United States Bankruptcy Court
Northern District of Illinois
Eastern Division

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Bankruptcy Number:	23 B 12352
Adversary Caption:	Innvantage Group, Inc. v. Millie and Severson, Inc.
Adversary Number:	24 A 222
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Judge:	David D. Cleary

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UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

In re:	)	
	)	Case No. 23 B 12352
INNVANTAGE GROUP, INC.,	)	
	)	
Debtor.	)	Chapter 11
_____	)	
	)	
INNVANTAGE GROUP, INC.,	)	
	)	Adv. No. 24 A 222
Plaintiff,	)	
	)	
v.	)	
	)	
MILLIE AND SEVERSON, INC.,	)	Judge David D. Cleary
	)	
Defendant.	)	

ORDER GRANTING IN PART AND DENYING IN PART MOTION TO COMPEL ARBITRATION

This matter comes before the court on the motion ("Arbitration Motion") of Millie and Severson, Inc. ("M&S") to compel arbitration and dismiss the complaint ("Complaint") filed by Innvantage Group, Inc. ("Debtor" or "Innvantage"). Innvantage filed a response in opposition to the Arbitration Motion ("Response") and M&S filed a reply in support of its requested relief ("Reply"). Having reviewed the papers submitted and heard the arguments of the parties, the court will grant the Arbitration Motion to the extent that it requests an order compelling arbitration to liquidate the amounts that M&S and Innvantage owe to each other. The court will deny the Arbitration Motion to the extent that it requests dismissal of the Complaint. Instead, the court will stay this adversary proceeding until the arbitration is completed. Once the arbitrator liquidates the amounts that the parties owe each other, this court will resolve the remaining claim

for relief, which is Innvantage's request that the court issue a declaratory judgment that M&S is estopped from asserting the defense of setoff.

I. JURISDICTION

The court has jurisdiction over this adversary proceeding under the district court's Internal Operating Procedure 15(a) and 28 U.S.C. § 1334(b), subject to the determination of whether the Subcontract (as defined below) removes the Complaint to an arbitral forum. The Arbitration Motion is a core proceeding under 28 U.S.C. § 157(b)(2)(A) and (O). Venue is proper under 28 U.S.C. § 1409(a).

II. BACKGROUND

On or about June 28, 2021, M&S and Innvantage entered into a subcontract agreement ("Subcontract") in connection with a construction project in Oakland, California. Severson Declaration, Ex. A. Innvantage eventually abandoned the construction project and then filed an arbitration demand upon M&S. M&S served a counterclaim against Innvantage. *Id.*, Exs. B and C.

The parties selected an arbitrator. Gropman Declaration, Ex. 1. Following a conference between the arbitrator, Innvantage and M&S on July 15, 2023, the American Arbitration Association ("AAA") set an evidentiary hearing on the arbitration for April 22-26, 2024. *Id.*, Ex. 2.

Before that evidentiary hearing could go forward, however, Innvantage filed for relief under subchapter V of chapter 11 on September 18, 2023. The U.S. Trustee appointed William B. Avellone as the subchapter V trustee ("Trustee").

On October 4, 2023, the AAA was notified of Innvantage's bankruptcy filing. Since that date the arbitration has been stayed. Gropman Declaration, Ex. 3.

About two weeks after the petition date, Debtor filed its schedules and Statement of Financial Affairs. *See* Case No. 23 B 12352, EOD 9 and 10.[1] Among other property listed on its schedules, Debtor included:

- $350,465 of accounts receivable that were 90 days old or less, in answer to Question 11 in Part 3 of Schedules A/B. Debtor stated that $101,886 were doubtful or uncollectible accounts.
- In answer to the same question, Debtor listed $592,920 of accounts receivable that were more than 90 days old. It stated that this entire amount consisted of doubtful or uncollectible accounts.
- Question 74 in Part 11 of Schedules A/B asked whether Debtor has any causes of action against third parties (whether or not a lawsuit has been filed). Debtor listed nothing, having indicated previously that it had no other assets not yet reported.
- On Schedules E/F, Debtor listed M&S as a nonpriority, unsecured creditor with a claim arising from a trade dispute that is disputed and unliquidated.

Debtor filed its subchapter V status report on November 1, 2023. EOD 22. The report includes a description of the company and its projects. According to the report, "Debtor ran into financial difficulties as result of the Covid pandemic and ultimately the expansion of its business into the State of California. The California operation resulted in substantial losses and has since been closed. However, there were/are a number of lawsuits pending related to the California operation and one from Virginia that resulted in collection proceedings in Illinois." *Id.*, ¶ 2.

Also on November 1, the court entered an order setting a bar date for non-governmental claims of November 27, 2023. Eighteen creditors filed proofs of claim; M&S did not.

[1] All further citations to docket entries are in Case No. 23 B 12352.

After working with various parties in interest, including the Trustee, the Debtor proposed its plan on January 22, 2024. EOD 34. About a month later, Debtor filed an amended plan ("Amended Plan"). EOD 37. Once creditors had voted on the Amended Plan, Debtor filed its ballot report as well as an affidavit in support of confirmation. EOD 53 and 56.

The Amended Plan includes a description of Debtor's historical business, as well as current and new contracts. Amended Plan, p. 4. In Section 4.1, Debtor described how the Amended Plan would be funded: "Payments under the Plan will be funded from income the Debtor generates in connection with its operations. Once all Claims have been paid to the extent provided herein, any and all of the Reorganized Debtor's remaining assets will be retained by the Reorganized Debtor." Amended Plan, p. 8.

According to the order setting the hearing on confirmation, objections to confirmation were due on or before May 1, 2024. EOD 48. No party, including M&S, filed an objection to confirmation. On May 22, 2024, the court confirmed the Amended Plan. EOD 61.

In Section 9.1, the Amended Plan provides that the court "shall retain and have jurisdiction over the Reorganized Debtor and the Plan" for several purposes, including:[2]

a. To enable the Reorganized Debtor to consummate the Plan and to resolve any disputes arising with respect thereto;…

d. To adjudicate all controversies concerning the classification or allowance of any Claims or Interests;…

f. To liquidate and/or defend against any Claims that are disputed, contingent, or unliquidated;…

j. To recover all assets and properties of the Debtor wherever located;…

l. To make such orders as are necessary or appropriate to carry out the provisions of the Plan;…[and]

[2] Section 9.1(g) provides that the court shall retain jurisdiction over the Reorganized Debtor and the Plan "[t]o determine any and all objections to the allowance of Claims[.]" M&S did not file a proof of claim.

o. To adjudicate and determine any adversary proceeding permitted under the Code[.]

On July 28, 2024, Debtor filed the Complaint against M&S and commenced adversary proceeding 24 A 222. EOD 68. In the prayer for relief, Debtor requested entry of a judgment in its favor and against M&S in the amount of $429,250.37. In paragraph 18 of the Complaint, Debtor requested that the court issue a declaratory judgment that M&S, who did not file a proof of claim in the underlying bankruptcy case, is estopped from asserting the defense of setoff.

About a month later, M&S filed the Arbitration Motion. M&S contends that because the Subcontract contains an arbitration clause, this court should compel arbitration of the dispute between the parties.

Paragraph 20 of the Subcontract is titled "CLAIMS RESOLUTION PROCEDURE." Paragraph 20(b) states:

> Except [as] otherwise described below, any and all disputes between Contractor [M&S] and Subcontractor [Debtor] or its subcontractors arising out of or related to this Subcontract shall be submitted to binding arbitration before the American Arbitration Association, pursuant to the Construction Industry Arbitration Rules then in effect, except that notwithstanding the amount of the dispute, there shall be a single arbitrator mutually agreeable to both parties who is an experienced construction lawyer with previous experience as an arbitrator. In addition, the arbitration shall be governed by the procedural provisions of the Federal Arbitration Act, rather than by any state arbitration procedures. Notwithstanding the foregoing arbitration provisions, in the event that either Contractor or Owner institutes an action or arbitration against the other, and either Contractor or Owner asserts a claim arising out of or related to Subcontractor's performance within that action or arbitration, the dispute resolution procedures contained in the Prime Contract between Contractor and Owner shall prevail over the arbitration provisions in this Subcontract.

M&S further contends in the Arbitration Motion that because the claims asserted against it are arbitrable, the court should dismiss the Complaint.

III. DISCUSSION

A. Demands for Arbitration in Bankruptcy Courts

M&S asserts that "[a]ll of the claims in the … Complaint are subject to mandatory and binding arbitration because they arise out of the Subcontract, and therefore come within the arbitration clause in the Subcontract." Arbitration Motion, p. 6. M&S even titled a section of its argument: "The Bankruptcy Court is Required to Compel Arbitration." *Id.*, p. 9.

In fact, this court is not required to compel arbitration. When M&S argues throughout the Arbitration Motion that "there is simply no reason to keep these claims, which do not rely on bankruptcy laws … in the bankruptcy court," it ignores the analysis in which this court must engage as a result of the tension between the Federal Arbitration Act and the Bankruptcy Code. M&S's failure to acknowledge this tension may be mere advocacy, but it undercuts the credibility of its remaining arguments.

Congress intended that the scope of a bankruptcy court's jurisdiction would be broad enough so that it could "deal efficiently and expeditiously with all matters connected with the bankruptcy estate[.]" *Celotex Corp. v. Edwards*, 514 U.S. 300, 308 (1995) (quotation omitted). As this court wrote in an earlier decision:

> The Supreme Court has guided lower courts to aid their determination of whether to enforce an agreement to arbitrate or to except such an agreement in favor of litigation. Generally, in commercial disputes, an arbitration agreement between parties must be enforced. The Federal Arbitration Act ("FAA") requires it. However, there is no national policy favoring arbitration. The federal policy is about treating arbitration contracts like all others, not about fostering arbitration.
>
> When an arbitration demand is made in a bankruptcy case, however, a conflict exists as to whether a bankruptcy court should enforce the bilateral arbitration agreement, or its *in rem* jurisdiction over the claims under the Bankruptcy Code. The court must address the two statutory schemes – the FAA and the Bankruptcy Code – and the potential conflict between them.

Johnson v. S.A.I.L. LLC (*In re Johnson*), 649 B.R. 735, 740–41 (Bankr. N.D. Ill. 2023) (quotation and citations omitted).

M&S takes an overly aggressive position in the Arbitration Motion, suggesting that arbitration is mandatory when such clauses are found in contracts between parties, even if one of those parties is a debtor in bankruptcy court. It also implies that the dispute between itself and Debtor is based only on a breach of contract predicated on state law. Yet M&S itself raises arguments in its Reply that implicate bankruptcy law issues, including its setoff rights under 11 U.S.C. § 553(a), judicial estoppel based on Debtor's failure to list a cause of action in its schedules and interpretation of the Amended Plan. Therefore, the court will engage in the required analysis in order to determine if it should enforce the agreement to arbitrate, or its *in rem* jurisdiction under the Bankruptcy Code.

B. The Court Will Enforce the Agreement to Arbitrate to the Extent the Complaint Seeks to Liquidate the Parties' Claims

The relief that Debtor seeks in the Complaint is entry of a judgment finding that M&S owes $429,250.37 to Debtor, and a declaration that M&S is estopped from asserting the defense of setoff against that amount.

"[T]he first task of a court asked to compel arbitration of a dispute is to determine whether the parties agreed to arbitrate that dispute." *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 626 (1985). In its Response, Debtor argues that there is no dispute to arbitrate because M&S did not participate in the bankruptcy case, and that it should not be compelled to arbitrate in any event. What Debtor does not argue, however, is that it did not agree to arbitration in the Subcontract. Having reviewed the applicable paragraph of the Subcontract, the court finds that M&S and Innvantage did agree that disputes between them arising from or relating to the Subcontract would be resolved by arbitration.

The next question, therefore, is whether that agreement to arbitrate should be enforced here. The Supreme Court tells us that courts must "rigorously enforce agreements to arbitrate, even if the result is 'piecemeal' litigation, at least absent a countervailing policy manifested in another federal statute." *Dean Witter Reynolds, Inc. v. Byrd*, 470 U.S. 213, 221 (1985). The burden is on the Debtor, as the party opposing arbitration, to prove "that the claims at issue are unsuitable for arbitration." *Green Tree Fin. Corp.-Ala. v. Randolph*, 531 U.S. 79, 91 (2000). "The key question, therefore, is whether there is an inherent conflict between arbitration and the underlying purposes of the Code in relation to *the particular dispute* for which a party seeks to enforce an arbitration clause." *Johnson*, 649 B.R. at 747 (emphasis added). Here, the particular disputes involve liquidation of the amounts that each party owes to the other, and whether the court should issue a declaratory judgment that M&S is estopped from asserting the defense of setoff against any amount it owes Debtor.

Debtor first argues that M&S's failure to participate in the bankruptcy case results in the loss of any right of setoff. *See U.S. v. Continental Airlines* (*In re Continental Airlines*), 134 F.3d 536, 542 (3d Cir. 1998), *as amended* (Mar. 23, 1998) ("[A]llowing the Government under the facts of this case to come forward after the plan of reorganization has been confirmed and *sua sponte* decide that it has a valid set-off without timely filing a proof of claim and asserting the set-off in the reorganization proceedings, has a probability of disrupting the plan of reorganization."). This argument may prevail when the question of setoff is presented,[3] but it does not support a finding that resolution of *its claim against M&S* is unsuitable for arbitration.

[3] Or it may not prevail. *See In re Bare*, 284 B.R. 870, 874 (Bankr. N.D. Ill. 2002) ("The clear ambit of § 553 does not lend itself to the *Continental Airlines* holding, which seizes upon the government's failure to object to the plan, to the detriment of a plain reading of the statute.").

Debtor's second argument is that the relief sought in the Complaint is a core matter because it seeks turnover of property of the estate. Yet this argument, too, quickly returns to the question of whether M&S will be allowed to exercise any right to setoff of claims. "In the event that the Court were to determine that Defendant may claim a setoff against the debt owed to the Debtor, notwithstanding the waiver of that claim, that will essentially allow the Defendant another bite at the apple via the claim it did not bring into the bankruptcy court by filing a timely proof of claim." Response, p. 8.

In this case, Debtor has already confirmed its Amended Plan. That plan does not rely on liquidation of prepetition receivables. Indeed, even in its schedules, Debtor discounted the likely recovery on those receivables. Not only has the Amended Plan been confirmed, it also has been substantially consummated. Therefore, there is no danger that allowing the arbitrator to liquidate the parties' claims against each other would conflict with the purposes of the Bankruptcy Code.

Consequently, as to this claim for relief, the court can defer to the parties' prepetition agreement. Debtor has not met its burden of proving that liquidation of its claim against M&S and of M&S's claim against Debtor is not suitable for arbitration. The court will therefore grant the Arbitration Motion to the extent that Debtor's claim against M&S, and M&S's claim against Debtor, can be liquidated through arbitration.

C. The Court Will Deny the Request to Dismiss the Adversary Proceeding, So That the Parties Can Return to Bankruptcy Court After Conclusion of the Arbitration

To the extent that M&S seeks dismissal of the Complaint, however, the court will deny the Arbitration Motion. Instead, the court will stay this adversary proceeding, pending liquidation of the parties' claims. Once Debtor's claim against M&S and M&S's claim against Debtor are liquidated, the parties can return to this court for adjudication of the remaining claim for relief under the Complaint – whether the court should issue a declaratory judgment that M&S

is estopped from asserting the defense of setoff against any amount it owes to Debtor. Although the result is that the claims for relief in the Complaint will be resolved in different forums, "relevant federal law *requires* piecemeal resolution when necessary to give effect to an arbitration agreement." *Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 20 (1983) (footnote omitted).

The remaining claim for relief in the Complaint presents questions of bankruptcy law rather than a dispute under the Subcontract. The questions of law that may be decided by this court in determining whether to issue the requested declaratory judgment could include:

--Does M&S have a right to setoff under 11 U.S.C. § 553(a)?

--Does M&S have an enforceable claim against Debtor, since it failed to file a proof of claim?

--Does M&S have a right to recoupment?

--If M&S has either a right to setoff or a right to recoupment, or both, can it exercise those rights against any liquidated amount it owes to Debtor?

-- If M&S has either a right to setoff or a right to recoupment, or both, were those rights waived because it failed to file a proof of claim?

--Does Debtor's failure to list the pending arbitration judicially estop it from collecting on any claim against M&S?

--Since Debtor did not list its claim against M&S in the Amended Plan, has that claim been preserved?

These issues are centered on core bankruptcy principles and affect the Debtor and its estate. The issues relevant to resolution of whether M&S should be estopped from asserting the defense of setoff against the Debtor are not issues that "aris[e] out of or [are] related to th[e]

Subcontract[.]" Therefore, resolution of that question is not governed by Paragraph 20(b) of the Subcontract, and arbitration is not required. The court will deny M&S's request to dismiss the Complaint, in order to retain jurisdiction over this remaining issue. Once the arbitration is concluded, the court will lift the stay on this adversary proceeding and determine whether to issue a declaratory judgment that M&S is estopped from asserting the defense of setoff against any amount it owes to Debtor.

IV. CONCLUSION

The court having engaged in the required analysis in order to determine if it should enforce the agreement to arbitrate, or its *in rem* jurisdiction under the Bankruptcy Code, **IT IS ORDERED THAT**:

1. The Arbitration Motion is **GRANTED** to the extent that the parties may return to arbitration for liquidation of their claims against each other;
2. The Arbitration Motion is **DENIED** to the extent that M&S seeks dismissal of the Complaint;
3. This adversary proceeding is stayed while the parties engage in arbitration to resolve the liquidation of their claims; and
4. Status on this adversary proceeding is set for **March 26, 2025, at 10:30 a.m.**, at which time the parties shall be prepared to advise the court regarding the arbitration schedule and when the next status hearing on this proceeding should be calendared.

ENTERED:

Date: March 4, 2025

DAVID D. CLEARY
United States Bankruptcy Judge