UNITED STATES BANKRUPTCY COURT
DISTRICT OF MINNESOTA
THIRD DIVISION

In re: Chapter 11 Case

D & P Partnership II, BKY Case No. 3-91-469

Debtor. ORDER

This matter came before the Court May 11, 1992, on motion by the Unsecured Creditors Committee ("Committee") objecting to the claim of Allen A. Spanier ("Spanier"). John Kelly and Brian Leonard appeared for the Committee. The Spanier appeared pro se. Based on all the files and records in this case, and being fully advised in the premises, the Court now makes this ORDER pursuant to the Federal and Local Rules of Bankruptcy Procedure.

I.

The parties have stipulated to the following facts:

1. In 1978, Spanier became a general partner along with Delroy R. Blaske ("Blaske"), in four general partnerships formerly known as B & S Partnership, B & S Rentals, D & A Partnership, and D & A Rentals ("Predecessor Partnerships") formed to acquire, own and operate Burger King Restaurant franchises ("Restaurants").

2. In 1987, discord between Spanier and Blaske concerning operation and financing of the Restaurants ultimately resulted in the termination of Spanier from his role as operations partner. Shortly thereafter, Spanier filed a lawsuit against Blaske and the Predecessor Partnerships in Hennepin County District Court. In addition to other requested relief, Spanier sought the dissolution of the Predecessor Partnerships, and reformation of all existing partnership agreements to provide equal financial treatment of Spanier and Blaske.

3. On or about July 5, 1990, Spanier settled his lawsuit with the Predecessor Partnerships and Blaske. The terms of the settlement obligated the Predecessor Partnerships to repurchase Spanier's equity interest for $330,000.00. Spanier would receive $25,000.00 upon closing on July 5, 1990, with the remaining $305,000.00 payable pursuant to a promissory note ("Note") in annual interest-free installments over an eleven-year period. Spanier purportedly secured the Note by taking a second mortgage in real estate ("Long Lake Property") formerly owned by B & S Rentals. However, no mortgage on the Long Lake Property was ever recorded. Spanier's failure to record the mortgage on the Long Lake Property left his claim against the Debtor's estate unsecured.

4. On July 1, 1990, Blaske and his wife formed D & P Partnership II ("Debtor") as the successor-in-interest to B & S Partnership, one of the Predecessor Partnerships. The Debtor assumed all liability under the Note.

5. Pursuant to the Settlement Documents, Spanier received $25,000.00 on July 5, 1990. Spanier's travel expenses to and from the closing of the settlement of $717.79 were also paid on July 5, 1990. Pursuant to the Note, Spanier received his first installment payment of $10,000.00 on December 12, 1990.

6. On January 28, 1991, the Debtor filed a voluntary petition for relief under Chapter 11 of the Bankruptcy Code. Shortly thereafter, the United States Trustee appointed the Committee. Since the bankruptcy filing, the Debtor has not made any additional payments to Spanier pursuant to the Note.

7. The Debtor listed Spanier in its schedules as the holder of an undisputed, unsecured claim in the amount of $295,000.00. In December 1991, the Committee objected to Spanier's claimed entitlement to treatment as an unsecured creditor, and seeks its subordination under 11 U.S.C. Section 510(c) on the grounds that payment represents return of equity.

II.

Should Spanier's claim be equitably subordinated to the claims of general unsecured creditors?

III.

The Bankruptcy Court sits as a Court of equity when determining the priority of claims entitled to a distribution from a debtor's estate. Pepper v. Litton, 308 U.S. 295, 303-304 (1939). The Court uses its equitable power to subordinate claims to prevent unfairness and injustice in the administration of an estate. Id, 308 U.S. at 307-308. Such case law concerning equitable subordination has been codified in Section 510 of the Bankruptcy Code.(FN1)

(1)11 U.S.C.Section 510 provides in pertinent part:

> (c) Notwithstanding subsections (a) and (b) of this section, after notice and a hearing, the court may-
>
> (1) under principles of equitable subordination, subordinate for purposes of distribution all or part of an allowed claim to all or part of another allowed claim or all or part of an allowed interest to all or part of another allowed interest . . . .

Equitable subordination is mandatory if the claimant engaged in some type of inequitable conduct which injured the creditors of the bankrupt, or conferred an unfair advantage on the claimant, and equitable subordination of the claim is not inconsistent with the provisions of the Bankruptcy Code. In re Bellanca Aircraft Corp., 850 F.2d 1275, 1282 (8th Cir. 1988). However, Courts have applied equitable subordination under circumstances where the claimant has not acted inequitably. Schultz Broadway Inn v. United States, 912 F.2d 230 (8th Cir. 1990). In a recent case, the Eighth Circuit

found that Congress intended to subordinate claims not only involving inequitable conduct, but also intended the doctrine to reach claims with a status susceptible to subordination. Id, at 233.(FN2) The Committee argues that Spanier's claim is in that class.

This Court agrees.

Spanier's sale of his equity interest to the Debtor does not entitle him to distribution as an unsecured creditor because thesale, by itself, does not create a debtor-creditor relationship between Spanier and the Debtor.

> A transaction by which a corporation acquires its own stock from a stockholder for a sum of money is not really a sale. The corporation does not acquire anything of value equivalent to the depletion of its assets . . . It is simply a method of distributing a proportion of the assets to the stockholder. The assets of a corporation are the common pledge of its creditors, and stockholders are not entitled to receive any part of them unless creditors are paid in full. When such a transaction is had, regardless of the good faith of the parties, it is essential to its validity that there be sufficient surplus to retire the stock, without prejudice to creditors, at the time payment is made out of assets.

Robinson v. Wangeman, 75 F.2d 756, 757 (5th Cir. 1935); See also Matter of Poole, McGonigle & Dick, Inc., 796 F.2d 318, 322-23 (9th Cir. 1986); Liebowitz v. Columbia Packing Co., 56 B.R. 222, 224 (D.Mass. 1985), aff'd 802 F.2d 439 (5th Cir. 1986). Courts have interpreted purchases of stock by a corporation from its stockholders, as one where the stockholder who accepts a note in payment for his equity interest assumes the risk that payments on the note will be made only after other general creditors are paid in full. In re Trimble Co., 339 F.2d 838, 843 (3rd Cir. 1964).

(FN2)In Schultz Broadway, the Court found a tax penalty claim of the IRS to be an instance where Congress expressly intended the Bankruptcy Court to subordinate without inequitable conduct. The Circuit Court cited Matter of Stirling Homex Corp., 579 F.2d 206 (2nd Cir. 1978), a case decided three months prior to the passage of the Code, in support of its position. Schultz Broadway, 912 F.2d at 232-33. The Stirling Court relied on the pending Congressional rationale behind Section 510(c)(1) to subordinate the claims of shareholders of a corporation, where the shareholders' claims arose from alleged fraud by the corporation. Stirling Homex Corp., 579 F.2d at 215-6. The result in Stirling is analogous to Spanier's situation to the extent that the good faith of a claimant does not prevent subordination. In Burden v. U.S., 917 F.2d 115, 117-18 (3rd Cir. 1990) the Court gives a summary of the situations where claims have been subordinated without inequitable conduct.

The Committee correctly argues that this principle should be applied to partnerships well.(FN3) The sale of Spanier's equity interest without more entitles the Committee to a determination that Spanier's claim must be subordinated.

NOW, THEREFORE, IT IS ORDERED:

The objection of the Unsecured Creditors Committee is sustained.

Dated:

Dennis D. O'Brien
U.S. Bankruptcy Judge

(FN3) Minnesota partnership law gives creditors priority over partners for distribution upon dissolution of the partnership. Minn.Stat. Section 323.39 provides in pertinent part:

> (2) The liabilities of the partnership shall rank in order payment, as follows:
>
> > (a) Those owing to creditors other than partners;
> > (b) Those owing to partners other than for capital and profits;
> > (c) Those owing to partners in respect to capital;
> > (d) Those owing to partners in respect to profits[.]

The Committee notes that the Debtor's partnership agreement contains a similar scheme for distribution.