

UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF NEBRASKA

IN THE MATTER OF)
)
MAHONEY HEATING & COOLING, INC.,) CASE NO. BK93-80762
)
DEBTOR) CH. 7

MEMORANDUM

Hearing was held on December 14, 1994, on a Motion to Compel Trustee to Abandon Property filed by the United States of America on behalf of the Small Business Administration. Appearing on behalf of the SBA was Gregg Stratman of Omaha, Nebraska. Appearing on behalf of the Trustee was Christopher Curzon of Schmid, Mooney & Frederick of Omaha, Nebraska. This memorandum contains findings of fact and conclusions of law required by Fed. Bankr. R. 7052 and Fed. R. Civ. P. 52. This is a core proceeding as defined by 28 U.S.C. § 157(b)(2)(A).

Background

The debtor, Mahoney Heating & Cooling, Inc.,¹ filed a petition for relief under Chapter 11 of the Bankruptcy Code on May 6, 1993. The debtor's case was converted to Chapter 7 on July 2, 1993. The debtor is a Nebraska corporation and was incorporated on December 12, 1987. The United States, on behalf of the Small Business Administration (the SBA), has filed a Motion for an Order Compelling Trustee to Abandon Property pursuant to 11 U.S.C. § 554 [hereinafter "SBA" shall be used to refer to the United States as the representative of the Small Business Administration as well as the Small Business Administration]. The Chapter 7 Trustee has resisted the SBA's motion.

On September 14, 1992, the SBA guaranteed a loan to the debtor in the amount of \$175,000 (the note). The note was secured by a security agreement, and a financing statement setting forth the

¹This judge is not related to, does not possess an interest in, and is not, outside of the formal bankruptcy proceedings, acquainted with the debtor, Mahoney Heating & Cooling, Inc., the debtor's President, Patrick Mahoney, or Patrick Mahoney's other corporation, Mahoney Bates Enterprises, Inc.

SBA's security interest was properly filed on August 9, 1993. The security interest granted to the SBA included all "general intangibles" of the debtor now owned or to be acquired in the future.

The sole shareholder and President of the debtor, Patrick Mahoney, and his wife, Sheila Mahoney, who acted as Secretary for the debtor, signed the security agreement in their capacities as officers of the debtor. Patrick and Sheila Mahoney filed a petition for relief under Chapter 13 of the Bankruptcy Code on August 8, 1994 (case no. BK94-81240). A Chapter 13 plan has not yet been confirmed, but an amended plan is currently pending.

By the end of the summer of 1993, the debtor defaulted on the note guaranteed by the SBA. The SBA claims that the amount due to the SBA under the note totaled \$95,022.08 as of July 12, 1994.

In the motion before the Court, the SBA is requesting that the Court require the trustee to abandon "the debtor's interest in a partnership interest of Cornerstone Limited Partnership and the proceeds therefrom." The SBA takes the position that its security interest in "general intangibles" includes the proceeds from the sale of a limited partnership interest in MII Cornerstone Limited Partnership (Cornerstone), which the SBA alleges is property of the debtor's bankruptcy estate.

The debtor did not, however, ever own or purchase a limited partnership interest in Cornerstone. Another corporation owned by Patrick Mahoney entitled Mahoney Bates Enterprises, Inc. (Bates) purchased a 4.5% interest in Cornerstone on June 4, 1991. Bates was incorporated in Nebraska on December 12, 1987. Like the debtor, Patrick Mahoney is the sole shareholder of Bates, and he and his wife Sheila are the only executive officers of Bates.

Despite the lack of a transfer or assignment of Cornerstone from Bates to the debtor, the property has been treated as part of the debtor's bankruptcy estate, and the Chapter 7 Trustee sold the limited partnership interest on October 15, 1993 for \$8,000.00, along with most of the debtors' other personal property. In the document executing the sale of the interest in Cornerstone, the trustee listed Bates as the record owner, but the trustee signed the document on behalf of the debtor as the "successor" to Bates.

The SBA takes the position that the trustee should abandon the proceeds from the sale of the partnership interest in Cornerstone to the SBA because the SBA has a first priority security interest in the limited partnership interest through its security interest in the general intangibles of the debtor.

In support of its position, the SBA argues that Patrick Mahoney, the sole shareholder and controlling officer of the debtor and Bates, considered the debtor and Bates the same corporation, but with a name change, and that the debtor was the successor corporation to Bates's assets. At the time the debtor applied for a loan guarantee from the SBA, the SBA claims that Patrick Mahoney and the debtor represented to the SBA that the limited partnership interest in Cornerstone was property of the debtor.

The Chapter 7 Trustee does not dispute the SBA's claim that the debtor and Patrick Mahoney represented to the SBA that the debtor owned the limited partnership interest in Cornerstone. However, the trustee takes the position that even though the estate has enough of an ownership interest to make the partnership interest and the proceeds therefrom part of the estate, the ownership interest is not enough to cause the SBA's security interest to attach to the proceeds.

Decision

The SBA's motion to have the proceeds from the sale of Bates's interest in the limited partnership abandoned to the SBA is denied. The proceeds from the sale are not property of the debtor's estate. The limited partnership agreement and Nebraska law prohibited Bates from assigning or transferring its interest in the limited partnership to the debtor without the consent of the general partners of Cornerstone. Not only was the consent of the general partners required to transfer the interest from Bates to the debtor, but consent would have also been required for the debtor to transfer a security interest in the limited partnership interest to the SBA. Since consent was never obtained from the general partners, no transfers or assignment of the limited partnership interest has occurred which would have caused the limited partnership interest to become property of the debtor.

Findings of Fact, Conclusions of Law and Discussion

Property of the estate is abandoned pursuant to 11 U.S.C. § 554(b), which states:

(b) On request of a party in interest and after notice and a hearing, the court may order the trustee to abandon any property of the estate that is burdensome to the estate or that is of inconsequential value and benefit to the estate.

Property of the estate includes "all legal or equitable interests of the debtor in property." 11 U.S.C. § 541. The sole

issue presented in this case is whether the limited partnership interest and the proceeds therefrom is property of the estate.

Nebraska has adopted the Uniform Limited Partnership Act to govern the law of limited partnerships. See NEB. REV. STAT. § 67-233 et. al. Assignments of partnership interests are governed by Section 67-272, which provides:

(a) Except as provided in the partnership agreement: (1) A partnership interest is assignable in whole or in part; (2) an assignment of a partnership interest does not dissolve a limited partnership or entitle the assignee to become or to exercise any rights or powers of a partner; (3) an assignment entitles the assignee to share in such profits and losses and to receive such distribution or distributions and such allocation of income, gain, loss, deduction, credit, or similar item to which the assignor would be entitled to the extent assigned; and (4) a partner ceases to be a partner and to have the power to exercise any rights or powers of a partner upon assignment of all his or her partnership interest and the admission of the assignee to the partnership in accordance with section 67-274.

NEB. REV. STAT. § 67-272(a) (Reissue 1990).²

The right of an assignee to become a limited partner is governed by Section 67-274(a), which provides:

(a) An assignee of a partnership interest, including an assignee of a general partner,

²The agreement prohibits the assignment or transfer of any of Bates's interest in the limited partnership agreement. See Subscription Agreement, ¶ 6(a), infra, at 6. The SBA and the trustee did not argue whether the granting of a security interest by the debtor to the SBA in the limited partnership agreement constitutes an "assignment" of an interest under NEB. REV. STAT. § 67-274. However, based upon the language of § 67-274 which defers to the agreement and the restriction in the agreement on "transfer" and "assignments," this Court will, for the purpose of this Memorandum, treat the grant of a security interest as the equivalent of an "assignment" or "transfer" of an interest in the property.

may become a limited partner if and to the extent that (1) the partnership agreement so provides or (2) all other partners consent. An assignee of a partnership interest becomes a limited partner at the time provided in and upon compliance with the partnership agreement or, of the partnership agreement does not so provide, when all other partners consent to such person's admission as a limited partner and such person's admission as a limited partner is reflected in the records of the limited partnership.

NEB. REV. STAT. § 67-274 (Reissue 1990).

B. Findings of Fact

Cornerstone is a Nebraska limited partnership. Under the terms of the limited partnership agreement, Bates's ownership interest or "Units" in Cornerstone is that of a limited partner, and two other entities, McGregor Realty, Inc. and LeGrande N. McGregor, are general partners. Under the agreement, Bates's authority to assign or transfer ownership "Units" was restricted by the general partners:

(h) The Units are being purchased solely for the account of [Bates] for investment and not for the account of any other person or for distribution, assignment or resale to others.

(i) [Bates] realizes that he may not be able to sell or dispose of the Units as there will be no public market for them. In addition, [Bates] understands that his right to transfer the Units will be subject to the conditions set forth in the Partnership Agreement, which includes restrictions against transfer unless the transfer is not in violation of the Act and applicable state securities laws (including investor suitability standards), and unless the General Partners consent to such transfer. [Bates] realizes that the General Partners will not consent to a transfer of any Units unless the transferee meets the financial suitability standards required of an initial subscriber or unless such conditions are waived by the General Partners, and the General Partners have the right, in their absolute discretion,

to refuse to consent to the transfer of a Unit.

Subscription Agreement: MII-Cornerstone Ltd., ¶ 2(h) & (i).

The agreement reinforces the restriction on assignments and transfers later in the document under "Miscellaneous" provisions:

(a) [Bates] agrees not to transfer or assign this agreement, or any of [Bates's] interest herein, and further agrees that the transfer or assignment of the Units acquired pursuant hereto shall be made only in accordance with the Partnership Agreement and all applicable laws.

Id., ¶ 6(a).

Bates did not transfer its interest in Cornerstone to the debtor. The Articles of Incorporation of Bates and the debtor were not amended or otherwise altered to reflect in any manner that the debtor was a continuation of Bates. There is no record of the debtor paying Bates any consideration or other remuneration to Bates for the partnership interest in Cornerstone.

While it appears that Patrick Mahoney took no action to transfer Bates's interest in Cornerstone to the debtor, Bates's partnership interest in Cornerstone was included on the debtor's bankruptcy schedules as an asset of the debtor.

LeGrande McGregor, a general partner of Cornerstone and the President of McGregor Interests, Inc., the other general partner of Cornerstone, stated in his affidavit that he was unaware of any transfer of Bates's limited partnership interest in Cornerstone to the debtor. In addition, Mr. McGregor stated that it is his belief and opinion that Bates was still the owner of Cornerstone on the date that the Chapter 7 trustee sold the limited partnership interest in Cornerstone.

At the time the SBA guaranteed debtor's loan, it had documentary evidence that Bates was either the true owner of the limited partnership interest in Cornerstone or claimed some interest in it. The SBA submitted three financial statements to the Court, two from the debtor and one from Bates, that the SBA claims it relied upon when it decided to guarantee the debtor's loan. The two from the debtor are for the twelve (12) months ended December 31, 1991 and for the six (6) months ended June 30, 1992. Both financial statements list the limited partnership interest in Cornerstone as an asset of the debtor.

However, the financial statement for Bates for the twelve (12) month period ended December 31, 1991, also lists the limited partnership interest in Cornerstone. All three financial statements were compiled and signed by a certified public accountant.

In this case, both the trustee and the SBA treated the limited partnership interest in Cornerstone as property of the debtor's estate, but in fact, the debtor never owned the limited partnership interest because ownership of the limited partnership was never transferred or assigned from Bates to the debtor. Therefore, the debtor never acquired a legal or equitable interest in the property.

The Uniform Limited Partnership Act at Section 67-272 of the Nebraska Revised Statutes, supra at 4, clearly states that the assignability of a limited partnership interest is subject to the restrictions on assignment in the partnership agreement. The general partners of Cornerstone did not consent to an assignment of Bates's interest to the debtor as required by the partnership agreement. Therefore, the debtor could not have succeeded to Bates's interest in the limited partnership without the consent of the general partners of Cornerstone.

The position of Patrick Mahoney that he intended for the debtor to succeed to the interests of Bates is not of consequence because there is no evidence that Patrick Mahoney effectively accomplished such a transfer. Patrick Mahoney took no action and executed no documents which would show that he intended or even attempted to transfer or assign Bates's assets to the debtor. Bates was never dissolved as a corporation before the debtor was incorporated, and the assets of Bates were never transferred to the debtor. Patrick Mahoney obviously knew how to incorporate and enter into partnership agreements, and he personally signed the partnership agreement on behalf of Bates and was, therefore, aware of the restriction.

Even if Patrick Mahoney did assign the interest in Cornerstone from Bates to the debtor in his capacity as a director of both corporations, no security interest could have been granted to the SBA. Not only would the general partners have been required under the partnership agreement to approve the assignment or transfer between Bates to the debtor, but also, the consent of the general partners would have been necessary to authorize the debtor to assign a security interest in the limited partnership to the SBA. In this case, the consent of the general partners was not obtained. Therefore, under Sections 67-272 and 67-274(a), supra at 4-5, of the Nebraska Revised Statutes, an assignment of the limited partnership interest in Cornerstone to the debtor would not have

automatically permitted the debtor to assign an interest to the SBA because the general partners did not consent to the debtor becoming a limited partner and did not consent to the assignment of a security interest from the debtor to the SBA.

The SBA argues that the consent requirements under the partnership agreement, and thus, Nebraska law, should be disregarded. The SBA's position is that because the SBA relied upon the representations of Patrick Mahoney and believed that the debtor owned the interest in Cornerstone, the SBA is entitled to a security interest in the limited partnership property.

The SBA's position fails because at the time of guaranteeing the note, the SBA could have discovered that Bates owned the interest in the limited partnership. Patrick Mahoney listed the interest in Cornerstone in both the debtor's and Bates's financial statements. If the SBA was actually relying on Patrick Mahoney's assertion that debtor owned the partnership interest, the fact that he listed the asset on financial statements of two different companies should have caused the SBA to investigate which entity actually owned the interest in Cornerstone. The SBA also could have reviewed the terms of the partnership documents and could have sought the general partners' consent in addition to requesting a security interest in Bates's assets.

In summary, Patrick Mahoney's conduct, whether intentional or only negligent, does not cause Bates's interest in Cornerstone to be treated as part of the debtor's estate. Patrick Mahoney's representations and SBA's reliance thereon are not relevant. Nebraska law clearly states that limited partnerships are subject to the underlying limited partnership agreement, which in this case required the general partners to consent to all transfers or assignments of interests.

While it may be beneficial to the SBA for the Court to find that the property belongs to the debtor's estate, it is not equitable to the other creditors of Patrick Mahoney or Bates. The creditors of Bates would have the first right to the proceeds, and if Bates is no longer incorporated and there are no creditors of Bates, the proceeds from the sale of the interest in Cornerstone belong to Patrick Mahoney as the sole shareholder and thus, are property of his bankruptcy estate. See NEB. REV. STAT. § 21-2091 (Reissue 1991) (under voluntary dissolution proceeding, corporate assets and property is distributed first to the creditors of the corporation, and second, to the shareholders); NEB. REV. STAT. § 21-2097 (under involuntary dissolution proceeding, assets and property is distributed by court appointed liquidating receiver to creditors and after creditors are provided for, to the shareholders of the corporation).

The SBA's motion is denied. The proceeds from the sale of the limited partnership interest are not property of the debtor's estate, and therefore, the Chapter 7 Trustee must turn the proceeds over to Bates, or if Bates has been dissolved, to the party entitled to the distribution of Bates's assets.

Separate journal entry to be filed.

DATED: February 17, 1995

BY THE COURT:

/s/ Timothy J. Mahoney
Timothy J. Mahoney
Chief Judge

Copies faxed by the Court to:

CURZON, CHRISTOPHER 493-7005
STRATMAN, GREGG 221-3680

Copies mailed by the Court to:

United States Trustee

Movant (*) is responsible for giving notice of this journal entry to all other parties (that are not listed above) if required by rule or statute.

UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF NEBRASKA

IN THE MATTER OF)	
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MAHONEY HEATING & COOLING,)	
INC.,)	CASE NO. BK93-80762
)	A
<u>DEBTOR(S)</u>)	
)	CH. 7
)	Filing No.
Plaintiff(s))	
vs.)	<u>JOURNAL ENTRY</u>
)	
)	
)	DATE: February 17, 1995
<u>Defendant(s)</u>)	HEARING DATE: December
)	14, 1994

Before a United States Bankruptcy Judge for the District of Nebraska regarding Motion to Compel Trustee to Abandon Property filed by the United States of America on behalf of the SBA.

APPEARANCES

Gregg Stratman, Attorney for SBA
Christopher Curzon, Attorney for Trustee

IT IS ORDERED:

The SBA's motion is denied. The proceeds from the sale of the limited partnership interest are not property of the debtor's estate, and therefore, the Chapter 7 Trustee must turn the proceeds over to Bates, or if Bates has been dissolved, to the party entitled to the distribution of Bates's assets. See Memorandum entered this date.

BY THE COURT:

/s/ Timothy J. Mahoney
Timothy J. Mahoney
Chief Judge

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