United States Bankruptcy Court
Western District of Wisconsin

Cite as: [Unpublished]

In re Richard L. Danner, Debtor
Bankruptcy Case No. 92-32747-7

United States Bankruptcy Court
W.D. Wisconsin

November 5, 1993

Carlyle H. Whipple, Whipple Law Offices, S.C., Madison, WI, for debtor.
Steven J. Kirschner, Ross & Stevens, S.C., Madison, WI, for Colony Court Associates.
Peter M. Gennrich, Jenswold, Studt, Hanson, Clark & Kaufmann, Madison, WI, for trustee.

Robert D. Martin, United States Bankruptcy Judge.

MEMORANDUM DECISION

Colony Court Limited Partnership ("Colony") was organized pursuant to a Limited Partnership Agreement ("the Agreement") dated October 31, 1984. The initial general partners were Richard L. Danner ("Danner"), the debtor in this case, and American Property Investments, Inc. Limited partners were added by subscription.

Prior to the syndication of Colony, Brenda Zamorski ("Zamorski") had rendered services to Danner for which she had not been paid. Danner agreed to pay Zamorski by purchasing for her four interests in Colony. Zamorski subscribed for the four limited partnership interests. Danner did not join in the subscription, but on December 5, 1984, accepted it on behalf of Colony. Zamorski was listed on Colony's books as the owner of the interests. Danner was, and because the debt remains unpaid, is the person responsible for payment of the subscription price. Colony's balance sheet, dated July 31, 1993, showed "subscriptions receivable" from Danner of $16,000, attributable to Zamorski's partnership interests.

Relief was ordered on an involuntary Chapter 7 bankruptcy petition filed against Danner on August 21, 1992. On October 20, 1992, Danner was removed as Colony's general partner. Danner's trustee seeks to exercise Danner's right under the limited partnership agreement to be paid the value of his partnership interest, which has been set at $10,000. Colony denies any liability by virtue of setting off Danner's debt of $16,000 for the Zamorski interests against the trustee's claim. The trustee argues that the setoff is impermissible in this bankruptcy.

The Bankruptcy Code recognizes and limits setoff in 11 USC §553(a) which provides in relevant part:

(a) Except as otherwise provided in this section and in sections 362 and 363 of this title, this title does not affect any right of a creditor to offset a mutual debt owing by such creditor to the debtor that arose before the commencement of the case under this title

against a claim of such creditor against the debtor that arose before the commencement of the case, except to the extent that --

(1) the claim of such creditor against the debtor is disallowed other than under section 502(b)(3) of this title;

(2) such claim was transferred, by an entity other than the debtor, to such creditor--

(A) after the commencement of the case; or

(B)(i) after 90 days before the date of filing of the petition; and

(ii) while the debtor was insolvent; or

(3) the debt owed to the debtor by such creditor was incurred by such creditor--

(A) after 90 days before the date of filing of the petition;

(B) while the debtor was insolvent; and

(C) for the purpose of obtaining a right of setoff against the debtor.

Setoff may be permitted if (1) the debts and claims are mutual, and (2) they existed pre-petition. See Matter of Lundell Farms, 86 BR 582, 584-85 (Bankr WD Wis 1988); In re Braniff Airways, Inc., 42 BR 443, 447 (Bankr ND Tex 1984).

Setoff of claims in bankruptcy is not mandatory, its allowance is within the discretion of the court. In re Express Freight Lines, Inc., 130 BR 288 (Bankr ED Wis 1991); In re Rosenbaum Grain Corp., 103 F2d 656, 658 (7th Cir 1939). The Bankruptcy Code does not create a right of setoff when no such right exists under state law. See In re Public Service Co. of New Hampshire, 884 F2d 11 (1st Cir 1989); In re Gerth, 136 BR 241 (Bankr D SD 1991). Wisconsin allows setoff of claims. In re Express Freight Lines, Inc., 130 BR 288, 290 (Bankr ED Wis 1991); Wisconsin Mut. Ins. Co. v. Manson, 24 Wis 2d 673, 678, 130 NW2d 182 (Ct App 1964); Oatman v. Batavian Bank, 77 Wis 501, 46 NW 881 (1890).

To prevail in this case, Colony must establish that (1) a debt is owed by Colony to Danner which arose prior to the commencement of the bankruptcy case; (2) a claim of Colony against Danner arose prior to the commencement of the bankruptcy case;[(1)] and (3) the debt and the claim are mutual obligations. See Matter of Lundell Farms, 86 BR 582, 584-85 (Bankr WD Wis 1988); In re Brooks Farms, 70 BR 368, 371 (Bankr ED Wis 1987) citing Matter of Fred Sanders Co., 33 BR 310 (Bankr ED Mich 1983). The initial question is when Colony's debt to Danner arose. The Agreement provides that, when a general partner is removed:

[If] the Partnership is not then dissolved, the Partnership shall, at the option of the removed General Partner (which option must be exercised by the removed General Partner within 60 days of being removed), purchase his/its entire interest in the Partnership at a price to be determined by two independent appraisers, one selected by the removed General Partner and one by the Limited Partners. In the event that such two appraisers are unable to agree on the value of the removed General Partner's interest, they shall jointly appoint a third independent appraiser whose determination shall be final and binding. The Partnership shall pay the removed General Partner for the value of his/its interest in cash or upon such other terms as are acceptable to the removed General Partner, and the removed General Partner shall be released from all guarantees and other obligations as a General Partner. The appraisers shall take into consideration in valuing the removed General Partner's interest his/its interest in Cash Flow

Distributions, Net Capital Proceeds and the tax allocations to be made to the General Partners hereunder. In the event that the removed General Partner does not elect to have his/its interest in the Partnership purchased pursuant to the foregoing, the removed General Partner shall continue to hold his/its Partnership interest as a Limited Partner.

Agreement section 7.5(f).

Colony argues that its debt arose when Danner became one of its general partners. The Agreement provides that Danner could have his interest in Colony purchased by the partnership if and when he was removed as general partner. That, Colony argues, created the obligation which it now wishes to setoff. Colony analogizes its debt under the Agreement to a note entered into pre-petition, with some payments due post-petition, and characterizes it as an "unmatured" pre-petition debt. Colony contends that Danner's post-petition removal only "matured" the debt. See In re Express Freight Lines, Inc., 130 BR 288 (Bankr ED Wis 1991).

The law of this district does not support Colony's analysis. Post-petition mortgage payments were held to be post-petition debts even if the payment obligation was incurred pre-petition in Matter of Isbell, 27 BR 926 (Bankr WD Wis 1983). Similarly, Colony's obligation to Danner is post-petition, notwithstanding the pre-petition agreement. The requirement to pay did not arise until Danner's post-petition removal. Although Isbell was distinguished in Express Freight as having been decided under the Bankruptcy Act, I am not dissuaded from the reasoning of Isbell.

Even if Express Freight reasoning is followed, Colony's debt to Danner would not have been "absolutely owing" pre-petition. See Express Freight, 130 BR at 292-93; Lundell Farms, 86 BR at 585-86. Colony's debt to Danner could only be "absolutely owing" after the occurrence of several conditions precedent.[(2)] First, Danner had to be removed. When relief was ordered, Danner retained his interest in Colony.[(3)] Second, an election was required by Danner or on his behalf to receive a payment or to continue to hold the interest as a limited partner. That election did not and, in fact, could not occur until after Danner was removed. Third, the partnership had to be solvent. If the partnership were insolvent, Danner's interest in the partnership at the time of his removal would have been appraised as having no value. If the interest is of no value, nothing is owed. Value for that purpose could only be determined at the time Danner was removed after bankruptcy.

Thus, under either suggested line of authority, Colony has failed to demonstrate that the debt it owed Danner and the claim it had against Danner enjoy temporal mutuality. Because mutuality is a statutory element required before a setoff may be permitted, Colony is required to pay the trustee the $10,000 value of Danner's interest. Colony does retain the right to file a claim for the $16,000 owed it by Danner, and the time for filing such a claim should be extended until 20 days after the order attached hereto has become final. It may be so ordered.

END NOTES:

1. The parties have stipulated that the $16,000 due for Zamorski's subscription is a pre-petition debt.

2. A condition precedent is "any fact or event, subsequent to the making of a valid contract, which must exist or occur before a right to immediate performance arises under the contract . . . . [It] calls for the performance of some act or the happening of some event after the contract is entered into, and upon the performance or happening of which its obligation is made to depend." Lundell Farms, 86 BR at 586.

3. Whether Danner retains his general partnership status or that of a limited partner depends upon the effectiveness of the Limited Partnership Agreement section 10.3 which states:

In the event of the death, (in the case of a natural person), dissolution (in the case of a corporation, trust, partnership or other business entity), insanity, withdrawal, adjudication of incompetency, or bankruptcy of a General Partner, or an assignment by any General Partner for the benefit of his creditors, the Partnership interest of the General Partner shall be converted into that of a Limited Partner and shall (whether or not the Partnership dissolves or is terminated) represent an identical interest in the Partnership's taxable income or loss, allocations and distributions he had as a General Partner under the provisions of this Agreement and this Agreement shall be amended accordingly. If the General Partner involved is not the last remaining General Partner, the Partnership will continue. If the General Partner involved is the last remaining General Partner, the Partnership shall dissolve unless all of the Limited Partners agree, in writing, to continue the Partnership. In the event all of the Limited Partners so elect to continue the Partnership, those Limited Partners holding a majority of Interests shall choose a successor General Partner (or General Partners) and the business of the Partnership shall continue. Until such time as a successor General Partner (or General Partners) has been chosen and substituted, the successor in interest to the dissolved, insane, bankrupt, incompetent, deceased, or withdrawn last remaining General Partner shall remain a General Partner. However, in the event the Limited Partners fail to choose a successor General Partner within 90 days after the occurrence of the event giving rise to the application of this section, the Partnership shall be dissolved.

Agreement section 10.3.

This section creates an automatic conversion of a general partner's interest into a limited partnership interest (with some delay if this general partner is the last remaining general partner) upon the general partner's bankruptcy filing. The effectiveness of this section depends upon whether 11 USC 365(e)(1) is applicable to this situation (whether the Limited Partnership Agreement is an executory contract) and whether an exception to 11 USC § 365(e)(1) exists in 11 USC § 365(e)(2). The parties stipulated that Danner was owed a $10,000 reimbursement.