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IN RE Barbara J. MATTA, Debtor

No. 95-10315.

United States Bankruptcy Court. D. Vermont.

Nov. 7, 1995.

T. Taylor, Esq., Law Offices of Todd Taylor, P.C., Burlington, Vermont, for Barbara J. Matta (Debtor).

R. Obuchowski, Obuchowski & Reis, Esq., Bethel, Vermont, for R. Obuchowski, Trustee for the Estate of Barbara J. Matta (Trustee).

MEMORANDUM DECISION SUSTAINING TRUSTEE'S OBJECTION TO CLAIM OF EXEMPTION

CONRAD

***1** Before us [FN1] is Debtor's claimed exemption of an oral partnership interest to which Trustee objects. We sustain Trustee's objection because we find that Debtor's claimed interest does not fall within the purview of the applicable exemption statute, 11 VSA § 1282, and therefore cannot be exempted from the bankruptcy estate.

STATEMENT OF FACTS

Debtor filed a Chapter 7 Petition on May 2, 1995. On her Schedule C, Debtor claimed as exempt "an oral partnership, between [sic] Debtor and two other partners involving the sale of a farm." Debtor contends that each partner is a mortgagee of a farm that the partnership sold. They are to receive monthly mortgage payments until the sale price of the farm is paid in full. Debtor claims an exemption of $18,000.00 under 11 VSA § 1282 [FN2] in what she calls a "partnership interest." The purchase and sale agreement and the 1099S tax form are attached to the Petition to support her partnership interest exemption.

Trustee timely filed an objection to Debtor's claimed exemption. Trustee argues, primarily, that Debtor's interest is merely one in real estate, not an existing partnership. Alternatively, Trustee contends that if any partnership did exist, it would have been dissolved the moment Debtor filed for bankruptcy under 11 VSA § 1323(5). [FN3] Finally, Trustee argues that any mortgage payments from an existing partnership should be attachable as a partner's interest

under 11 VSA § 1283 and § 1285 [FN4] and not "specific partnership property" under 11 VSA § 1282. Debtor in response argues that the mortgagees are partners and that the partnership interest cannot be attached. The parties planted the issues. We now must consider whose horse is strong enough to plow the Exemption Field.

DISCUSSION

The first issue we must address is whether Debtor and her co-mortgagees are in fact partners. If no partnership exists, then Debtor's claimed exemption cannot stand, and Trustee will harvest Debtor's share of the mortgage proceeds for the benefit of creditors. The only evidence before us is (1) a purchase and sales contract listing Debtor and two other persons as sellers and future mortgagees and (2) Debtor's personal 1099S tax form representing her proceeds from that real estate transaction. Trustee argues that on their face, these documents establish only a real estate interest in the Debtor, not a partnership interest. While we agree with Trustee, we cannot hold that Debtor is not a partner in the claimed partnership. There is no other evidence before us either proving or disproving the existence of a partnership. In this instance, before ruling we must examine who carries the burden ofproof.

In objections to exemption hearings, the objecting party bears the burden of proof. F.R.Bank. P. Rule 4003(c). Parties objecting to a debtors' exemptions must present evidence that "rebuts the prima facie effect of the claim of exemption." In Re Lester, 141 B.R. 157, 161 (S. D.Ohio 1991); Gagne v. Bergquist, 179 B.R. 884 (D.Minn.1994), citing Lester, supra. In fact, courts may simply accept a debtors' characterizations of their claim as long as the claimed exemption could reasonably fall within an exempt category. In Re Lester, supra 141 B.R. at 162. Arguably, as the Supreme Court reminds us in Taylor v. Freeland & Kronz, 503 U.S. 638, 644, 112 S.Ct. 1644, 1648, attorneys who could be held subject to Rule 9011 sanctions will not likely claim objectively unreasonable exemptions. The .ester court, then, makes a sound argument that "[i]n most cases, without evidence to the contrary, a court may accept the Debtor's claim as reasonable without an evidentiary showing." In Re Lester, supra 141 B.R. at 163.

***2** As the facts suggest, Trustee in this case has made no affirmative showing about the existence or non-existence of a partnership. Debtor and her co-mortgagees may or may not be partners. In Vermont, jointly held property need not be in a partnership name to be considered partnership property. Willis v. Freeman, 35 Vt. 44, 45 (1861). In determining whether a partnership exists, we would have to take a more in-depth look at the monies used to purchase the property, the purpose of the property and the business of the partnership. [FN5] Id. Neither Trustee nor Debtor has provided us with information regarding the business of the partnership or lack thereof. We must presume in this instance that Debtor and her comortgagees are partners because Trustee has failed to meet his burden of proving the contrary. The foregoing discussion regarding burdens as well as the notion that exemption

provisions should be liberally construed in favor of the debtor compel this conclusion. See In Re Rule, 38 B.R. 37, 41 (Bkrtcy.D.Vt.1983).

Unthwarted by the rocky soil of partnership law, Trustee trods [FN6] on, seeking in the concept of dissolution, a blade sharp enough to reap the harvest. He argues that Debtor's exemption still must fail because even if a partnership once existed it would have been dissolved at the time Debtor filed for bankruptcy. Trustee cites 11 VSA § 1323(5). The partnership having been dissolved, Trustee argues, Debtor's mortgage receipts are fully attachable.

Once again, Trustee finds his encounter with Vermont's infamous rocky till unsuccessful. Although the Vermont statute is quite straightforward, there is considerable case law that finds this type of state statute to be preempted by bankruptcy law and policy. See, e.g., In Re Corky Foods Corp., 85 B.R. 903, 904 (Bkrtcy.S.D.Fla.1988); In Re Clinton Court, 160 B.R. 57, 60 (Bkrtcy.E.D.Pa.1993); In Re Rittenhouse Carpet, Inc., 56 B.R. 131, 133 (Bkrtcy.E.D. Pa.1985). The cases above all found that partnerships were executory contracts which, under 11 USC § 365(e)(1) [FN7], cannot be modified or dissolved solely because of a provision of nonbankruptcy law that calls for modification or dissolution of a partnership upon the filing of a bankruptcy petition. Rittenhouse, supra 56 B.R. at 131-2 2; Corky Foods, supra 85 B.R. at 904; Clinton Court, supra 160 B.R. at 59-60.

We agree with the ultimate disposition of the above cases, but not the rationale upon which they rely because we find that they made an unnecessary exploration into the executory nature of partnership contracts. Indeed, some courts have allowed partnerships to be dissolved upon a bankruptcy filing after making a factual finding that the partnership contracts were not in fact executory. See, e.g., In Re Phillips, 966 F.2d 926, 935 (5th Cir.1992); In Re Smith, 185 B.R. 285, 294 (Bkrtcy.S.D.Ill.1995). We hold that the Code's generic prohibition against ipso facto clauses, § 541(c)(1), controls here. Section 541(c)(1) reads:

***3** ... [A]n interest of the debtor in property becomes property of the estate ... notwithstanding any provision in any agreement, transfer instrument, or applicable nonbankruptcy law--... (B) that is conditioned on the insolvency or financial condition of the debtor, the commencement of a case under this title or on the appointment of or taking possession by a trustee in a case under this title ... that effects or gives an option to effect a forfeiture, modification, or termination of the debtor's interest in the property.

By enacting this section, Congress intended that all interests of the debtor at the time of filing be brought into the bankruptcy estate, including, but not limited to, executory contracts. Summit Investment and Development Corp. v. LeRoux, 1995 WL 447800, *10 (D.Mass.), citing H.R.Rep. No. 95-595, 95th Cong., 1st Sess. at 369 (1972), U.S.Code Cong. & Admin. News 1978, pp. 5787, 6325 and See, Cohen v. Drexel Burnham Lambert Group, Inc., 138 B.

R. 687, 702 (Bkrtcy.S.D.N.Y.1992) (holding that executory contracts are part of the bankruptcy estate) [FN8]. These interests encompass, for example, a partner's right to manage a partnership. Summit Investment, supra at *10. Thus, § 541(c)(1) preempts a state's ability to divest a debtor of any property rights solely by reason of a debtor's filing of a bankruptcy petition. To illustrate, a state cannot take away a debtor's right to conduct business in a partnership simply because he or she sought relief from a bankruptcy court. Any such forfeiture would fly directly in the face of the policies and commands of the Bankruptcy Code. Accordingly, presuming that Debtor was a partner at the time of filing, Debtor is still a partner today, despite 11 VSA § 1323(5).

Steadfast, despite two broken blades, Trustee plows onward, finding at last a blade sharp enough to harvest the field. We found earlier that by default a partnership exists and that it has not been dissolved. Following our findings to a logical conclusion, Debtor's interest in the partnership is attachable under 11 VSA § 1285. The interest is not in itself "specific partnership property."

The purpose of 11 VSA § 1282 and other similar statutes which prohibit execution upon specific partnership assets is to prevent disruption of partnership business. Myrick v. Second National Bank of Clearwater, 335 So.2d 343, 345 (Fla.App.D2 1976). Disruption of partnership affairs would also disturb the priority that creditors of a partnership have with regard to satisfaction of debts from partnership property over creditors of individuals. Willis v. Freeman, 35 Vt. 44, 46 (1861). Rather than attaching or selling a piece of property owned by all, thereby destroying the business of the partnership, 11 VSA § 1285 permits the execution upon an individual partner's interest in the partnership. An "interest" is defined as a partner's share in surplus and profits. 11 VSA § 1283. Defining "interest" separately ensures that partnership debts are satisfied before an individual creditor can attach.

***4** In the case before us and specifically on its limited facts, we find that the farm mortgage is "specific partnership property." It belongs to the partnership. Debtor's percentage share of the mortgage,however, is entirely separate from the mortgage or farm itself. It is a partnership interest. It would be fully alienable at a judicial sale. See 11 VSA § 1285(b) and Bohonus v. Amerco, 602 P.2d 469, 470 (Ariz.1979). Also, Debtor's right to monthly mortgage payments is, as she called it, a "partnership interest." At the very least, outside of bankruptcy, a receiver could be appointed for Debtor's $300.00 per month payments under 11 VSA § 1285(a). These payments were listed on Debtor's Schedule I as personal income. They are surplus or profits from the partnership, having already passed through the affairs of the partnership and accrued to her personally.

CONCLUSION

We sustain Trustee's objection to Debtor's claim of exemption because her partnership interest, if any, is attachable under 11 VSA § 1285(a). Trustee is to submit a settled order

within ten (10) days.

FN1. Our subject matter jurisdiction over this controversy arises under 28 USC § 1334 (b) and the General Reference to the Court under Part V of the Local District Court Rules for the District of Vermont. This is a core matter under 28 USC § 157(b)(2)(A). This Memorandum of Decision constitutes findings of fact and conclusions of law under F.R.Civ.P. 52, as made applicable by Fed.R.Bkrtcy.P. Rule 7052.

FN2. 11 VSA § 1282(a)(3) reads in part:

A partner's right in specific partnership property is not subject to attachment or execution, except on a claim against the partnership.

FN3. 11 VSA § 1323(5) calls for dissolution of a partnership when any one partner or the partnership becomes bankrupt.

FN4. 11 VSA § 1283 describes a "partner's interest" as personal property which amounts to a share in profits and surplus from the partnership. 11 VSA § 1285 allows a court to charge the interest of a partner to satisfy creditors' claims and appoint a receiver of a partner's share in profits or any other money due from the partnership.

FN5. The individual tax form is not determinative. The Internal Revenue Service allows individuals in some rental partnership situations to file a Schedule "E" Form 1040 rather than a partnership information return.

FN6. We realize that this use of "trod" is obsolete, but we use it currently with fondness.

FN7. Section 365(e)(1) provides as follows:

Notwithstanding a provision in an executory contract or unexpired lease, or in applicable law, an executory contract or unexpired lease of the debtor may not be terminated or modified, and any right or obligation under such contract or lease may not be terminated or modified, at any time after the commencement of the case solely because of a provision in such contract or lease that is conditioned on ... (B) the commencement of a case under this title ...

FN8. See, Cohen v. Drexel Burnham Lambert Group, Inc., 138 B.R. 687, 700-702 (Bkrtcy S.D.N.Y.1992) for an explanation of Professor Andrew's view that executory contracts are not part of the bankruptcy estate until assumed, a view we did not adopt in Cohen and reject today.

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