

UNITED STATES BANKRUPTCY COURT
DISTRICT OF MINNESOTA
THIRD DIVISION

In re:

HEAVY DUTY AIR, INC.,

Debtor.

MICHAEL J. IANNACONE, Trustee,

BKY 3-91-4952

Plaintiff,

ADV 3-92-227

v.

BALDWIN FILTERS, INC.,

ORDER GRANTING MOTION OF
DEFENDANT/
THIRD-PARTY PLAINTIFF

Defendant, Counterclaim
Plaintiff and Third-Party
Plaintiff,

FOR SUMMARY JUDGMENT

v.

MICHAEL J. IANNACONE, Trustee,

Counterclaim Defendant,

ROY F. WESTON, INC., CONSOLIDATED
FREIGHTWAYS, LAKEVIEW INDUSTRIES,
FARR COMPANY, INDUSTRIAL GASKET
COMPANY, JENNER & BLOCK MOTORWAYS,
NELSON DIVISION, PORTLAND PLASTICS
COMPANY, ROADWAY EXPRESS, INC.,
SAFETY-KLEEN CORPORATION, T.C. SERVICES,
INC., and TPL ASSOCIATES, INC.,

Third-Party Defendants.

At St. Paul, Minnesota, this ____ day of February, 1994.
This adversary proceeding came on before the Court on
September 1, 1993, for hearing on the motion of the Defendant
and Third-Party Plaintiff ("Baldwin Filters") for summary
judgment. Baldwin Filters appeared by its attorney, Barbara
Saunders Lutter. The Plaintiff appeared pro se. Third-Party
Defendant Lakeview Industries ("Lakeview") appeared by its
attorney, Thomas G. Wallrich. Third-Party Defendant
Consolidated Freightways ("Consolidated") appeared by its

attorney, Pattye S. Hechter. Hollingsworth & Bose, a party in interest to the underlying bankruptcy case, appeared by its attorney, Kim A. Anderson. Upon the moving and responsive documents and the arguments of counsel, the Court makes the following order.

FINDINGS OF FACT

This adversary proceeding, and the underlying bankruptcy case, are the products of a bulk transfer that did not quite play its way out to the desired conclusion. Prior to May, 1991, the Debtor was a Minnesota business concern that was engaged in the manufacture and sale of air filters and other industrial equipment in Shakopee, Minnesota. In that month, the Debtor sold substantially all of its operating assets, including saleable inventory, to Baldwin Filters, a Delaware corporation that has its principal place of business in Kearney, Nebraska. Both parties to the sale were represented by counsel.

As the date for the sale approached, the Debtor was carrying a significant number of outstanding accounts payable. The Debtor and Baldwin Filters undertook to comply with the requirements of the law then applicable to a transaction with the characteristics presented--Article 6 of the Minnesota enactment of the Uniform Commercial Code, known as the "Bulk Transfer Act."(1)

As the first step in this process, on or about May 8, 1991, the Debtor furnished Baldwin Filters with the affidavit of Weir Beckon, the Debtor's President. In the affidavit, Beckon presented an extensive list of creditors in an attached exhibit, recited that the exhibit was a true list of all of the existing creditors of the Debtor as of April 30, 1991, and recited the amounts owed to those creditors.

On the same date, counsel for Baldwin Filters mailed a Notice of Bulk Transfer to all of the creditors listed in the exhibit to Beckon's affidavit, by certified mail, with return receipt requested. In it, Baldwin Filters notified the recipients of the fact that it intended to buy most of the Debtor's operating assets at a sale scheduled for May 20, 1991, and recited the following details:

- (1) The current and past business addresses of the Debtor, and the current address of Baldwin Filters.
- (2) Baldwin Filters was in doubt as to whether the Debtor's debts were to be paid in full as they became due, because the sale would deprive the Debtor of "most of [its] operating assets."
- (3) The Debtor estimated that the total of its outstanding debts, including claims covered by insurance, was \$2,132,671.00.
- (4) Baldwin Filters estimated that its purchase price for the assets would be \$2,000,000.00, subject to adjustment for inventory actually on hand at closing.
- (5) Baldwin Filters believed that, of the price, all but \$200,000.00 was to be paid in cash at closing, and that it was to execute a non-negotiable promissory note for the \$200,000.00 to the Debtor.
- (6) Under the sale agreement between the Debtor and

Baldwin Filters, approximately \$1,306,524.00 of the cash payment was to be disbursed to three of the Debtor's secured creditors at closing, in order to obtain releases of their security interests against the subject assets.

(7) Baldwin Filters was to then hold the balance of the consideration for application to the claims of creditors, pursuant to former Minn. Stat. Section 336.6-106.

(8) The process by which the Debtor's creditors could make a claim and receive payment from the remaining sale proceeds was described as:

(a) Creditors shown on an attached list (identical to that attached to Beckon's prior affidavit) were to file a written claim form with Baldwin Filters no later than June 7, 1991.

(b) After the expiration of that deadline, Baldwin Filters was to distribute the remaining sale proceeds to all creditors filing claim forms. This distribution was to be on a pro rata basis if the funds were not sufficient to pay all such claims in their final determined amount.

(c) If the Debtor disputed any timely-asserted claim, Baldwin Filters was authorized to withhold distribution to that creditor "until the dispute [was] settled with [the Debtor] or adjudicated."

(d) If it became necessary to make a pro rata distribution and a dispute existed as to the amount of any creditor's claim, Baldwin Filters was not to make distribution to other creditors until the dispute was resolved.

(9) The Debtor was to continue to collect its outstanding accounts receivable, which it estimated would be in the amount of \$1,071,000.00 after closing, and was to apply all amounts so collected "in an effort to avoid the need for a pro rata distribution of sale proceeds by" Baldwin Filters.

The sale from the Debtor to Baldwin Filters closed as scheduled. By a letter dated May 24, 1991, counsel for Baldwin Filters notified all of the creditors identified in Beckon's affidavit that the sale had closed. Counsel summarized the current financial results of the sale, under which Baldwin was holding approximately \$517,000.00 in sale proceeds, subject to adjustment based on post-sale inventory valuations. Finally, counsel advised that Baldwin Filters would have to make a pro rata distribution, since the Debtor's list of creditors "showed amounts owing to unsecured creditors, including certain claims covered by insurance, totalling approximately \$826,000.00." With the letter, counsel furnished creditors with a form for a "Creditor's Proof of Claim," and notified them of the June 7, 1991 deadline to file such proofs. Counsel also stated that "[a]ll claims will be reviewed with [the Debtor]"; that, if the

Debtor disputed the amount of a creditor's claim, Baldwin Filters intended to make a pro rata distribution "based upon that part of [such creditor's] claim not disputed by" the Debtor, and advised such creditors that it would "be necessary for you and [the Debtor] to resolve any such dispute" before the creditor could receive any additional distribution.

As ultimately adjusted, the net sale proceeds totalled \$549,723.60. The total of the claims asserted on proofs filed with Baldwin Filters was \$955,796.88. Baldwin Filters then prepared to make a distribution to creditors on the basis of the ratio between the assets on hand and the total of the claims, 59.1443 percent.

The Debtor objected in whole or in part to the claims of 56 creditors. On or about July 9, 1991, Baldwin Filters made a partial distribution of the net sale proceeds, based upon the claims that the Debtor did not dispute and the undisputed portion of those claims that the Debtor disputed in part. It withheld a total of \$51,560.40, (2) pending the resolution of the disputes between the Debtors and the creditors holding disputed claims.

The Debtor apparently was unable to resolve the claim disputes in a fashion that would have enabled a completed distribution under the Bulk Transfer Act. On September 11, 1991, it filed a voluntary petition for relief under Chapter 7.

The Plaintiff was appointed as the trustee of the Debtor's bankruptcy estate. On August 14, 1992, he filed the complaint in this adversary proceeding. In it, he sought a judgment pursuant to 11 U.S.C. Section 542(3), requiring Baldwin Filters to turn over the \$51,560.40 in remaining sale proceeds to him for his administration.

In its answer, Baldwin Filters denied the Trustee's right to turnover, asserting as an affirmative defense that [c]ertain creditors of the Debtor may have rights and interests in the \$51,560.40 fund held by Baldwin [Filters] which may be superior to the claim asserted by the [Plaintiff]. [Baldwin Filters's] compliance with the [Plaintiff's] demand to turnover the funds could result in subjecting Baldwin [Filters] to liability to such creditors.

Though the answer does not cite as such, Baldwin Filters's concern arises from its status as a participant in the bulk transfer, the designated disburser of the sale proceeds, and a stakeholder in the funds; it fears that it could be sued by those creditors that hold claims timely-asserted but disputed in the bulk transfer transaction, under a theory that it owed them some sort of duty not to subject the remaining funds to an allocation through the administration of the bankruptcy estate

To put these issues into suit, Baldwin Filters included a third-party complaint as part of its answer. In it, it joined those creditors that had not consented to a turnover of the remaining funds to the Trustee, and (much in the nature of an interpleader action) requested a determination as to the other parties' rights to the funds.

Baldwin Filters now moves for summary judgment pursuant

to Fed. R. Civ. P. 7056.(4) It seeks a determination that the funds should be turned over to the Plaintiff for distribution on account of claims allowed in the Debtor's bankruptcy case, in accordance with the statutory priorities of the Bankruptcy Code. The Plaintiff, of course, supports the motion. A stipulation of facts has been executed and filed by Baldwin Filters, the Plaintiff, and the four named third-party defendants that actually participated in the litigation of this matter in any way. In it, their counsel have identified and stipulated to all facts that they deem to be material. The governing law does not appear to contradict their conclusions as to materiality. This matter, then, is ripe for summary adjudication. In re Sunde, 149 B.R. 552, 554 (Bankr. D. Minn. 1992).

DISCUSSION

As framed by the pleadings,(5) the motion at bar raises four issues. Three of them go to whether the sale proceeds were property of the bankruptcy estate, or should remain such. The fourth goes to whether the sale proceeds are now subject to some sort of setoff in favor of the remaining creditors that did not receive a distribution from the bulk transfer.

I. THE SALE PROCEEDS AS PROPERTY OF THE ESTATE

A. General Arguments and General Principles.

Baldwin Filters and the Plaintiff argue that the remaining sale proceeds are clearly property of the bankruptcy estate by operation of 11 U.S.C. Section 541(a),(6) and as such are subject to administration by the Plaintiff. In the three subsidiary arguments that make up their response, Lakeview and/or Consolidated take alternative positions. The first position (argued by Lakeview) is that, as a matter of contract or law, the Debtor had no property interest in the sale proceeds when it filed for bankruptcy. If it did, they both argue in the alternative, the Debtor had only a very limited interest--that of a trustee for the benefit of its trade creditors under an actual or constructive trust. Under these latter arguments, 11 U.S.C. Section 541(d)(7) prevented the beneficial interest in the proceeds--their economic value--from passing into the estate.

Congress, of course, intended the sweep of Section 541(a) to be quite broad. *United States v. Whiting Pools, Inc.*, 462 U.S. 198, 206 (1983); *In re Swanson*, 873 F.2d 1121, 122, (8th Cir. 1989); *In re Graham*, 726 F.2d 1268, 1270 (8th Cir. 1984); *In re Schauer*, 62 B.R. 526, 529 (Bankr. D. Minn. 1986), *aff'd*, 835 F.2d 1222 (8th Cir. 1987). However, "the definition [of property of the estate under Section 541(a)] was not designed to enlarge the debtor's rights against others beyond those existing at commencement of the case." *In re N.S. Garrott & Sons*, 772 F.2d 462, 465-466 (8th Cir. 1985). The existence, nature, and scope of those property rights are to be determined with reference to state law. *Barnhill v. Johnson*, ___ U.S. ___, ___, 112 S.Ct. 1386, 1389 (1992); *Butner v. United States*, 440 U.S. 48, 54 (1979). The scope of property rights encompassed by Section 541(a) "cannot be expanded where none existed under [nonbankruptcy] law." *California Board of Equalization v. MGM Liquor Warehouse*, 52 B.R. 77, 80 (D. Minn. 1985). See also *In re Schauer*, 835 F.2d at 1225; *In re Solberg*, 125 B.R. 1010, 1015 (Bankr. D. Minn. 1991).

B. Relinquishment or Persistence of Property Interest in Debtor:

Contractual or Statutory

Lakeview's and Consolidated's theory on their first argument is that the Debtor relinquished all rights to the sale proceeds in favor of its creditors as an incident of the bulk transfer. Lakeview does not produce any specific statement or acknowledgement by the Debtor to prove this up as a matter of fact; rather, it argues that, as a matter of law, the relinquishment was effected as a consequence of the Debtor's performance as seller.

While initially attractive on its face, this argument is neither borne out by the basic legal attributes of a bulk transfer, nor supported by any specific provision of the former Bulk Transfer Act.

As Lakeview's counsel would have it, ". . . pursuant to Debtor's obligations under the Bulk Sale Agreement, Debtor transferred all of it [sic] interest in the property to Baldwin and to Debtor's creditors." This statement is somewhat convoluted; it rolls together two separate aspects of the larger transaction without distinction. It is correct, insofar as the Debtor's machinery, equipment, inventory, and other operating assets are concerned, and insofar as Baldwin Filters is identified as a transferee; the underlying sale of assets is now final, and there is no allegation (such as inadequacy of consideration, or the like) that would challenge the passage of title to the subject assets. However, it is not accurate as to the property right in the cash proceeds of sale. In the "purest" of cases, upon the closing of a sale with the tender of goods acceptable to the purchaser, the title to the goods passes to the purchaser; as against the purchaser, the seller gains the right to receive the full cash consideration. This functional consequence may be altered contractually, and frequently is through escrow arrangements for the adjustment of the amount of consideration for the current value of inventory, for the payment of secured debt or unpaid taxes chargeable against the subject assets and their proceeds, and so forth.

In one type of sale of goods, the law has recognized protectable interests beyond those of sellers, purchasers and secured parties, and has attempted to give them a claim to the value passing in the transaction. During the time it was on the statute books in Minnesota, the Bulk Transfer Act afforded protection to trade creditors whose interests might be affected by the sale of "a major part of the materials, supplies, merchandise or other inventory of an enterprise," former Minn. Stat. Section 336.6-102(1) (1990), where the "principal business [of the enterprise was] the sale of merchandise from stock," including merchandise manufactured by the seller, former Minn. Stat. Section 336.6-102(3) (1990). Such trade creditors were legally deemed to have granted credit to the seller on the strength of its ongoing inventory on a going-concern basis, and to have factored the possibility of exercising post-judgment levy against the inventory into their initial determination of the seller's creditworthiness. *Stone's Pharmacy, Inc. v. Pharmacy Accounting Management, Inc.*, 812 F.2d 1063, 1065 (8th Cir. 1987), and *Stone's Pharmacy, Inc. v. Pharmacy Accounting Management, Inc.*, 875

F.2d 665, 667 (8th Cir. 1989) (both applying Texas enactment of Article 6); J. White and R. Summers, Uniform Commercial Code at 886-890 (3d ed. 1988) (hereafter "White and Summers"). The Act afforded protection to trade creditors by providing that, unless the parties follow a procedure designed to enable such creditors to make claims against the proceeds of sale,(0) "a bulk transfer . . . is ineffective against any creditor of the transferor . . ." Former Minn. Stat. Section 336.6-104(1) (1990). See, in general, White and Summers at 889-890.(1)

Conspicuously lacking from any specific protection under the former Bulk Transfer Act, however, is the seller. This is because its residual interests had enough protection already, through its contractual right to the cash consideration and its actual or constructive receipt of it during the post-closing administration. On its face, the Act did nothing to alter the operation of the most basic precepts of the law of contracts and sales: as between buyer and seller, the seller receives the right to the cash consideration from a sale, once title to the subject goods is transferred. Lakeview has produced no evidence to indicate that the Debtor and Baldwin Filters altered this basic precept by contract, either. There is certainly nothing in the record to indicate that Baldwin Filters would have been entitled to receive any unclaimed surplus of the sale proceeds; under the basic principles noted, that would have gone to the Debtor.(2) The legal "title" to the sale proceeds, then, still lay in the Debtor as the administration of the proceeds under the bulk transfer went forward, and it reposed in the Debtor as of the commencement of this case.(3)

C. Exclusion of Sale Proceeds From Estate As Subject of Trust.

The sweep of property into the bankruptcy estate under Section 541(a) is rendered somewhat more subtle by 11 U.S.C. Section 541(d).(4) In cases where a debtor holds title to property in the status of an actual or constructive trustee under nonbankruptcy law, this provision recognizes that his or her bankruptcy filing does not collapse the pre-petition trust so as to bring the equitable rights of the beneficiary of the trust into the estate. E.g., *United States v. Whiting Pools, Inc.*, 462 U.S. 198, 204 n. 8 (1983) (" . . . Congress intended to exclude from the estate property of others in which the debtor had some minor interest such as a lien or bare legal title:"); *In re Flight Transp. Securities Litigation*, 730 F.2d 1128, 1136 (8th Cir. 1984), cert. denied, 469 U.S. 1207 (1985); *In re N.S. Garrott & Sons, Inc.*, 772 F.2d at 466 (" . . . where the debtor holds bare legal title without any equitable interest, the estate acquires bare legal title without any equitable interest."). Lakeview and Consolidated argue that they should have the benefit of this section against the sale proceeds, under two variant theories.

1. "Express" Trust.

Lakeview and Consolidated first argue that the parties' performance under the bulk transfer created an express trust for the benefit of all creditors that had trade claims against the Debtor. Under Minnesota law, the elements of an express

- a. a designated trustee subject to specific and enforceable duties;

- b. a designated beneficiary vested with specific and enforceable rights; and
- c. a defined trust res, in which the trustee's legal title and estate is separated from the vested beneficial interest of the beneficiary of the trust.

In re Bush's Trust, 81 N.W.2d 615, 620 (Minn. 1957); Droege v. Brockmeyer, 7 N.W.2d 538, 543 (Minn. 1943).

On a superficial reading, this argument has some attractiveness. However, it ultimately fails for several reasons.

Not the least of them is that Lakeview never quite identifies the trustee of the supposed trust. By turns, its counsel hints that Baldwin Filters is the trustee (allegedly designated as such by the sale agreement's provision that "[t]he balance of the consideration [would] be held by buyer for application to creditors' claims . . ."), and that the Debtor somehow still features as a party to the trust analysis (because its alleged lack of an "interest in the trust res" means that the bankruptcy estate should have no interest in them).

If the trust analysis applies at all, it is clear that Baldwin Filters--not the Debtor--has to be considered as the trustee. It was the entity placed into control of the funds, the one imposed with obligations to the alleged beneficiaries, and then, by rights, the one into which any trustee's "bare legal title" was to repose. The Debtor, having had no possibility of control over the proceeds until after administration, just does not neatly fit into any of the assigned roles.(5)

Once this alignment is applied, it is clearly incorrect to characterize the tenure under which Baldwin Filters holds the remaining sale proceeds as a trust. The legal basis for its possession of them, purely contractual and statutory in origin, simply does not impose a heightened fiduciary obligation on it as possessor. Clearly, the motivation for Baldwin Filters's participation was entirely self-interested. It lay in its wish to avoid exposure to fraudulent-conveyance liability, and to clear the subject assets from the cloud of such exposure. In no way did Baldwin Filters expressly or tacitly assume fiduciary duties in relation to the sale proceeds. Nothing in the statute denominates a transferee administering bulk sale proceeds as a trustee, and the record contains no contractual provision to the same end. Neither source of governance imposes any special duty of action on Baldwin Filters, other than to hold the funds temporarily.(6)

All told, the status of Baldwin Filters was really much more akin to that of a bailee, possibly even a bailee-for-hire, than it was to that of a trustee. Its sole real duty was to hold the funds until it saw that they were turned over to the parties legally entitled to them. In doing so, it was acting out of self-interest--certainly not under the utmost duty of fidelity imposed on a trustee. The value of the sale proceeds, then, is not excluded from the estate as the property of a beneficiary that is not in bankruptcy.

2. Constructive Trusts.

In the alternative, Lakeview and Consolidated argue that

this Court should impress the sale proceeds with a constructive trust in their favor, based on the "equities" of the situation. Under Minnesota law, a court sitting in equity may impose a constructive trust against assets after the fact, to prevent the unjust enrichment of a person or entity that gained possession of the asset under a duty to convey them or use them for a specific purpose. *Wright v. Wright*, 311 N.W.2d 484, 485 (Minn. 1981). A party may obtain the imposition of a constructive trust by proving, by clear and convincing evidence, the existence of a fiduciary relationship and the abuse of confidence and trust bestowed under it, to the actual or potential harm of the beneficiary under the relationship. *Dietz v. Dietz*, 70 N.W.2d 281, 285 (Minn. 1955); *Wilcox v. Nelson*, 35 N.W.2d 741, 744 (Minn. 1949). It is not absolutely necessary to prove up a fiduciary relationship; however, the proponent must at least show fraud, bad faith, or some other "unconscientious manner" by which the purported trustee took title of the assets in question, such that unjust enrichment would result were the trust not imposed. *In re Inv. Sales Diversified, Inc.*, 30 B.R. 446, 450-451 (Bankr. D. Minn. 1984). The party must identify "some specific property identified as belonging, in equity and conscience" to the claimant. *Rock v. Hennepin Broadcasting Assoc., Inc.*, 359 N.W.2d 735, 739 (Minn. Ct. App. 1984). See also *Chiu v. Wong*, ___ F.3d ___, ___, No. 93-1987, slip op. at 6-9 (8th Cir. February 11, 1994).

This argument fails for a specific reason, and a general one.

As noted earlier, Lakeview and Consolidated have not shown as a matter of fact that Baldwin Filters knowingly and expressly assumed any fiduciary duties in relation to the Debtor's creditors; it was motivated solely by self-interest in following through with a statutory bulk transfer, to avoid the possibility of a cloud on the title of the assets it was purchasing. There is no basis in the facts for imputing any such heightened duty to it as a matter of law. The argument, then, fails on the signal element of the first means for justifying a constructive trust.

It meets the same fate on the other alternative: there is no proof of bad faith or overreaching on the part of either Baldwin Filters or the Debtor, in the way in which the remaining funds stayed in the possession of Baldwin Filters until the bankruptcy filing.

The more general reason for denying a constructive trust goes, in a way, to the question of unjust enrichment. As noted earlier, the imposition of a constructive trust is an equitable remedy, one evolved in the context of disputes between single parties. Like most equitable remedies, it brings about a judicial override of the result that would obtain were the law otherwise to be applied, hard and fast, to relevant facts. It is generally imposed in situations characterized by some sort of troubling abuse or overreaching on the part of the deemed trustee. E.g. *Wright v. Wright*, 311 N.W.2d at 485 (imposition of constructive trust appropriate where "legal title . . . is obtained through fraud, oppression, duress, undue influence, force, crime, or similar means, or by taking advantage of a confidential or fiduciary relationship . . ."). It adjusts the specific legal relationship between that putative wrongdoer and its victim, to achieve a result deemed more "fair" or "just."

Given its genesis, the remedy of constructive trust is not a particularly good "fit" into a bankruptcy case. Bankruptcy operates within a statutory framework that creates its own estate for the benefit of all creditors. Bankruptcy has the goals of centralized administration of a debtor's assets, under a prioritization of claims that is designed to achieve ratable distribution among all creditors within statutorily-specified classes. Retroactively impressing estate assets with claims or charges in favor of creditors asserting constructive trusts will usually give such creditors a far greater benefit from their participation in the bankruptcy case than that accorded to creditors who are otherwise similarly situated under the statutory priorities. For this reason, courts should be careful in imposing constructive trusts in bankruptcy cases, where to do so threatens the ordering of the Bankruptcy Code's scheme for estate administration. State-law burdens of proof should be strictly imposed on parties claiming to be the beneficiaries under such after-the-fact artifices.

When this is done, it is equally clear that Lakeview and Consolidated should not prevail. They have shown no wrongdoing on the part of either the Debtor nor Baldwin Filters in their performance under the bulk transfer. Nor, really, have they shown that any party would be unjustly enriched by leaving the funds where they are-in the bankruptcy estate.(7)

Lakeview and Consolidated hold claims that otherwise would be classified as general unsecured claims in the Debtor's case. For whatever reason, they were not able to settle with the Debtor on its objections to their claims, before the Debtor pitched itself into bankruptcy. Now that they are here, they have no special "equitable" right to receive full satisfaction of their claims from the sale proceeds before they are turned over to the Plaintiff.

C. Lakeview's Right of Setoff.

As its final argument, Lakeview maintains that the right of setoff, as preserved by 11 U.S.C. Section 553(a),(8)

enables it to draw on the sale proceeds to the extent of the full amount of its claim. To the extent this argument is posited on Lakeview's asserted "ownership interest in the funds held by" Baldwin Filters, it is defeated by the conclusions noted earlier.

Beyond this, the right of setoff simply does not apply to the configuration of parties and rights at bar. For the right of setoff to be available in cross-running contractual or legal relationships, the debts in question must be mutual. *United States v. Gerth*, 991 F.2d 1428, 1431 (8th Cir. 1993); *Adams v. Resolution Trust Corp.*, 927 F.2d 348, 353, n. 14 (8th Cir. 1991); *In re Greseth*, 78 B.R. 936, 941-942 (D. Minn. 1987); *In re Matthieson*, 63 B.R. 56, 58 (D. Minn. 1986). "To exhibit the requisite mutuality, the debts must be in the same right." *Adams v. Resolution Trust Corp.*, 927 F.2d at 353, n. 14.

If there are even two "debts" running here, they are not mutual. The Debtor has a simple trade debt that runs directly to Lakeview as a matter of contract.(9) Baldwin Filters, the entity that holds the sale proceeds, has no "debt" to Lakeview that is of the same legal character. All it had was a statutory duty under former Minn. Stat. Section 336.6-106(1) to

apply the sale proceeds to properly-submitted claims. While that statutory duty ran "to all the holders of shown or filed debts, and [could] be enforced by any of them for the benefit of all," former Minn. Stat. Section 336.6-106(1), Baldwin Filters had the absolute right to terminate the duty by relinquishing the administration of the funds to the state district court, in fairly short order, after it received the subject assets from the Debtor. See former Minn. Stat. Section 336.6-106(4). Given the statutory right of Baldwin Filters to opt out of administering the sale proceeds, one certainly cannot conclude that, under the Bulk Transfer Act, Baldwin Filters assumed any personal liability for the Debtor's debt to Lakeview. For there to have been truly "mutual" cross-running debts, it would have to have it.

Since Lakeview has not satisfied the threshold element of setoff for the purposes of Section 553(a), it has no protection under that statute either.

CONCLUSION

These are all the material issues properly before the Court on the motion at bar.(10) On the stipulated facts, Baldwin Filters has shown that it and the Plaintiff are entitled to judgment in their favor.

ORDER FOR JUDGMENT

Upon the foregoing, then,

IT IS HEREBY ORDERED, ADJUDGED, AND DECREED:

1. That the funds presently in the possession of Defendant Baldwin Filters, Inc., as the proceeds of the Debtor's pre-petition sale of certain assets to it, are property of the Debtor's bankruptcy estate, and are subject to administration by the Plaintiff.

2. That, pursuant to 11 U.S.C. Section 542(a), Defendant Baldwin Filters, Inc. shall forthwith turn over all

of the sale proceeds to the Plaintiff.

3. That, upon its turnover of the proceeds pursuant to Term 2 hereof, Defendant Baldwin Filters, Inc. shall be relieved of all further liability under the Bulk Transfer Act, former Minn. Stat. Section 336.6-101, et seq., to the Third-party Defendants, and to any other creditor of the Debtor, as to the disposition of those funds.

LET JUDGMENT BE ENTERED ACCORDINGLY.

BY THE COURT:

GREGORY F. KISHEL
U.S. BANKRUPTCY JUDGE

(1)

In 1991, Article 6 was codified at Minn. Stat. Section 336.6-101 et seq. (1990). In 1991, the Minnesota Legislature repealed Article 6 in its entirety. See Minn. Sess. L. 1991, c. 171, art. 2, Section 4.

(2) This sum equated to 59.1443 percent of the total of: 1. the amounts of the claims that the Debtor disputed in whole; and 2. the disputed portion of those claims that the Debtor disputed in part.

(3) Subject to two exceptions not relevant here, this statute provides in pertinent part that

. . . an entity . . . in possession, custody, or control, during the [bankruptcy] case, of property that the trustee may use, sell, or lease under [11 U.S.C. Section 363]... shall deliver to the trustee, and account for, such property or the value of such property, unless such property is of inconsequential value or benefit to the estate.

(4) Fed. R. Bankr. P. 7056 makes Fed. R. Civ. P. 56 applicable to adversary proceedings in bankruptcy cases. In turn, Fed. R. Civ. P. 56(c) provides that, upon such a motion,

The judgment sought shall be rendered forthwith if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law.

(5) The pleadings consist of Baldwin Filters's motion and its supporting memorandum, and responsive memoranda and affidavits submitted by counsel for Lakeview and Consolidated. In response to the third-party complaint, Third-Party Defendant Motorways filed an answer and Third-Party Defendant Nelson Division (under the name of Nelson Industries) entered an appearance through counsel. Though their counsel executed the stipulation of facts for this motion, they did not participate in briefing or argument. The rest of the third-party defendants are in default.

(6) In pertinent part, and subject to two exceptions not relevant here, this statute provides as follows:

(a) The commencement of a [bankruptcy] case . . . creates an estate. Such estate is comprised of all the following property, wherever located and by whomever held:

(1) . . . all legal or equitable interests of the debtor in property as of the commencement of the case.

(7) In pertinent part, this statute provides:

Property in which the debtor holds, as of the commencement of the case, only legal title and not an equitable interest, . . . becomes property of

the estate under [11 U.S.C. Section 541](a)(1) . . . only to the extent of the debtor's legal title to such property, but not to the extent of any equitable interest in such property that the debtor does not hold.

(8)Specifically, the purchaser had to require the seller to furnish a signed and sworn list of the seller's "existing creditors," former Minn. Stat. Section Section 336.6-104(2) (1990) and 336.104(1)(a) (1990); had to give such creditors at least ten days' advance notice of the proposed sale, former Minn. Stat. Section 336.6-105 (1990), with prescribed content for the notice, former Minn. Stat. Section 336.6-107 (1990); and had a duty "to assure that the . . . consideration [was] applied so far as necessary to pay" the debts on the seller's list and all others properly evidenced by claims filed with the seller after the notice, former Minn. Stat. Section 336.6-106 (1990).

(9)Though the framers of Article 6 probably did not recognize it

explicitly, another constituency derived some protection from the statutory scheme: buyers in bulk sales, which otherwise might have been exposed to suits by trade creditors seeking to attach the transferred assets on a fraudulent-conveyance theory. Their protection derived from the obverse of the proposition that gave protection to trade creditors: as long as the purchaser/transferee complied with its duty "to assure that the new consideration is applied so far as necessary to pay those debts to the transferor" that are timely evidenced and presented to the transferee, former Minn. Stat. Section 336.6-106(1) (1990), and so long as it bought in good faith and for fair value, it would take the goods free and clear of any claim that it received them via a fraudulent conveyance. See, in general, White and Summers at 916.

(10))To be sure, there would have been no such surplus, under the specific structure of debts and assets involved here. This, however, makes no difference to the precise issue in question.

(11)This is the bare conclusion reached in the only case cited by any party, that is founded on comparable facts: In re Armstrong, 56 B.R. 781 (W.D. Tenn. 1986). Armstrong, however, is rather thin as persuasive authority goes; the decision does not rely on a theoretical analysis of the characteristics of the underlying transaction as much as it takes a practical, remedies-oriented approach: someone had to administer the funds; once the debtor went into Chapter 7, the remedies under the Bankruptcy Code took primacy over the interpleader/Article 6 remedies previously invoked in state court; and (in something of an exercise of reverse logic) the sale proceeds just had to be property of the bankruptcy estate, so as to enable that primacy to be effectuated. Given the flaws in Armstrong's approach--and in the face of Lakeview's counsel's deeper theoretical argument--counsel for Baldwin Filters was not well-put to exclusively rely on it.

(12)In pertinent part, this statute provides:

Property in which the debtor holds, as of the

commencement of the case, only legal title and not an equitable interest, . . . becomes property of the estate under [11 U.S.C. Section 541](a)(1) or (2) . . . only to the extent of the debtor's legal title to such property, but not to the extent of any equitable interest in such property that the debtor does not hold.

(13)For this reason Section 541(d) has no direct utility to Lakeview's argument. By analogy, though, the underlying thought does--the property interest of a debtor under a trust relationship has real significance to the bankruptcy estate only if it is the equitable interest of a beneficiary.

(14)Several possibilities for such duties come to mind, all much more consistent with a trustee's status than the bare duty to hold and disburse the funds that actually obtained. There could have been a specific obligation to manage and invest the funds, so as to increase their value and the resulting percentage distribution. There could have been a duty to become involved in the resolution of the Debtor's objections to filed claims, whether as advocate for the creditors or as mediator. The latter duty would have expedited disbursement and, as such, would certainly have made the role of Baldwin Filters look much more like that of a trustee.

(15)A good argument could be made, in fact, that, were Lakeview and Consolidated to prevail on their argument, they would be unjustly enriched at the expense of the creditors that have cooperated with the Plaintiff in the presentation of this adversary proceeding.

(16)In pertinent part, and subject to several exceptions not applicable to the facts at bar, this statute provides as follows:

[The Bankruptcy Code] 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 [bankruptcy] case . . . against a claim of such creditor against the debtor that arose before the commencement of the case . . .

(17)This debt, of course, gave rise to a claim against the bankruptcy estate. See 11 U.S.C. Sections 101(12), 101(5), and 502(a).

(18)In its brief, Consolidated raised a fifth issue: under longstanding federal law regulating common carriers, the Debtor had no basis for disputing its claim during the administration of the bulk transfer. To support this argument, it submitted the affidavit of one of Consolidated's employees. Under Rule 16, Consolidated is out of bounds in raising a new issue in this fashion. All counsel had previously agreed to submit this adversary proceeding only on issues sounding under Sections 541 and 542, and the Court's scheduling order contemplated that being done on narrow and stipulated facts. In any event, the argument is entirely

premature. Regardless of the Debtor's pre-petition bona fides, the remaining sale proceeds were trapped in the estate on the commencement of the case. Consolidated's argument goes to the amount of its claim and its resultant pro-rata share of the estate. Consolidated can certainly raise the issue if it has filed a proof of claim in the larger amount and if the Plaintiff objects to it, but it goes not one whit to the status of the proceeds as property of the estate.