§ 362(a)(3)
§ 362(a)(4)
§ 541(a)
Bankr. Rule 9011
Sanctions

McGinnis v. U. S. Fiduciary Corp., Adv. No. 88-0383-P
In re Lew Stewart McGinnis, Case No. 386-05563-P11

2/16/90 ELP Unpublished

The plaintiff sought to avoid a post-petition foreclosure of a security interest in a promissory note and deed of trust. The defendants argued that the property upon which they foreclosed was a partnership asset and not property of the estate.

After considering conflicting testimony from the debtor and his partner, the court concluded that a settlement agreement between the partners initiated a winding up of their partnerships but not a termination of the partnerships. After a transfer of the property from one trust to another, the property remained a partnership asset. Thus the property was not property of the estate subject to the automatic stay.

Because the plaintiff had a good faith argument for his claims, sanctions are not appropriate.

UNITED STATES BANKRUPTCY COURT

FOR THE DISTRICT OF OREGON

In Re LEW STEWART McGINNIS, Debtor.	)	Case No. 386-05563-P11
LEW STEWART McGINNIS, Plaintiff, v. U. S. FIDUCIARY CORPORATION, an Arizona corporation, individually and as trustee for Beta Sigma Trust and Omega Trust; and Benjamin Storek, Defendants.	)	Adversary No. 88-0383 MEMORANDUM OPINION

Plaintiff Lew McGinnis ("McGinnis") seeks, under §549(a) and §362(a)(3) and (4)[1], to avoid a post-petition foreclosure of a security interest in a promissory note and Deed of Trust and to recover damages including attorney fees and punitive damages. Defendants U.S. Fiduciary Corporation ("USFC") and Benjamin Storek argue that the

[1] All references are to the Bankruptcy Code, 11 U.S.C. §101 et seq., unless otherwise specified.

foreclosure sale is not avoidable because the property upon which they foreclosed was not property of the estate. In the alternative, they assert that the post-petition transfer claim is time barred pursuant to §549(d)(1). Defendants request sanctions against McGinnis pursuant to Bankruptcy Rule 9011. The court concludes that McGinnis's interest in the promissory note and Deed of Trust was a partnership asset and thus not property of McGinnis's bankruptcy estate. These matters are core proceedings under 28 U.S.C. §157(b)(2).

FACTS

On April 12, 1983, USFC loaned $175,000 to McGinnis. As security for the note, McGinnis collaterally assigned to USFC his undivided 50% interest in a promissory note and Deed of Trust securing the note, referred to as the Parkwood receivable[2]. At the time of the collateral assignment, although McGinnis held the 50% interest in the receivable in his name, this 50% interest in the receivable was really an asset of a partnership in which McGinnis and Robert Washburn ("Washburn") were partners.

On August 27, 1984, McGinnis and Washburn entered into an Agreement for Termination of Partnership and Settlement of all Claims and Addendum thereto, which provided in part that:

> All existing Partnership interests will be transferred to the names of Lew S. McGinnis and Robert S. Washburn, or at the election of both McGinnis and Washburn to a trust to be administered by a title company agreeable to both, and any transactions including, without limitation, mortgages, deeds, hypothecations or conveyances regarding same, shall require the

[2] As additional security, McGinnis also collaterally assigned his 100% interest in a promissory note and Deed of Trust described as the Phoenician Gardens receivable. This second receivable has not been foreclosed on and is not at issue in this proceeding.

> signature of both Washburn and McGinnis whether held in their respective names or held in trust.

On November 10, 1984, McGinnis transferred his interest in the receivable to Fidelity National Title Agency Trust No. 10,016, of which McGinnis was beneficiary. On September 25, 1985, at McGinnis's direction, the trustee of Trust No. 10,016 transferred its interest in the Parkwood receivable to Stewart Title and Trust of Tucson ("Stewart Title") as trustee under Trust No. 3002, which was established pursuant to the terms of a Land Trust Agreement of July 16, 1985. The trustors of the trust were various California partnerships in which McGinnis and Washburn were partners.

On October 15, 1986, McGinnis filed his Chapter 11 petition. On January 15, 1987, as a result of a default by McGinnis under the terms of his note to USFC, USFC conducted a foreclosure sale of the Parkwood receivable. Before it conducted the sale, USFC obtained a title report to determine the ownership of the Parkwood Deed of Trust, which indicated that Stewart Title Trust No. 3002 was the beneficiary of the Deed of Trust. USFC ascertained that Washburn was the beneficiary named in the trust agreement under which Stewart Title was operating.

ISSUES

1. Did the McGinnis-Washburn settlement agreement immediately terminate the partnerships, or did it set in motion a winding up and dissolution of the partnerships?

2. Did McGinnis retain any interest in the Parkwood receivable after his interest was conveyed to Trust 3002?

3. If so, what interest did he retain?

4. If McGinnis retained an interest that was property of the estate, did defendants willfully violate the automatic stay?

5. If not, are sanctions against McGinnis appropriate in the case?

SUMMARY OF THE PARTIES' CONTENTIONS

McGinnis argues that defendants' actions violated sections 362(a)(3) and (4), which extend the automatic stay to actions "to obtain possession of property of the estate or of property from the estate or to exercise control over property of the estate" and "to create, perfect, or enforce any lien against property of the estate." McGinnis argues that the defendants knew McGinnis had filed a Chapter 11 petition and that he claimed an interest in the Parkwood receivable. Nevertheless, the defendants willfully and intentionally conducted a foreclosure sale in violation of the automatic stay. McGinnis argues that the Parkwood receivable was not a McGinnis and Washburn partnership asset on the date of the foreclosure sale because the partnership was terminated. Even if the partnership were not terminated, the Parkwood receivable was property of the estate because McGinnis retained an interest in the receivable after it was transferred to Trust 3002.

Defendants argue that the Parkwood receivable was a partnership asset at the time of the foreclosure sale because the settlement agreement between McGinnis and Washburn did not immediately terminate the partnership but, rather, provided the mechanism for accomplishing a termination through dissolution and winding up as contemplated by California law. In the alternative, the settlement agreement created a new "de facto" partnership or joint venture.

Either way, the Parkwood receivable was a partnership asset which did not constitute property of an individual partner's (McGinnis's) bankruptcy estate.

ANALYSIS

A. Settlement Agreement

Under California law, which governs the settlement agreement, a partnership may be dissolved by agreement of the partners. Cal. Corp. Code § 15031. Dissolution is defined as "the change in the relation of the partners caused by any partner ceasing to be associated in the carrying on as distinguished from the winding up of the business." Cal. Corp. Code § 15029. "On dissolution the partnership is not terminated, but continues until the winding up of partnership affairs is completed." Cal. Corp. Code § 15030. Winding up and an accounting are necessary steps to termination. 59A Am. Jur. 2d Partnership § 809 (1987). Only upon termination does the partnership cease to exist. Id. at § 1101. Assets of the partnership continue to be partnership assets until termination. Cal. Corp. Code § 15040; 59A Am. Jur. 2d at § 894.

Dissolution may be caused by agreement of the partners. Cal. Corp. Code § 15031(1)(c). Here, the settlement agreement (Defendants' Exhibit V-1) entered into by McGinnis and Washburn contains ambiguities regarding whether the agreement was intended to set in motion the statutory dissolution and winding up process or was meant to immediately terminate the partnerships. For example, the agreement is titled "Agreement for Termination of Partnership." The parties agreed to an immediate liquidation of partnership assets, and all partnership assets were to be transferred to the names of both

parties or to a trust subject to the control of both partners. Washburn was to receive a security interest in plaintiff's share of the partnership assets. On the other hand, in paragraph 3G. of the agreement, plaintiff agreed that "upon the winding up of the Partnerships to execute a Note due Washburn . . . . The principal amount of such Note shall be the amount found owing to Washburn by the final accounting required under Paragraph 5 herein." Similarly, paragraphs 3H. through I. also provide for dealing with partnership assets and an accounting. Paragraph 5 provides for a final accounting in connection with the Partnerships. Paragraph 10 allows the Partnerships, in order to maintain and preserve the partnership assets, to refinance the properties.

McGinnis testified that he and Washburn drafted their settlement agreement, dated August 27, 1984, by using a draft of another settlement agreement with the Colman Group who were creditors and former partners of the McGinnis and Washburn partnerships. After making changes in the Colman Group settlement agreement which served as a model, Washburn and McGinnis had their settlement agreement typed in McGinnis's office. McGinnis understood that the Washburn-McGinnis settlement agreement terminated the McGinnis and Washburn partnerships and that the assets would be owned by McGinnis and Washburn as individuals. They would sell the assets and pay off the Colman Group. The addendum, prepared at Washburn's insistence, required the partnership assets to be transferred into their joint names or to a trust agreeable to both. Either way, any conveyance would require the signature of both.

Upon cross-examination, McGinnis explained that the use of

the word "Partnerships" in paragraphs 3H, 5, and 10 of the settlement agreement and in paragraph B. of the addendum did not mean partnerships, it meant McGinnis and Washburn as individuals. As an explanation for this ambiguity, he stated that the language which included the word "Partnerships" was taken from the Colman Group settlement agreement.

Plaintiff's Exhibit 30, Statement of Affairs for Debtor Engaged in Business was filed in McGinnis's bankruptcy case on January 7, 1987. In response to a question asking for all transfers made within one year of filing, McGinnis disclosed assignments of property made through an assignment of land trust to Washburn as trustee for their partnerships. McGinnis explained that he was referring to some collateral assignments made to Washburn in 1983. His answer implies that he was not referring to the assignment of trust deed, dated September 25, 1985, and recorded December 5, 1985, whereby Trust 10,016 conveyed McGinnis's beneficial interest in the Parkwood receivable to Stewart Title Trust 3002 for which Washburn was the beneficiary as discussed below.

Schedule B-2 at Note O (Plaintiff's Exhibit 5) lists McGinnis's partnership interest in the four McGinnis and Washburn partnerships[3] as personal property owned by McGinnis on the date of filing. McGinnis explained that he listed the partnerships even though there were no longer any partnership assets. In his opinion the partnerships existed without assets because no final income tax

[3] M & W Investments, Ltd., a California general partnership; Sabino Investors, a California general partnership; Sonoita Investors, a California general partnership; and Broadway Income Properties, a California general partnership.

returns had been filed for the partnerships.

Washburn testified that the purpose for the McGinnis-Washburn settlement agreement was to provide a means for liquidating the partnership assets and paying the creditors of the partnership pursuant to the Colman group settlement agreement. (Exhibit 26-g, p.28, l. 10-18). The McGinnis and Washburn partnerships would not cease to exist as a result of the settlement agreement and the addendum. First they had to liquidate the assets, conduct a proper accounting, repay the debts, and then divide the excess proceeds between the two partners. (Exhibit 26-g, p. 28, l. 22 through p. 29, l. 4 and l. 21-25). The settlement agreement was intended to facilitate the liquidation of assets toward an eventual termination of the partnerships. (Exhibit 26-g, p. 30, l. 1-5) The purpose for the language in the addendum providing for the transfer of the assets to their names jointly or to a trust which they would jointly control was to prevent McGinnis from being able to deal with the assets as if they were his own property. (Exhibit 26-g, p. 32, l. 1-6). A trust (Trust 3002 discussed below) was eventually created to take title to the partnership assets but it was controlled only by Washburn at the insistence of their creditors instead of being controlled by both Washburn and McGinnis as contemplated in the addendum. (Exhibit 26-g, p. 32, l. 20 through p. 33, l. 13).

Considering the testimony, I find the testimony of Washburn to be more credible than McGinnis concerning the intent of the parties in drafting the settlement agreement and the addendum. Upon examining the ambiguities in the documents themselves and admissions made by McGinnis on his schedules and statement of affairs, I conclude that

the credible evidence is consistent with the continued existence and winding down of the partnerships after the execution of the settlement agreement and addendum.

B. Trust 3002

It is undisputed that the Parkwood receivable was an asset of a McGinnis and Washburn partnership before it was conveyed to Trust 3002. On September 25, 1985, at McGinnis's direction as beneficiary of Trust 10,016, Trust 10,016 conveyed "all beneficial interest" under the Parkwood trust deed and the note to Stewart Title as trustee for Trust 3002. McGinnis argues that this transfer coupled with the trust agreement which established Trust 3002 was not intended to terminate his ownership interest in the partnership assets, and that the transfer to Trust 3002 was an implementation of the termination agreement. However, it is not clear from the trust agreement establishing Trust 3002 whether assets were to be held as assets of the partnerships or as assets of McGinnis and Washburn individually.

Generally under Arizona law, which governs the trust agreement, the intention of the trustor is to be ascertained from the language of the written agreement. Olivas v. Board of National Missions of Presbyterian Church, 405 P.2d 481, 485 (Ct. App. Az. 1965). However, when the language used does not plainly express the intention of the trustor, the court may receive extrinsic evidence and look into the circumstances surrounding the creation of the trust and the nature of its terms and it beneficiaries. Id. Thus it is proper to consider extrinsic evidence concerning the parties' intentions at the time of the creation of Trust 3002.

Two trust agreements for Stewart Title Trust 3002 were

admitted into evidence. These were exhibits to the deposition of Wanda Dannenfelser, a senior vice president for Stewart Title who has worked in Stewart Title's trust department for over twenty years. She stated that the first trust agreement, dated July 16, 1985, (Defendants' Exhibit J and Exhibit 1 to Plaintiff's Exhibit 26-b) established Trust 3002 and named Washburn as the sole beneficiary. (Exhibit 26-b, p.5, l.9 -16 and p.9, l.15-16) The settlors, four McGinnis and Washburn California partnerships[4], named Stewart Title as trustee. Dannenfelser stated that Stewart Title did not draft Exhibit 1 but that it had been drafted by attorneys outside Stewart Title who used the Stewart Title land trust agreement form and changed some of the wording. (Exhibit 26-b, p. 16 l. 22 and p. 31 l. 5-15).

Exhibit 1 contains duplicate signature pages. McGinnis and Washburn did not sign the same copy but rather different copies of identical signature pages. McGinnis's signature appears on the signature pages of the agreement four times in his capacity as partner for each of the four McGinnis and Washburn partnerships, the trustors. McGinnis's signature appears on a page which includes a signature line for Washburn as beneficiary. Washburn also signed as a partner for the four partnerships and as beneficiary.

Dannenfelser testified that a draft of a second trust agreement (Exhibit 6 to Plaintiff's Exhibit 26-b) for Stewart Title Trust 3002 had been prepared by one of the employees at Stewart Title. The original copy had been picked up by an employee of McGinnis. (Exhibit 26-b, p. 16 l. 9-11). The draft was the standard Stewart

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[4] See Footnote 3.

Title form with the blanks filled in. (Exhibit 26-b, p. 17, l. 1-2). This second version which was unsigned named four McGinnis and Washburn partnerships as beneficiaries (Exhibit 26-b, p. 17, l. 5-9). Dannenfelser explained that it was kept in the file while waiting for the original to be returned and remained in the file when a different version was returned. (Exhibit 26-b p. 18, l.20-24).

McGinnis testified that he saw Exhibit 6 (the second version) about July 16, 1985, but that he did not execute it because it was not correct. He also stated that he did not execute Exhibit J (the first version) in its present form. The version he signed did not contain a cross-out on page one and Washburn was not listed on the sole beneficiary. He stated that he signed a trust agreement that included both McGinnis and Washburn as beneficiaries. No copies of a third version which is compatible with his testimony was offered into evidence by the plaintiff.

Washburn testified in his deposition that he was named as beneficiary of Trust 3002 instead of McGinnis and Washburn because the creditors of the partnerships wanted to see Washburn in complete control of the assets and their liquidation. Furthermore, the creation of the trust with Washburn as the sole beneficiary was done with the knowledge and consent of McGinnis (Exhibit 26-g, p. 33, l. 3-16 and p.43, l. 11-20). Washburn's testimony is consistent with McGinnis's trial testimony that the Colman Group was applying pressure to require Washburn to have exclusive control over the partnership assets. McGinnis also testified that his ownership "tainted" the assets and his removal from ownership would allow a quicker sale of the assets. Washburn testified that, once the assets were

transferred into Trust 3002, McGinnis still had an interest in the assets. McGinnis's interest was a partnership interest as defined by their partnership agreement. McGinnis's right to distribution and right to the property were no different than his rights which existed before the settlement agreement except for the additional obligations created by the settlement agreement. (Exhibit 26-g, p. 33, l. 16 through P. 34 l. 11). However, in order to placate their partnership creditors, McGinnis no longer had the right to manage the assets. (Exhibit 26-g, p.43, l. 6-20).

McGinnis executed a Power of Attorney on July 13, 1985, which irrevocably appointed Washburn as attorney in fact for McGinnis with respect to McGinnis and Washburn partnerships properties and assets including

> any trust in which such beneficial interest is nominally held by McGinnis for the benefit or true ownership of any of the M&W Entities including (without limitation) Stewart Title & Trust of Tucson, Inc., an Arizona corporation, as Trustee under Trust No. 3002.

Defendants' Exhibit W.

The power of attorney had a stated term of August 1, 1985 to August 1, 1986. McGinnis testified that he signed the power of attorney in response to the pressure from the Colman Group but that it was only necessary under the version of the trust agreement naming both Washburn and McGinnis as beneficiaries. Washburn testified that the purpose of the power of attorney was to give Washburn control over the assets so that he could deal with them without obtaining the consent of McGinnis and that there was no intent to change the ownership of

the assets. (Exhibit 26-g, p. 44, l. 2-16.)

Again, I find Washburn's explanation of the intent of the parties in drafting the trust agreement and transferring the assets to Trust 3002 to be more credible that of McGinnis. The power of attorney which McGinnis granted to Washburn is consistent with Washburn's testimony that McGinnis was forced to relinquish his right to manage partnership assets to Washburn. I find that the Parkwood receivable continued as a partnership asset after it was transferred to Trust 3002 and that Washburn, as beneficiary of the trust, was a fiduciary for the McGinnis and Washburn partnerships. Thus the Parkwood receivable was a partnership asset when the defendants conducted the foreclosure sale.

C. Property of the estate

Property of the estate is defined in section 541(a), which provides:

> The commencement of a case . . . creates an estate. Such estate is comprised of all the following property, wherever located and by whomever held:
>
> > (1) Except as provided in subsections (b) and (c)(2) of this section, all legal or equitable interests of the debtor in property as of the commencement of the case.

A general partner's interest in a partnership is personal property and comes into each debtor partner's bankruptcy estate. In re Cardinal Industries, Inc., 105 Bankr. 834, 19 B.C.D. 1450, 1460 (Bankr. S.D. Ohio 1989)[5]. However, property owned by a partnership is not subject

[5] The debtor in Cardinal is the general partner in hundreds of limited partnerships, however the reasoning is still applicable to determining the nature of property owned by a general partnership as in this case.

to the automatic stay and §362(a)(3) does not bar foreclosure actions against the property. Id. The mere fact that a partner, as a tenant in partnership, has an ownership interest in partnership property, does not mean that partnership property is an asset of an individual partner's bankruptcy estate. Id. at 1461; cf. In re Minton, 46 B.R. 222 (S.D.N.Y. 1985)(general partner debtor has only an interest in the partnership which "owns" the asset, therefore the trustee can not reach partnership property)[6]. Thus, because the Parkwood receivable was a McGinnis and Washburn partnership asset, it is not property of the estate subject to the automatic stay[7].

D. Sanctions

Alleging that McGinnis's complaint was brought without substantial justification and thus constitutes harassment, the defendants seek sanctions pursuant to Bankruptcy Rule 9011. The standard for imposition of sanctions under Rule 9011 is the reasonableness of the conduct under the circumstances. In re Film Ventures International, Inc., 89 B.R. 80, 83 (9th Cir. BAP 1988). The pleader must state an arguable claim accompanied by an objective good faith argument of what the law is or should be. Id. This case presented complex issues of fact and conflicting interpretations of law. Because McGinnis had a good faith argument for his claims, I conclude that sanctions are not appropriate in this case.

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[6] In re Imperial "400" National, Inc., 429 F.2d 671 (3rd Cir. 1970), cited by the plaintiff, is distinguished by the Minton court because the partners in Imperial "400" held their interest in the partnership as tenants in common and not as tenants in partnership.

[7] Plaintiff argues that even if the stay violation is not willful, the foreclosure sale was a post-petition transfer avoidable under section 549(a). Because the Parkwood receivable was not property of the estate, I do not need to address this the merits of this claim or its timeliness.

CONCLUSION

For the reasons set forth above, judgment will be granted for the defendants. Defendants' request for sanctions is denied. This Memorandum Opinion shall constitute Findings of Fact and Conclusions of Law pursuant to Bankruptcy Rule 7052 and Fed. R. Civ. Proc. 52, and they shall not be separately stated. Defendants shall submit a judgment consistent with this opinion.