UNITED STATES BANKRUPTCY COURT
DISTRICT OF MINNESOTA
THIRD DIVISION

In Re:
Citi-Equity Group, Inc.
CHAPTER 11
Debtor.

Bky. 3-94-2494

WMF/Huntoon, Paige Associates Limited,
Plaintiff,

v. Adv. No. 3-95-164

Citi-Equity Group, Inc.,

and

Weybridge, Inc., ORDER FOR PARTIAL SUMMARY JUDGEMENT

and

Paradigm Management Company, Inc.,

Defendants.

This matter was heard on cross motions for summary judgment by Plaintiff WHF/Huntoon, Paige Associates (Huntoon) and Defendant Citi-Equity Group, Inc. (Citi-Equity) on January 26, 1996. Appearances were as noted in the record. The Court, having heard oral arguments; having received and reviewed all pleadings, motions, affidavits, memoranda and supporting exhibits; and, being fully advised in the matter; now makes this ORDER pursuant to the Federal and Local Rules of Bankruptcy Procedure.

I.
OVERVIEW

This litigation was commenced by Huntoon as the agent for mortgagee Chemical Bank, which is the trustee for holders of certain certificates that evidence mortgage money loaned to various limited partnerships that once were managed by the Defendants. The limited partnerships each owned and operated single asset commercial real estate projects that were subject to the Chemical Bank mortgages. Citi-Equity was the general partner of the limited partnerships, and Defendant Paradigm Management Company, Inc., was manager of the

projects. Defendant Weybridge, Inc. became the managing agent of Citi-Equity, by order of this Court, entered May 25, 1994, shortly after the involuntary filing of Citi-Equity under 11 U.S.C. Chapter 11 on May 19, 1994.

Huntoon claims that the Defendants wrongfully diverted rents of the projects during pendency of the Citi-Equity bankruptcy case, using the rents for the benefit of Citi-Equity rather than to service the mortgages. Huntoon alleges that the conduct of the Defendants: 1) violated the Court's Order Approving Cash Management of July 27, 1994; 2) constituted fraudulent transfers under the Uniform Fraudulent Transfers Act; and, 3) was a breach by Citi-Equity of the mortgage notes. Huntoon and Defendant Citi-Equity moved for summary judgment on all issues. As an alternative to complete summary judgment in its favor on the notes, Citi-Equity seeks summary declaratory judgment that any Citi-Equity liability under the notes has the status of prepetition unsecured claims.

This Order grants Citi-Equity judgment on the pleadings regarding Huntoon's cause of action for violation of the Court's July 27, 1994, Order, based on the Court's finding that it states a claim for which relief cannot be granted; and, the Order grants Citi-Equity declaratory judgment that Huntoon's breach of contract claim is a prepetition unsecured claim. The motions are in all other respects denied.

II.
FACTS

A. Background.

Debtor/Defendant Citi-Equity Group, Inc., created by Gary Lefkowitz, was engaged primarily in the business of acting as the general partner for more than 65 limited partnerships formed to develop and own tax qualified low income housing projects across the United States(1F). Essentially, Citi-Equity provided all of the management support for the operations of these limited partnerships, through its wholly owned subsidiary, Defendant Paradigm Management Corporation. In addition, Citi-Equity managed all of the financial affairs for the limited partnerships through its offices in Culver City, California. Citi-Equity maintained all of the bank accounts for the limited partnerships; managed all of the rental income received from the Properties owned by them; and, Citi-Equity paid all of the expenses of the limited partnerships.

Plaintiff Huntoon is engaged in the business of acting as the servicing agent for the holders of real estate mortgages. In August 1992, Citi-Equity arranged for the refinancing of 14 properties owned by 14 limited partnerships. Chemical Bank essentially acted as the lender in

the transaction, lending the 14 limited partnerships over $21,700,000 in the mortgage refinancings. Huntoon is the servicer of these mortgage loans and has authority to act on behalf of the mortgagee.

B. The Notes.

On September 23, 1992, the limited partnerships executed 12 virtually identical promissory notes ("Notes" or "Note") evidencing the mortgage loans Chemical Bank made to these 12 limited partnerships. Citi-Equity and Gary Lefkowitz executed the Notes as the general partners of the limited partnerships.

Each Note provided that the Note was "non-recourse" - i.e., neither Citi-Equity nor the limited partnership was personally liable on the obligation. However, the last paragraph on the fifth page of each Note provided these exceptions to the non-recourse nature:

> Subject to the provisions of this paragraph, and notwithstanding any other provision contained herein or in the Mortgage or Other Loan Documents (other than the provisions of the Environmental Compliance and Indemnification Agreement, executed by Borrower [limited partnerships] and dated the date herewith), the personal liability of the Borrower any partner of the Borrower to pay the principal and interest on the debt evidenced by the Note and any other agreement evidencing Borrower's obligations hereunder or under the Mortgage or Other Loan Documents shall be limited to (1) the real and personal property described as the Property in the Mortgage, and (2) the rents, profits, issues, products and income of the Property, including any received or collected by or on behalf of Borrower after an event of default... Borrower, and any general partner of the Borrower, shall be personally liable in the amount of any loss, damage, or cost resulting from..., (z) all rents, profits, issues, products and income of the Property received following an event of default hereunder or under the Mortgage and not applied to the payment of principal and interest due hereunder (including any received or collected by or on behalf of Borrower after an event of default, except to the extent that borrower did not have the legal right, because of a bankruptcy, receivership or similar judicial proceeding, to direct the disbursement of such sums). (emphasis supplied).
>
> (Wellington Ridge II Multi-Family Note, Exhibit 1 I (pages 5 and 6) to the

Affidavit of Jose Perez, filed on January 12, 1996, submitted by Huntoon in connection with its Motion For Summary Judgment).

C. Citi-Equity's Operation of the Limited Partnerships During The Bankruptcy.

On May 19, 1994, an involuntary petition in bankruptcy under Chapter 11 was filed against Citi-Equity. During the course of the bankruptcy, Citi-Equity continued to act as the general partner of the 12 limited partnerships. Among other things, its subsidiary, Paradigm, collected the monthly rental income the limited partnerships earned from the properties and deposited the rental income into each limited partnership's bank account. Citi-Equity, as general partner of the limited partnerships, initially made the monthly interest payments to Huntoon on the Notes.(2F) However, beginning in approximately February 1995, Citi-Equity stopped making the monthly payments on the Notes. Instead, Citi-Equity applied the rental income to its own operating expenses through August 1995.

D. Funds Borrowed And Expenses Allocated.

The limited partnership agreements authorized Citi-Equity to borrow funds from the limited partnerships, both to lend to other partnerships and to use for its own purposes. For instance, Article IX, 9.02(5) of the Citi-Sauk Rapids Limited Partnership Agreement provided:

> 9.02. In connection with such management and control, the General Partners, in their sole discretion, shall have the separate and complete power and authority to do or cause to be done any and all acts, under the Act or otherwise provided by law, including, but not by way of limitation, the power and authority indicated below:
>
> > (5) To lend money or extend credit on behalf of the Partnership to third parties, including the General Partners and their Affiliates.
>
> (Citi-Equity, Motion For Summary Judgment, Jan. 9, 1996, Exhibit B-7, page A-5)

The agreements also provided that the limited partnerships: pay Citi-Equity for reasonable expenses incurred in connection with the particular limited partnership; and, that they pay pro rata expenses incurred in connection with all partnerships and other Citi-Equity activity. Article VII, 7.04 of the Citi-Sauk Rapids Limited Partnership Agreement, typical of the provisions, stated:

> 7.04 The General Partners may charge the

> Partnership for all reasonable expenses actually incurred by them in connection with the Partnership's business and for allocable portions of expenses incurred in connection with all partnerships and other General Partner activities; such allocation is to be determined on any basis selected by the General Partners consistent with generally accepted accounting principles. Such expenses shall include, but shall not be limited to, payment of fees and expenses of attorneys, accountants, special consultants, and others, title insurance, real property taxes and general and administrative expenses, in connection with the Partnership's organization, as well as the operation of the Partnership business.
> (id.)

Finally, the agreements recognized a wide range of activities that Citi-Equity and its affiliates might engage in. For instance, the Citi-Sauk Rapids Limited Partnership Agreement provided, in Article IX, 9.05:

> 9.05 The General Partners and their affiliates shall at all times be free to engage in all aspects of the real estate business or any other business for their own accounts. The General Partners and their affiliates shall also have the right to organize and operate partnerships (limited and general), joint ventures, or other real estate investment programs similar to the Limited Partnership.
> (id., page A-6)

The limited partnership agreements provided Citi-Equity broad authority to borrow from the limited partnerships, and to allocate expenses to them. This Court's Order Approving Cash Management, entered on July 27, 1994, continued that authority under circumstances otherwise allowed by law. The Order provided:

> 1. Citi-Equity is authorized to continue managing the cash generated from the housing projects owned by the limited partnerships in which it is the general partner in a manner which is consistent with its contracts, obligations, terms of its partnership agreements, and applicable law, including Title 11 of the U.S. Code. The Debtor is further authorized to take the following actions , which must be consistent with its contracts, obligations, terms of its partnership agreements and applicable law, including Title 11 of the U.S. Code:

> (i) authorizing the payment of ordinary and necessary operating costs associated with each housing project; (ii) allowing partnerships to lend funds to other partnerships to the extent necessary to pay operating expenses; and (iii) transferring funds to its own operating account sufficient to cover its operating expenses, including the expenses associated with the bankruptcy proceeding. The Debtor shall provide bi-weekly reports to the Official Committee of Unsecured Creditors;
> (Order Approving Cash Management, July 27, 1994 ,[Exhibit A, Citi-Equity Motion For Summary Judgment, Jan. 9, 1996])

Beginning in March 1995, Citi-Equity stopped servicing the Notes. The record is not clear regarding the extent to which operating expenses of the limited partnerships were thereafter paid out of the rental income. But, at least with respect to the Notes, Citi-Equity caused the limited partnerships to default; the rents being diverted to Citi-Equity as loans.

On August 4, 1995, this Court approved a sale of all Citi-Equity's interests as general partner in the limited partnerships to Koll Equity Group, effective on August 31,1995. On August 31st, Citi-Equity reclassified the loans on the books and records, apparently both its own and the limited partnerships', to allocated expense charges. As a result, the accounts showed no balance owing by Citi-Equity to the limited partnerships. All the books and records were then transferred to Koll Equity Group in consummation of the sale, pursuant to the August 4, 1995 order. Approximately $612,340, in loans from the various limited partnerships, were reclassified.

III.
DISCUSSION

Summary Judgment.

Rule 7056, F.R.Bankr.P., which is identical to Rule 56, F.R.Civ.P., provides that summary judgment should be entered in favor of a party where:

> the pleadings, depositions, answers to interrogatories 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 judgment as a matter of law.

The moving party bears the burden of demonstrating the absence of a genuine issue of material fact. Adickes v. S.H. Kress and Co., 398 U.S. 144, 157 (1970). A plaintiff, who moves for summary judgment, must show entitlement to the relief through specific, admissible, and

uncontradicted evidence that supports every element of the claim.(3F) Webber v. American Express Co, 994 F.2d 513 (8th Cir. 1993). The burden can be met by a defendant, through demonstrating the absence of evidence to support the plaintiff's case on which the plaintiff would have the burden of proof at trial. Celotex Corp. v. Catrett, 477 U.S. 317, 322 (1986).

The July 27, 1994, Order.

Huntoon claims that the diversion of rents and the subsequent reclassification of the loans by Citi-Equity violated the Court's Order Approving Cash Management, entered on July 27, 1995. Huntoon initially sought an injunction that would have required compliance with the Order. Huntoon continues to claim entitlement to damages resulting from the alleged violation, on behalf of the mortgage lenders.

On August 31, 1995, Citi-Equity transferred all of its interest in the limited partnerships to a third party, and no longer has any connection with the projects, their management, or their rents. Accordingly, no basis for injunctive relief exists any longer, regarding the Order, even if it be determined that the Order had been violated.

The Order Approving Cash Management did not provide a separate private right to damages for its violation. Huntoon's right to damages, if any, for the Defendants' conduct must be grounded somewhere else. The cause of action for damages, based on violation of the Order Approving Cash Management, states a claim for which relief cannot be granted. Defendant Citi-Equity is entitled to judgment on the pleadings pursuant to Rules 7056, 7012(c) and (h)(2), F.R.Bankr.P., accordingly.

Fraudulent Transfer.

All the limited partnerships, except Citi-Sauk Rapids, are under separate bankruptcy protection, and the estates have commenced their own fraudulent transfer actions against the Defendants arising out of the same transfers. Accordingly, the Court issued its order of March 4, 1996, on stipulation of the parties, dismissing the cause of action pertaining to those limited partnerships included in this proceeding, without prejudice, pending their bankruptcies. The fraudulent transfer action, in this adversary proceeding, only pertains to Citi-Sauk Rapids Limited Partnership. Citi-Sauk Rapids is organized under California law. Therefore, the California version of the Uniform Fraudulent Transfers Act ("Act"), Cal. Civ. Code Section 3439.01, et seq., applies.

Huntoon and Citi-Equity seek summary judgment on the cause of action. These are the relevant provisions of the Act, as adopted by California:

Section 4 of the Act provides -

(a) A transfer made or obligation incurred by a debtor is fraudulent as to a creditor, whether the

> creditor's claim arose before or after the transfer was made or the obligation was incurred, if the debtor made the transfer or incurred the obligation:
>
> (1) With actual intent to hinder, delay or defraud any creditor of the debtor; or
>
> (2) without receiving a reasonably equivalent value in exchange for the transfer or obligation, and the debtor:
>
> (i)was engaged or was about to engage in a business or a transaction for which the remaining assets of the debtor were unreasonably small in relation to the business or transaction; or
>
> (ii)intended to incur, or believed or reasonably should have believed that he or she would incur, debts beyond his or her ability to pay as they became due.
>
> Section 5 of the Act provides -
>
> A transfer made or obligation incurred by a debtor is fraudulent as to a creditor whose claim arose before the transfer was made or the obligation was incurred if the debtor made the transfer or incurred the obligation without receiving a reasonably equivalent value in exchange for the transfer or obligation and the debtor was insolvent at the time or the debtor became insolvent as a result of the transfer or obligation.

Huntoon argues that the record supports a finding of fraudulent transfer under each of the above provisions. But, Huntoon's argument does not support a finding under any of them.

A. Intentional Fraud.

Huntoon argues that the record is sufficient to support its claim that Citi-Equity transferred the rents, and later reclassified the loans, with the specific intent to delay Huntoon, resulting in the transfers as fraudulent under Section 4(a)(1). As evidence of actual intent to delay the Plaintiff, Huntoon points to the testimony of a former Citi-Equity employee, who says that he was told to delay Huntoon if questioned about the interruption in the interest payments.(4F) But, the intentional delay of collection efforts by means other than transferring property, is not proscribed by the statute. The intentional delay proscribed by the statute, is delay that is attempted or accomplished by transfer of property

out of a creditor's reach.

Much of Huntoon's argument on the issue is enveloped in vilifying rhetoric, with references such as "stealing" and "siphoning" of funds. But, the evidence behind the rhetoric does not suggest that the actual intent regarding the transfers involved here was: to steal or siphon another's property; to harm Huntoon; or, to damage the limited partnerships. The evidence suggests that the intent was to provide Citi-Equity needed operating funds during the pendency of its bankruptcy case by borrowing from the limited partnerships. The evidence offered by Huntoon is simply not persuasive that the transfers were made with the intent to delay or defraud Huntoon. The facts that Huntoon relies upon in its argument, would not sustain a finding of fraudulent conveyance under Section 4(a)(1).

B. Constructive Fraud.

Huntoon's argument would not sustain a finding under Sections 4(a)(2) or 5, either. Huntoon claims that there existed no consideration for the transfers, because they were loans that were subsequently reclassified as unsubstantiated allocated expenses. Huntoon discusses the loans and reclassification as if they were parts of a single transfer.(5F) But that is not evident from the record.

1. Funds Transfers.

The funds transferred from Citi-Sauk Rapids were in the form of unsecured loans, purportedly obtained by Citi-Equity in the ordinary course. In return for the transfers, Citi-Sauk Rapids received the right to repayment as an administrative expense under 11 U.S.C. Sections 364(a) and 503(b)(1). In connection with the funds transferred, the issue of reasonable equivalent value remains to be resolved.(6F) The parties have not addressed the question, whether the receipt of unsecured obligations, having the status of administrative priority in the Citi-Equity bankruptcy estate, constituted reasonable equivalent value to Citi-Sauk Rapids for the funds transferred.

2. Allocation of Expenses.

The later allocation of expenses, through the reclassification of the loans, constituted a separate and distinct transfer, through payment of the debt by an off-set designated as pro-rata expense charges. The allocations were made on the last day of Citi-Equity's control of Citi-Sauk Rapids and its books. Apparently, no specific breakdown or identification of expenses was made in connection with recording the charges on Citi-Sauk Rapids' books. The balance owing was simply off-set by an equal amount that was designated as miscellaneous expenses.

Huntoon argues that it is entitled to a finding that the transfers were without reasonable equivalent value. Huntoon claims that: the

procedure did not comply with generally accepted accounting principles; the specific expenses could not be identified by Citi-Equity in a later deposition of its manager, Leonard Sebesta; and, therefore, Citi-Equity cannot show its entitlement to allocate the charges under the Citi-Sauk Rapids Limited Partnership Agreement.(7F) However, resolution of the matter is not so simple.

The fact that the recording procedures might not have complied with generally accepted accounting principles, does not necessarily lead to the conclusion that the determination of the allocation was on a basis inconsistent with generally accepted accounting principles. If the total allocable expenses exceeded the total amount owed to the limited partnerships by Citi-Equity; and, if the portion of the expenses charged Citi-Sauk Rapids did not exceed its pro rata liability under the Citi-Sauk Rapids Limited Partnership Agreement; then, it would seem that the reasonable equivalency test under Sections 4(a)(2) and (5) is met, even though the specific expenses allocated to Citi-Sauk Rapids have not been identified or recorded. In any event, the issue remains one of fact to be developed at trial.

But, even if the record conclusively demonstrated that Citi-Sauk Rapids did not receive equivalent value for the debt cancellation, Huntoon would not be entitled to summary judgment. The issue of Citi-Sauk Rapids' financial condition has not been resolved, in connection with the debt cancellation. Unlike the initial borrowing of the funds by Citi-Equity, the later off-set did not necessarily place Citi-Sauk Rapids in a financial condition where it thereafter incurred debts beyond its ability to pay as they became due. See: Section (4)(a)(2)(ii) of the Act. Nor is it clear that the off-set rendered Citi-Sauk Rapids insolvent. See: Section 5 of the Act. The fact that the cash flow from the Citi-Sauk Rapids property apparently exceeded costs of operation and debt service, suggest that Citi-Sauk Rapids was solvent both before and after the off-set.(8F)

C. Summary On Fraudulent Transfer, Huntoon's Motion.

Huntoon is not entitled to summary judgment against Citi-Equity on its fraudulent transfer claims because: it has not shown the requisite actual intent of City-Equity to delay Huntoon under Section 4(a)(1); it has not shown that Citi-Sauk Rapids received less than the reasonably equivalent value for the funds transferred in the loan transactions, or for the value transferred through the debt cancellation in the later off-set; and, because, regarding the off-set, Huntoon has not shown that Citi-Sauk Rapids was financially distressed or insolvent under the statute.

D. Citi-Equity's Motion.

Citi-Equity seeks summary judgment on the

fraudulent transfer action, essentially on the grounds that: 1) Citi-Equity was entitled to borrow the money and allocate the expenses under the Citi-Sauk Rapids Limited Partnership Agreement, and under this Court's Order Approving Cash Management; and, 2) Huntoon has no evidence to offer on the issue, other than what it offered in connection with its own failed motion for summary judgment. Therefore, Citi-Equity claims, the Defendant is entitled to summary judgment on the cause of action.

Neither the Citi-Sauk Rapids Limited Partnership Agreement, nor the Court's July 27, 1994, Order, authorized Citi-Equity to receive fraudulent transfers from Citi-Sauk Rapids. Accordingly, they provide Citi-Equity no protection against liability for fraudulent transfers, and cannot be the basis for summary judgment in its favor.

Although it appears doubtful, the question whether the loans were made with the actual intent to defraud Huntoon, is ultimately a question of fact. It would be inappropriate to determine the issue in Citi-Equity's favor as a matter of law, based on the failure of Huntoon's motion for summary judgment.

It would also be inappropriate to, in effect, determine the reasonable equivalence and financial condition issues against Huntoon, as a matter of law. Neither party effectively focused discussion on the issues presented by the initial funds transfers, and later off-set. It is not clear from the arguments what the record holds concerning these matters, or what might be proven at trial on the issues regarding the transfers.

Breach Of Contract.

Huntoon has submitted a claim in the form of a breach of contract action on the Notes. The Plaintiff claims that the damages to which Huntoon is entitled equals the interest payments due on the Notes for the months March through August 1995, plus other fees, costs and charges, in the total amount of $1,258,160.44.(9F) In addition to the interest payments that were due under the Notes in the total amount of $760,773.93, Huntoon claims that it is entitled to: monthly maintenance fees in the total amount of $32,714.47; monthly late charges in the total amount of $49,576.09; monthly default interest in the total amount of $411,229.19; and, escrow deficit in the total amount of $3866.76.

Citi-Equity claims that Huntoon has not proven its damages under the Notes; and, that therefore, Citi-Equity is entitled to summary judgment on the cause of action. But, if that doesn't work, then Citi-Equity seeks declaratory judgment that whatever damages, if any, Citi-Equity might be liable for, is a prepetition general unsecured claim.

Huntoon responds that the status of its claim

is improperly raised by Citi-Equity in this adversary proceeding, because declaratory judgment actions on administrative expense claims are not provided for under F.R.Bank.P. 7001. But, if that doesn't work, Huntoon seeks its own declaratory judgment that the claim is entitled to administrative expense status.

A. The Amount Of The Claim.

As it relates to the issues here, Citi-Equity's liability is described in the Notes by this recitation:

> the personal liability of the Borrower and any partner of the Borrower to pay the principal and interest on the debt evidenced by the Note and any other agreement evidencing Borrower's obligations hereunder or under the Mortgage or Other Loan Documents shall be limited to... the rents, profits, issues, products and income of the Property, including any received or collected by or on behalf of Borrower after an event of default... Borrower, and any general partner of the Borrower, shall be personally liable in the amount of any loss, damage, or cost resulting from..., (z) all rents, profits, issues, products and income of the Property received following an event of default hereunder or under the Mortgage and not applied to the payment of principal and interest due hereunder (including any received or collected by or on behalf of Borrower after an event of default, except to the extent that borrower did not have the legal right, because of a bankruptcy, receivership or similar judicial proceeding, to direct the disbursement of such sums). (emphasis supplied). (Wellington Ridge II Multi-Family Note, Exhibit 1 I (pages 5 and 6) to the Affidavit of Jose Perez, filed on January 12, 1996, submitted by Huntoon in connection with its Motion For Summary Judgment).

Huntoon argues that the rent collected from the properties, for the period March through August 1995, in each instance exceeded the interest due under the Notes. Therefore, Huntoon claims, Citi-Equity is personally liable: under the first part of the above paragraph, for the interest that should have been paid from the rents, $760,773.93; and, under the second part of the above paragraph, for the $497,386.51 in fees, costs and charges as "loss, damage, and cost resulting from...rents...received following an event of default...and not applied to the payment of...interest due...."

The relevant inquiry is the extent to which

the monthly rents from each property exceeded the property's monthly operating costs that were paid by Citi-Equity; not, whether the rents exceeded the interest due. Huntoon argues that the payment of operating costs by Citi-Equity is irrelevant to its liability for the interest payments. But, the payment of operating costs is relevant to the extent that the rents might have been thereafter insufficient to cover the interest payments.

Citi-Equity was obligated under the supporting mortgages, and therefore under the Notes, to pay operating expenses of the properties out of the rents. See, for instance: Multifamily Mortgage, paragraphs 2, 4, 5 and 6, Exhibit 2-I to the Affidavit of Jose Perez, submitted by Huntoon and filed on January 12, 1996, in connection with its Motion For Summary Judgment. Furthermore, in the Rider To Multi-family Instrument, attached to the Mortgage, the Borrower represented that:

> [T]he primary purpose of the Borrower is to develop, own, and operate the Property and that for so long as the indebtedness secured by this Mortgage shall remain outstanding Borrower shall engage in no other business...
>
> Id., Wellington Ridge II, Rider To Multi-Family Instrument, page 2, paragraph D(I).

The rents were the limited partnerships' only sources of income. The parties contemplated, indeed the lender required, that all ordinary course obligations under the Notes and mortgages be paid from the rents. Accordingly, under the non-recourse provisions of the Notes, neither the limited partnerships, nor Citi-Equity as general partner, would be personally liable for unpaid interest payments resulting from deficiencies in cash flow due to the payment of operating expenses for the particular properties.

Citi-Equity argues that there exists in the record no evidence regarding the operating costs of the properties paid during the period for which the interest payments were defaulted. While Citi-Equity accepted, for purposes of the discussion regarding fraudulent transfer, Huntoon's assertion that cash flow of the properties exceeded operating and debt service costs, Citi-Equity makes no similar concession here.(10F) Citi-Equity claims that Huntoon has failed to prove either breach or damages. According to Citi-Equity, Huntoon is not entitled to summary judgment, but Citi-Equity is.

The Notes were breached. To the extent that the rents exceeded operating costs paid by it, Citi-Equity is liable under the Notes for unpaid interest. Huntoon has not shown what portion of the rents collected from each property was available to pay the interest payments due under the Notes, after payment of operating expenses by Citi-Equity. But, it hardly follows that Citi-

Equity is entitled to summary judgment on the cause of action. The facts pertaining to the operating costs of the properties, paid during the periods for which the Note payments were not made, are, or were, uniquely within the knowledge of Citi-Equity. If the operating costs prevented servicing the Notes, even partially, one would think that Citi-Equity itself would have made the information known in its own defense.

In any event, Huntoon will be entitled to summary judgment in the minimum amount of $612,340, which is the total amount of loans taken by Citi-Equity from the limited partnerships. The rents collected exceeded the operating costs of the limited partnerships paid by Citi-Equity, by at least the amount of $612,340; since those rents were borrowed and used to fund Citi-Equity's own operating costs.

Personal liability of Citi-Equity under the Notes, however, extends by the express terms of the Notes themselves, to loss and damage resulting from failure to pay the interest and principal only; it does not extend to maintenance fees or escrow charges.(11F)

Citi-Equity is not liable for late charges or default interest charges, either. These charges, relating to the unpaid interest, could accrue and become part of the allowed amount of Huntoon's claim only if the original unpaid interest liability had the status of an administrative expense claim. For reasons discussed below, the liability has the status of a prepetition general unsecured claim. Since the breaches occurred postpetition, no late charges or default interest charges, relating to the breaches, could thereafter accrue. Postpetition interest and late charges are not allowable on prepetition general unsecured claims. See: 11 U.S.C. Section 502(b).

B. Nature Of The Claim As Prepetition General Unsecured Claim.

Citi-Equity seeks declaratory judgment that Huntoon's breach of contract claim is a prepetition unsecured claim. Huntoon argues that this adversary proceeding is an improper forum to determine priority of its claim. The Plaintiff asserts that Rule 7001, F.R.Bankr.P., does not provide for resolution of disputes regarding administrative status of claims.

Huntoon asserted the claim, along with other claims against Citi-Equity, through this adversary proceeding. Citi-Equity, the Debtor-in-Possession, is entitled to both object to the claim and to challenge its priority in the proceeding in which the claim itself is asserted. See: Rule 3007, F.R.Bankr.P.

Addressing the substantive issue, Huntoon argues that it is entitled to administrative expense status for the breach of contract claim, because the estate benefitted from the use of the

limited partnership funds taken by Citi-Equity during pendency of the case. It is true that the estate benefitted from the postpetition transfers of the funds. But, the transfers did not constitute any postpetition performance or consideration furnished by Huntoon's principal; and, even though the transfers resulted in postpetition breach of the Notes, the claim for damages due to the breach remains a prepetition unsecured claim.

Except in the case of an assumed executory contract, a contract creditor is entitled to administrative expense status, in connection with postpetition breach of prepetition contract, only to the extent that both: 1) the creditor renders performance postpetition; and, 2) the estate receives the benefit of the postpetition performance.

> When the claim is based upon a contract between the debtor and the claimant, the case law teaches that a creditor's right to payment will be afforded first priority only to the extent that the consideration supporting the claimant's right to payment was both supplied to and beneficial to the debtor-in-possession in the operation of the business.... It is equally clear that a claimant who fully performs under a contract prior to the filing of the petition will not be entitled to first priority even though his services may have resulted in a direct benefit to the bankrupt estate after the filing. See Denton & Anderson Co. v. Induction Heating Corp., 178 F.2d 841 (2d Cir. 1949) (Frank, J.). Similarly, even when there has technically been performance by the contract creditor during the reorganization period, he will not be entitled to s 64(a)(1) priority if the bankrupt estate was not benefitted in fact therefrom. Cf. American Anthracite & Bituminous Coal Corp. v. Leonardo Arrivabene, S. A., 280 F.2d 119, 124-25 (2d Cir. 1960).

Cramer v. Mamoth Mart, Inc., 536 F2d 950, 954 (1st Cir. 1976). See also: Pension Benefit Guarantee Corporation v. LTV Corporation, 87 B.R. 779, 796 (S.D.N.Y. 1988) ("Where the debtor's obligations stem from contractual liability, even a post-petition breach will be treated as giving rise to a prepetition liability where the contract was executed prepetition.")

Viewed as lending transactions, the postpetition funds transfers from the limited partnerships to Citi-Equity, constituted both postpetition performance to, and benefit by, the estate. But performance, in connection with the

transfers, was rendered by the limited partnerships - not by Huntoon's principal, Chemical Bank. Therefore, the limited partnerships would ordinarily be entitled to administrative expense status regarding the resulting liability of Citi-Equity to the limited partnerships on the postpetition transactions. See also: 11 U.S.C. sec. 364(a).

Chemical Bank rendered no postpetition performance to the estate. The Bank's entire performance was rendered prepetition in lending the money, upon which the Notes are based, to the limited partnerships.

It is true that the estate benefitted by breach of the prepetition Notes. But it is not unusual for debtors-in-possession to breach prepetition agreements, through rejection of executory contracts or otherwise. Furthermore, motivation for breaching prepetition contracts is nearly always to benefit the estate by the breach. The ability of estates to breach prepetition contracts, without resulting administrative expense liability, is an important feature of both the distribution and reorganization schemes of the Bankruptcy Code. The mere beneficial breach by an estate, postpetition, of a prepetition contract, does elevate the status of the resulting claim to an administrative expense.

Huntoon's breach of contract claim is properly focused on postpetition defaults in payments due under the Notes; not on the postpetition transfer of funds by the limited partnerships to Citi-Equity. While the latter resulted in potential administrative claims in favor of the limited partnerships, the former resulted in a prepetition unsecured claim in favor of Chemical Bank. Citi-Equity is entitled to summary judgment determining the status of the claim as a prepetition unsecured claim, accordingly.

IV.
DISPOSITION

Based on the foregoing, it is hereby ordered:

1. Defendant Citi-Equity is entitled to judgment on the pleadings, regarding Plaintiff WMF/Huntoon's cause of action for violation of the Cash Management Order, entered July 27, 1994; and, Plaintiff WMF/Huntoon, Paige Associates is entitled to no recovery on the cause of action.

2. Defendant Citi-Equity is entitled to summary judgment that Plaintiff WMF/Huntoon, Paige Associates' breach of contract claim, regarding the Notes, is a prepetition general unsecured claim.

3. The parties' motions for summary judgment are in all other respects denied.

LET JUDGMENT BE ENTERED ACCORDINGLY, on paragraph 1 and 2.

Dated: May 1, 1996. By

The Court:

/s/

DENNIS D. O'BRIEN
Chief U.S. BANKRUPTCY JUDGE

(1F) Lefkowitz was convicted of 48 counts of fraud in connection with the Citi-Equity enterprise, and is currently serving a twenty-four year sentence in federal prison.
(2F) Terms of the Notes generally ran for five to seven years, during which only interest payments were due. Principal was payable in a single lump sum payment at the end of the terms.
(3F) But, a defendant must "do more than simply show that there is some metaphysical doubt as to the material facts." Matsushita Electric Industrial Co. Inc. v. Zenith Radio Corp., 475 U.S. 574, 586, 106 Sup. Ct. 1348, 1355 (1986). Speculation, or mere denials are not enough to raise genuine issues of fact. To avoid summary judgment, a defendant must establish the existence of enough evidence such that the trier of fact could return a verdict in its favor. See Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 247-51, 106 Sup. Ct. 2505, 2510-11 (1986).
(4F) The testimony is in the form of an affidavit from Nicholas Vinolus, who was Citi-Equity's cash manager at the time. Mr. Vinolus testified that he was instructed to attempt to delay collection efforts by Huntoon, if the Plaintiff should contact him regarding the interruption in interest payments. Mr. Vinolus did not say whether he was actually contacted by Huntoon. See: Plaintiff's Response To Citi-Equity's Motion For Summary Judgment, Jan. 23, 1996, Affidavit Of Nicholas Vinolus, Jan. 23, 1996.
(5F) So does Citi-Equity. See: Memorandum In Support Of Citi-Equity's Motion For Summary Judgment, Jan. 9, 1996, at page 7.
(6F) The issue of solvency under Section 5 of the Act remains as well. The cash flows generated by Citi-Sauk Rapids apparently exceeded the amount required to operate the property and service the mortgage. That suggests that the limited partnership was solvent both before and after the transfers. But, the financial test of Section 4(a)(2)(ii) seems to be satisfied. The limited partnership incurred debts monthly beyond its ability to currently pay them as a result of the borrowings. Both Sections 4(a)(2) and (5) apply the reasonable equivalency test. If Huntoon prevails on the issue of reasonable equivalency, the funds transfers will Section be found to have been fraudulent under Section 4(a)(2); and, the application of Section 5 is moot. If Huntoon does not prevail on the reasonable equivalency issue, the transfers will be found to not have been

fraudulent under either section. Accordingly, there seems to be no reason to pursue the issue of solvency under Section 5, as it pertains to the funds transfers.

(7F) The Agreement , in Article VII, 7.04, provides that "... such allocation is to be determined on any basis selected by the General Partners consistent with generally accepted accounting principles."

(8F) Huntoon makes the allegation regarding cash flow in its complaint, and argues the positive cash flow position in its brief. Citi-Equity accepts the position for discussion of the fraudulent transfer issue. The Court has been unable to find information in the record regarding cash flow of Citi-Sauk Rapids, or of the other limited partnerships.

(9F) This figure, and the breakdowns that follow are taken from the Jose Perez Affidavit, and attached Exhibits 3A through 3L, submitted by Huntoon and filed on January 12, 1996, in support of its Motion For Summary Judgment. Mr. Perez is Huntoon's vice president. The original affidavit is unsigned, and the Court has been unable to locate a signed copy. Additionally, the figures are apparently incorrectly computed, both in paragraph 7 of the Affidavit, and in Exhibit 3L. The total represented in paragraph 7 is overstated by $358, 744.90; and, the total represented on Exhibit 3L omits a stated escrow deficiency, in the amount of $ 3,866.76, from the calculation.

(10F) Huntoon's assertion, made in the complaint, defeated the presumption of insolvency, for fraudulent transfer consideration, that arose from Citi-Sauk Rapids' defaulting on the Note payments. Failure to pay debts as they become due creates a presumption of insolvency under the Uniform Fraudulent Transfers
Act. See: Section 2 of the Act.

(11F) Huntoon has not asserted a claim against Citi-Equity for payment of principal.