 F.3d at 1035; *In re Revel AC Inc.*, 909 F.3d at 603; *In re McWilliams*, 384 B.R. 728, 730 (Bankr. D.N.J. 2008). Thus, it is quite clear that, in the Third Circuit, the bankruptcy estate takes property subject to the rights of recoupment.

The key requirement of recoupment is that the claims must arise from the same transaction. *In re Flagstaff Realty Associates*, 60 F.3d at 1035. The Third Circuit provided a definition of "same transaction" in *In re University Medical Center*: "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." 973 F.2d at 1081.

A bankruptcy court in *In re Clowards, Inc.*, 42 B.R. 627, 628 (Bankr. D. Idaho 1984), considered an identical situation to the case at bar. There, two contractors sought to reduce monies due to Clowards, the debtor, under several construction contracts by the damages they incurred as a result of Clowards not completing its obligations under the same contracts. *Id.* Because the claims arose from the same transaction, the bankruptcy court allowed recoupment. *Id.* Even though it was decided outside the Third Circuit, the Court finds the Idaho bankruptcy court's decision in *In re Clowards, Inc.* persuasive.

Frankoski may utilize the defense of recoupment in this case. It is undisputed that both the Debtor's and Frankoski's debts arise out of the provisions of the Subcontract. Frankoski's debt stems from the Debtor's postpetition work under the Subcontract, and Frankoski's claim against the Debtor stems from the Debtor's breach of the Subcontract. While Frankoski paid the Debtor in monthly increments, the contract price was negotiated beforehand. Any deviation by the Debtor from the agreed-upon scope of work could result in an adjustment of the contract price. Because of this, both the Debtor's and Frankoski's claim arise out of a single integrated transaction. It would be inequitable for the Debtor to continue receiving the benefit of its contract with Frankoski and then breach the contract with limited consequences, causing Frankoski to incur substantial additional costs in completing the contracted-for work. This situation is identical to the facts in *In re Clowards, Inc.* and a logical extension of the Third Circuit's reasoning in *In re Flagstaff Realty Associates* and *In re Revel AC Inc.*

The Court cannot grant summary judgment with respect to the money owed to the Debtor or Frankoski's rejection damages. With respect to the Debtor, the Court cannot grant summary judgment on the money Frankoski owes the Debtor because of factual issues regarding the Debtor's last payment application and the amount of retainage owed. But the Court finds that, based on the Subcontract, retainage is due to the Debtor upon the completion of the project and New Jersey Transit's acceptance of the work.[2]

[2] In its most recent filing, Frankoski stated it used the retainage balance to complete the project. [ECF No. 33]. The Court does not know whether or not this impacts the amount of retainage due to the Debtor. The status of the retainage balance shall be determined at trial.

As to the amount of Frankoski's rejection damages, the Court cannot grant summary judgment in the full amount requested by Frankoski because it has not sufficiently proven all the rejection damages it seeks. The United States Supreme Court held that conclusory statements from an affidavit are insufficient to grant summary judgment. *Lujan v. Nat'l Wildlife Fed'n*, 497 U.S. 871, 888 (1990). Conclusory statements must be supported by at least circumstantial evidence for a court to give them any weight in deciding a motion for summary judgment. *King v. Cape May Cnty. Board of Freeholders*, 2007 WL 2300785, *3 (D.N.J. Aug.8, 2007). With these principals in mind, the Court's calculation of damages is summarized in the chart below.

Damages Frankoski Claims it Incurred	***Frankoski's Proven Damages***	***Nature of Damages***	***Evidence for Damage Amount***
$44,000.00	Unsupported	Damages due to the termination of the Subcontract, re-procurement of the Subcontract, and Debtor's delays	Certification of Stan Frankoski, Jr. [ECF No. 27-1].
$3,750.00	Unsupported	Claims Frankoski received from Debtor's subcontractors	Certification of Stan Frankoski, Jr. [ECF No. 27-1].
$123,400.63	$123,400.63	Difference between money paid to Woljchik Electric ($882,070.00) and the unpaid balance of Subcontract at the time of Debtor's rejection ($758,669.37)	Woljchik Electric purchase order [ECF No. 30-4, Ex. C]; balance of Subcontract at rejection is undisputed. [ECF No. 29-2, ¶ 6].
$13,994.75	$13,417.25[3]	Money paid to Mulvey Electric Inc. for work in March and April 2021	Payment application. [ECF No. 30-5, Ex. D].
$185,145.38	$136,817.88	**Frankoski's Rejection Damages**	

[3] Frankoski alleges in its brief from September 23, 2022, that it also paid Mulvey Electric, Inc. fifteen percent overhead and profits in addition to its hourly rate for the work performed in April. [ECF No. 30-1]. There is nothing in Mulvey Electric, Inc.'s bills suggesting it received fifteen percent overhead and profits for its April work. [ECF No. 30-6, Ex. D]. This is the reason for the difference between $13,994.75 and $13,417.25.

Frankoski has not supplied sufficient evidence of the $44,000 damage amount. The only support for the $44,000 claim is a conclusory certification of Stan Frankoski, Jr. The $3,750 stemming from the Debtor allegedly not paying subcontractors is also only supported by Mr. Frankoski's certification. Thus, Frankoski has sufficiently proven it spent $136,817.88 to complete the Debtor's work following the Debtor's rejection of the Subcontract.

THEREFORE, IT IS ORDERED:

1. Frankoski's Motion for Summary Judgment is partially granted.
2. Frankoski can recoup its rejection damages against the amount it owes to the Debtor under the Subcontract. For the purposes of summary judgment, Frankoski has proven it spent $136,817.88 to complete the Debtor's work under the Subcontract.
3. The total amount due to the Debtor under the Subcontract and the balance of Frankoski's rejection damages are in dispute and shall be determined at trial.