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Partnerships And Partners Under The Bankruptcy Code: Claims And Distribution

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PARTNERSHIPS AND PARTNERS UNDER THE BANKRUPTCY CODE: CLAIMS AND DISTRIBUTION

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I. THE JINGLE RULE

The distribution of the proceeds of partnership and partners' estates in bankruptcy has been strongly influenced by rules that evolved in equity.[1] The governing principle has been the so-called "jingle rule": "Firm estate to firm creditors, separate estate to separate creditors, anything left over from either to go to the other."[2] The rule was embodied in section 5g of the Bankruptcy Act,[3] and the Commissioners on Uniform State Laws incorporated the rule in section 40 of the Uniform Partnership Act,[4] largely in deference to the provision for it in the

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[1] *See* Shroder, *Distribution of Assets of Bankrupt Partnerships and Partners*, 18 HARV. L. REV. 495, 496-97 (1905).

[2] Professor MacLachlan attributed the jingle rule to Professor James Barr Ames. *See* J. MACLACHLAN, HANDBOOK OF THE LAW OF BANKRUPTCY § 355, at 424 & n.9 (1956). The origins of the rule can be traced as far back as *Ex parte* Crowder, 2 Vern. 706, 23 Eng. Rep. 1064 (Ch. 1715), but the jingle rule apparently derived its greatest impetus from Lord Hardwicke. *See* J. STORY, PARTNERSHIP 579-80 (7th ed. 1881). The rule was well established in the United States before the Supreme Court decided Amsinck v. Bean, 89 U.S. 395, 401 (1874). The rule is sometimes referred to as the "dual priorities" rule. *See* Hecker, *The Revised Uniform Limited Partnership Act: Provisions Affecting the Relationship of the Firm and Its Members to Third Parties*, 27 U. KAN. L. REV. 1, 15 (1978).

[3] Bankruptcy Act, ch. 541, § 5g, 30 Stat. 544, 11 U.S.C. § 23(a) (1976) (repealed 1978). This is the only time that citation to 11 U.S.C. will be made in this article when the intended reference is to the Bankruptcy Act. The numbering of the sections of the Bankruptcy Act differs from their numbers in 11 U.S.C. The numbering of the Bankruptcy Act, which corresponds to the original numbering in the legislation as enacted in the Statutes at Large, is that generally used in cases and commentaries pertaining to bankruptcy.

Section 5g of the Bankruptcy Act stated that "[t]he net proceeds of the partnership property shall be appropriated to the payment of the partnership debts and the net proceeds of the individual estate of each general partner to the payment of his individual debts." The subdivision provided further that any surplus remaining from any general partner's property shall be added to the partnership estate, and any surplus of the partnership property shall be proportionately distributed among the partners' estates.

[4] *See* UNIFORM PARTNERSHIP ACT § 40(h). Section 40(h) states that "[w]hen partnership property and the individual properties of the partners are in possession of a court for distribution, partnership creditors shall have priority on partnership property and separate creditors on individual property, saving the rights of lien or secured creditors as heretofore." The Uniform Partnership Act has been enacted by all states except Georgia and Louisiana. *See* 6 U.L.A. 1 (Supp. 1982).

Other provisions of § 40 of the Uniform Partnership Act elaborate the jingle rule. Section 40(i) recognizes the right of partnership creditors to share in a distribution of a partner's estate after the separate creditors have been paid. There is no correlative right of separate creditors of a partner to share directly in any distribution of partnership property, their right being confined to that of sharing in the distribution of the property of the partner, including his share of the capital and profits of the partnership distributed after partnership creditors have been fully paid. *See* UNIFORM PARTNERSHIP ACT § 40(b).

The jingle rule and its adaptations in the Bankruptcy Act and the Uniform Partnership Act prescribe marshalling requirements that apparently apply irrespective of whether

Bankruptcy Act.[5] Since the partners are liable for partnership obligations, the branch of the rule that precludes the distribution of the proceeds of a partner's property to partnership creditors unless and until the partner's separate creditors have been paid in full has been criticized as artificial and indefensible.[6] No question appears to have arisen,

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the estates of the partnership and the partners are jointly or separately administered and without regard to the size of any of the estates involved or to the extent of the liabilities to partnership creditors or separate creditors. Although a majority of cases in the United States and England have honored the priority of the separate creditors in the distribution of the partner's estate, this application of the jingle rule has been much criticized, and a number of courts declined to follow the rule in such a distribution. *See* F. MECHEM, ELEMENTS OF THE LAW OF PARTNERSHIP §§ 453-56 (2d ed. 1920).

[5] *See* Lewis, *The Uniform Partnership Act—A Reply to Mr. Crane's Criticism*, 29 HARV. L. REV. 291, 306-07 (1916). Mr. Lewis thought that it would not only be unwise for the Uniform Partnership Act to differ from the Bankruptcy Act but that it would be impossible to get the Uniform Act widely adopted if it did not incorporate the jingle rule.

[6] Mr. Justice Story criticized the rule as artificial. *See* J. STORY, *supra* note 2, at 579-84. Professor Crane criticized the rule as logically indefensible. *See* J. CRANE, HANDBOOK ON THE LAW OF PARTNERSHIP AND OTHER UNINCORPORATED ASSOCIATIONS 514 (2d ed. 1952) (citing and quoting J. PARSONS, PARTNERSHIP § 191 (1889)). *See also* J. MACLACHLAN, *supra* note 2, § 355, at 424.

Professor James Parsons of the University of Pennsylvania, in the passage cited by Professor Crane, emphasized that the assumption underlying the jingle rule, *viz.*, that the joint creditors relied upon the firm assets and the separate creditors looked to the separate estate for payment, contradicted experience. *See* J. PARSONS, *supra*, § 191. Another treatise on partnership by another Parsons, Professor Theophilus Parsons of Harvard, had taken a quite different position 22 years earlier: "It seems to us a simple rule, eminently practical, and founded upon principles of justice and of policy, so certain and obvious, that they upon whom the rule presses heavily are seldom disposed to question its general propriety. And we cannot but think that, as a rule of equity, it is impregnable, and that it will be recognized as a rule of law." T. PARSONS, PARTNERSHIP 482 (1867).

When Professor Joseph Beale's revision of the latter Parsons' treatise on partnership appeared in 1893, however, the last sentence of the passage quoted in the preceding paragraph had disappeared, and the following two sentences appeared in a footnote: "Since the partners are liable for all firm debts, it would seem that the partnership creditors might also prove against the estates of the individual partners, and share with the other individual creditors. That they may make proof of their claims against the individual estates is everywhere admitted." T. PARSONS, PARTNERSHIP 476 n.1 (J. Beale ed. 4th ed. 1893).

The most recently published edition of Professor Crane's treatise also reflects a modification of the view taken toward the jingle rule:

> The predecessor of this work called it logically indefensible. The present author feels less strongly and merely notes that the rule has been sharply criticized for destroying or diminishing the partnership creditor's rights against partners' separate property—which he has been led to expect by their joint or joint and several liability for firm debts—at the very time when he most needs them. But the law has been settled long enough that creditors must be charged with knowledge of it and not permitted to complain of frustrated expectations. The critics . . . must be assuming that partnership credit is socially or economically more important or productive than individual credit in order to enjoy priority in one arena and parity in the other. To the extent that partnership credit is business credit and individual credit is not, some such argument can be made. But it has not been proved. Moreover, it seems quite doubtful in the age of mass con-

however, regarding the propriety of the branch of the rule that accords priority to partnership creditors in the distribution of the partnership estate.[7]

The Commission on Bankruptcy Laws, following a recommendation of the National Bankruptcy Conference,[8] proposed the explicit abolition of the jingle rule insofar as it postponed participation by partnership creditors in the distribution of a separate partner's estate until his creditors had been fully paid.[9] The legislative reports accompanying the bills that became the Bankruptcy Reform Act of 1978 (Bankruptcy Code)[10] stated that section 723[11] "repeals the jingle rule, which, for ease

> sumer credit . . . which looms so large in the American economy. On the whole, the rule seems to do rough justice. One would be hard put to improve, in the abstract, its approximate balance.

J. CRANE & A. BROMBERG, LAW OF PARTNERSHIP 533 (1968).

[7] *See In re* Wilcox, 94 F. 84, 104 (D. Mass. 1899); J. MACLACHLAN, *supra* note 2, § 355, at 424.

[8] *See* Kennedy, *A New Deal for Partnership Bankruptcy*, 60 COLUM. L. REV. 610, 630-32 (1960) (discussion of draft proposals for the National Bankruptcy Conference).

[9] *See* REPORT OF THE COMMISSION ON THE BANKRUPTCY LAWS OF THE UNITED STATES, PART II, H.R. DOC. NO. 137, PART II, 93d Cong., 1st Sess. 111, 115 (1973) [hereinafter cited as COMMISSION REPORT II]. Section 4-405(f) of the Commission's proposed Bankruptcy Act of 1973 read as follows: "The creditors of a partnership shall share in the distribution of the proceeds of the estate of a general partner in the same manner and to the same extent as other creditors of such partner." *Id.*

[10] Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549 (1978) (codified at 11 U.S.C. §§ 101-151326 (Supp. IV 1980)). In this article all citations to the Bankruptcy Reform Act are references to title 11 of the United States Code unless otherwise indicated.

[11] Section 723 of the Bankruptcy Code reads as follows:

> § 723. Rights of partnership trustee against general partners
>
> (a) If there is a deficiency of property of the estate to pay in full all claims allowed in a case under this title concerning a partnership, then each general partner in such partnership is liable to the trustee for the full amount of such deficiency.
>
> (b) To the extent practicable, the trustee shall first seek recovery of such deficiency from any general partner in such partnership that is not a debtor in a case under this title. Pending determination of such deficiency, the court may order any such partner to provide the estate with indemnity for, or assurance of payment of, any deficiency recoverable from such partner, or not to dispose of property.
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> (c) Notwithstanding section 728(c) of this title, the trustee has a claim against the estate of each general partner in such partnership that is a debtor in a case under this title for the full amount of all claims of creditors allowed in the case concerning such partnership. Notwithstanding section 502 of this title, there shall not be allowed in such case a claim against such partner on which both such partner and such partnership are liable, except to any extent that such claim is secured only by property of such partner and not be [by] property of such partnership. The claim of the trustee under this subsection is entitled to distribution in such case under section 726(a) of this title the same as any other claim of the kind specified in such section.
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> (d) If the aggregate that the trustee recovers from the estates of general partners under subsection (c) of this section is greater than any deficiency not recovered under subsection (b) of this section, the court, after notice and a hearing, shall determine an equitable distribution of the surplus so recovered, and the

of administration, denied partnership creditors their rights against general partners by permitting general partners' individual creditors to share in their estates first to the exclusion of partnership creditors."[12] The reports declared their purpose to track "more closely . . . generally applicable partnership law, without a significant administrative burden."[13]

The jingle rule is not explicitly overruled by the Bankruptcy Code, however, and there is at least some risk that in view of the long acceptance of the rule for administration of partnership and partners' estates in equity and in bankruptcy, the ancient rule may be deemed to have survived to the extent not inconsistent with the provisions of the Bankruptcy Code. Section 723 is directly applicable only in partnership liquidation cases under Chapter 7, and it is thus arguable that the jingle rule remains the law applicable in other cases under the Bankruptcy Code.[14] The definition of "insolvency" in the Bankruptcy Code,[15] for example, in-

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trustee shall distribute such surplus to the estates of the general partners in such partnership according to such determination.

[12] H. R. REP. NO. 595, 95th Cong., 1st Sess. 381 (1977), *reprinted in* 1978 U. S. CODE CONG. & AD. NEWS 6337 [hereinafter cited as HOUSE REPORT]; S. REP. NO. 989, 95th Cong., 2d Sess. 95, *reprinted in* 1978 U. S. CODE CONG. & AD. NEWS 5881 [hereinafter cited as SEN. REPORT].

[13] HOUSE REPORT, *supra* note 12, at 381, 1978 U. S. CODE CONG. & AD. NEWS 6337; SEN. REPORT, *supra* note 12, at 95, 1978 U. S. CODE CONG. & AD. NEWS 5881; *see also* HOUSE REPORT, *supra* note 12, at 201, 1978 U. S. CODE CONG. & AD. NEWS 6161.

[14] The Bankruptcy Code provides for five kinds of cases, each governed by a different chapter. Chapter 7 contemplates liquidation of a debtor's estate. Chapter 9 governs the adjustment of indebtedness of a municipal corporation or other eligible governmental unit. Chapter 11 provides for the reorganization of a debtor, though a plan of liquidation may actually qualify as a plan of reorganization. Chapter 13 authorizes an individual, with or without a spouse, to effect a composition or extension of debts, or both, by payments over time up to five years. Eligibility for relief under the several chapters is governed by § 109. A voluntary case may be commenced by an eligible debtor under any of these chapters. An involuntary case may be commenced against an amenable debtor under Chapter 7 or Chapter 11 by a party or parties other than the debtor.

The jingle rule could then apply in a partnership case under Chapter 11 as well as in a partner's case under Chapter 7, 11, 13, or conceivably Chapter 9. Since a partnership is not eligible for or amenable to relief under Chapter 9 or 13, the question of the applicability of the jingle rule in a partnership case cannot arise under either of these chapters.

[15] Section 101(26)(B) defines "insolvent" to mean:

with reference to a partnership, financial condition such that the sum of such partnership's debts is greater than the aggregate of, at a fair valuation—

(i) all of such partnership's property, exclusive of property of the kind specified in subparagraph (A)(i) of this paragraph [*i.e.*, property fraudulently concealed or transferred]; and

(ii) the sum of the excess of the value of each general partner's separate property, exclusive of property of the kind specified in subparagraph (A)(ii) of this paragraph [*i.e.*, property that may be exempted] over such partner's separate debts.

Senate Bill 863, as passed by the Senate on July 17, 1981, during the first session of the 97th Congress, would have substituted "nonpartnership" for "separate" each place it appears in this definition. *See* S. 863, 97th Cong., 1st Sess., 127 CONG. REC. S7894 (daily ed. July 17, 1981).

cludes a provision applicable to partnerships that is substantially identical to the definition of partnership insolvency that has been applied under the Bankruptcy Act.[16] By providing that in the calculation of partnership insolvency, there shall be added to partnership property the surplus of each general partner's separate property in excess of the value of the partner's separate debts, the drafters arguably enshrined in the new law the notion that partnership creditors should not participate in the separate property of the partners except to the extent a surplus exists.

Section 723 nevertheless negates the operation of the jingle rule insofar as it would protect separate creditors of a partner from competition for the proceeds of the partner's estate by partnership creditors whenever the partnership is a debtor under Chapter 7. It does not matter whether the partner is a debtor under Chapter 7, Chapter 11, or Chapter 13, or is not a debtor under the Bankruptcy Code at all.[17] This

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[16] The definition of "insolvent" in § 1(19) of the Bankruptcy Act did not indicate how or whether the separate property of the general partners should be counted in determining partnership insolvency. Section 67d(1)(d) of the Bankruptcy Act, however, defined partnership insolvency for the purposes of the section vesting power in the trustee to avoid a fraudulent transfer. Section 67d(1)(d), which was an adaptation of § 2(2) of the Uniform Fraudulent Conveyance Act, read in pertinent part as follows:

> To determine whether a partnership is insolvent, there shall be added to the partnership property the present fair salable value of the separate property of each general partner in excess of the amount required to pay his separate debts . . . .

Notwithstanding the restricted purpose of this definition of partnership insolvency, it was an accurate statement of what most bankruptcy courts did in determining partnership insolvency for any purpose under the Bankruptcy Act. *See* 1A J. MOORE & L. KING, COLLIER ON BANKRUPTCY ¶ 5.06 (14th ed. 1974).

The definition of partnership insolvency in § 101(26)(B) of the Bankruptcy Code is thus consistent with, and is indeed derived from, the definitions of insolvency found in § 2(2) of the Uniform Fraudulent Conveyance Act and the adaptation thereof in § 67d(1)(d) of the Bankruptcy Act. Under either system of distribution if, after application of the partnership property to the payment of the partnership debts, there is still not enough separate property of the partners to pay all of the debts of the partnership and the partners, the partnership is insolvent. If the jingle rule is not applied, however, allowing the partnership creditors to compete with the separate creditors in the distribution of the partners' estates may render the partnership solvent, although the separate creditors of one or more partners may not receive full payment.

[17] The fact that the partnership is a debtor under Chapter 7 presents no interpretive difficulty when a petition for relief under Chapter 11 is filed by or against a member of the partnership, so long as the partner meets the requirements of § 109(e). Nor is the fact that a petitioner under Chapter 13 is a partner a ground for denying relief, even though the partnership is ineligible as a debtor under the chapter. The debtor must, of course, meet the requirements of § 109(e) in order to be entitled to relief under Chapter 13. *Cf. In re* Krokos, 12 Bankr. 520, 4 COLLIER BANKR. CAS. 2D 1020, BANKR. L. REP. (CCH) ¶ 68,220 (Bankr. S.D.N.Y. 1981) (Chapter 13 petition filed jointly by husband and wife dismissed because relief sought was for a partnership and all debts scheduled were liabilities of partnership). It is perhaps unlikely that a municipality eligible under § 109(c) to file a petition for relief under Chapter 9 would be a partner, but there appears to be nothing in the Bankruptcy Code to preclude such a possibility. The observations made in this note regarding partners apply equally to general and limited partners.

conclusion is compelled by a consideration of the rights of a trustee of the partnership granted by section 723.[18]

The radiations from section 723, moreover, suggest that it impinges on far more than the liquidation of a partnership case under Chapter 7. It is first to be noted that in a Chapter 11 case involving the reorganization of a partnership debtor, the partnership creditors are entitled to insist that a plan provide at least as much to each of them as would be yielded by a liquidation of the partnership under Chapter 7.[19] This means that the partnership creditors may require the plan to reflect what would be recoverable from the separate partners' estates without hindrance from the jingle rule. Section 723 may thus apply indirectly to a Chapter 11 partnership case to the extent of imposing a minimum on the distribution that must be provided for partnership creditors by a reorganization plan.[20]

When the partnership is not a debtor in a case under the Bankruptcy Code, section 723 does not purport to prescribe the order of distribution of the proceeds of a partner debtor's estate. It is thus arguable that the distribution of a partner's estate in such a case shall be governed by nonbankruptcy law.[21] Since nonbankruptcy law has generally followed the jingle rule,[22] the case law that has protected the separate creditors of a partner from competition in the distribution of the proceeds of a

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[18] If a partner is not a debtor in a case under the Bankruptcy Code, the partnership trustee may, under § 723(a) and (b), seek recovery of any deficiency of the partnership property to meet claims against the partnership, and there is no limitation of the recovery to the value of the partner's separate property in excess of the partner's separate debts. If a partner is a debtor under any chapter of the Bankruptcy Code, the partnership trustee has an automatic claim under § 723(c) against the partner's estate for all the amount of the partnership creditors' claims allowed in the partnership case. *See infra* text accompanying notes 61-73.

[19] Section 1129(a)(7) requires a plan to provide that each holder of a claim "will receive or retain . . . property of a value, as of the effective date of the plan, that is not less than the amount that such holder would so receive or retain if the debtor were liquidated under Chapter 7 of this title on such date."

The House Report is at pains to point out in two places the relevance of § 723 in applying § 1129(a)(7) in a partnership case. *See* HOUSE REPORT, *supra* note 12, at 200, 412-13, 1978 U. S. CODE CONG. & AD. NEWS 6160, 6368-69. *See also* Rosenberg, *Partnership Reorganization Under the Bankruptcy Reform Act: Filling in the Interstices*, 56 N.Y.U. L. REV. 1173, 1191, 1193 (1981); *Structuring and Documenting Business Financing Transactions Under the Federal Bankruptcy Code of 1978*, 35 BUS. LAW. 1645, 1661 (1980).

[20] So long as the minimum is provided by the plan, however, nothing in the Bankruptcy Code forbids application of the jingle rule in a partnership case under Chapter 11, either in a reorganization plan or a liquidation that is administered in a Chapter 11 case. If the proponent of a Chapter 11 plan classifies the partnership creditors separately from the creditors of the individual partners, there is a rational basis for the classification, and it may be forcefully argued that the governing rules of distribution are to be found in the state laws that would apply if no petition had been filed under the Bankruptcy Code. These rules generally prescribe distribution according to a version of the jingle rule. *See supra* note 4.

[21] *See* Kashner, *Financing Limited Partnerships and Their Partners: Caveat Creditor*, 37 BUS. LAW. 171, 188 n.52 (1981).

[22] *See supra* note 4.

partner's estate may remain fully applicable, at least until a partnership becomes a debtor. As the excerpts from the legislative history of the Bankruptcy Code quoted above suggest,[23] this result seems not to have been contemplated or intended, at least when the partner is a debtor in a Chapter 7 case. If it was contemplated, it is surprising that neither the statute nor the legislative history takes into account the complications of administration that would ensue when a partnership case is commenced after a case concerning one of its member partners has been partially administered. The difficulties can be illustrated by the following hypothetical case of Partner *A*, in which a distribution has been ordered to *A*'s separate creditors:

A's estate	$1000
Partnership creditors' claims	$2000
A's separate creditors' claims	$2000

If the jingle rule is applied, the partnership creditors are entitled to no distribution and *A*'s separate creditors receive no more than a fifty percent distribution.[24] Suppose, however, that after this distribution but before *A*'s case is closed, the partnership of which *A* is a member becomes a debtor in a case under the Bankruptcy Code. Section 723(c) would now apply but with what consequence so far as the distribution is concerned? Would section 723(c) now require a redistribution after disgorgement by the separate creditors of part or all of what they have received from the trustee of the partner's estate? The recovery of funds distributed pursuant to orders of a court of competent jurisdiction is repugnant to sensible administration. If the completed distribution according to the jingle rule should be regarded as not subject to rectification, there would remain the question of its effect on any subsequent distribution in the event additional funds came into *A*'s estate. Section 508(b), which requires an equalization of distribution when a partnership creditor receives a payment or transfer from a partner who is not a debtor in a Chapter 7 case,[25] would be inapplicable, though arguably it could be applied by analogy.

Whatever conclusion is drawn concerning the appropriate solution of the hypothetical problem presented in the preceding paragraph, it would arise only if the jingle rule is deemed applicable in Partner *A*'s case prior to the commencement of the partnership's case. The consequence of recognizing the survival of the jingle rule for application in partners' cases but subject to termination or at least modification on institution of

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[23] *See supra* text accompanying notes 12 & 13.

[24] *Cf. In re* Saratoga Dev't Corp., 3 BANKR. CT. DEC. 1373, 15 COLLIER BANKR. CAS. 767 (Bankr. S.D. Cal. 1978) (FDIC as assignee of partnership creditor's claim filed under Chapter XI of the Bankruptcy Act against corporate partner subordinated to unsecured claims of partner's separate creditors).

[25] *See infra* text accompanying notes 127-36.

a case by or against the partnership would generate such confusion, litigation, delay, and inordinate expense of administration that the courts can be expected to eschew its application.[26] Notwithstanding theoretical and analytical justifications that may be advanced for the jingle rule's viability under the Bankruptcy Code, pragmatic considerations and cogent evidence of legislative intent that it be abolished require its general rejection as a guide to distribution under the new law.[27]

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[26] If partnership creditors may insist on application of the rule of § 723 in a partnership case, efforts of separate creditors of the partners to obtain the benefits of the jingle rule by keeping the partnership out of the bankruptcy court are unlikely to succeed when much is at stake. Even if the partnership becomes a debtor in a Chapter 11 case, the right of the partnership creditors to insist on a plan that treats them as well as would a liquidation in which the partner's separate creditors are denied priority in a partner's estate is a serious restriction on the protection derivable by the separate creditors from the jingle rule. To avoid or minimize the problems referred to in the text, partnership creditors will be well advised to file a petition against the partnership as soon as possible after a petition has been filed by or against a partner. Whether it will also be advisable to seek an order for relief against other partners will depend on an assessment of the comparative advantages to the partnership creditors of the rights afforded them by subsections (a) and (b) and by subsection (c) of § 723. In view of the fact that the rights given by subsections (a) and (b) are in no way subordinated to the rights of the separate creditors, the partnership creditors will not ordinarily have any incentive to institute involuntary proceedings against partners under the Bankruptcy Code.

General nonpayment of his debts, including those owed partnership creditors by a partner, is a sufficient ground for an involuntary petition to be filed against the partner by partnership creditors. *See* HOUSE REPORT, *supra* note 12, at 198, 1978 U. S. CODE CONG. & AD. NEWS 6158; Kennedy, *The Commencement of a Case Under the New Bankruptcy Code*, 36 WASH. & LEE L. REV. 977, 1006 (1979).

[27] In addition to the excerpts from the legislative history quoted in the text accompanying notes 12 and 13 *supra*, the House Report and Senate Report both contain the statement that "[c]laims of partnership creditors who may have filed against the partner will be disallowed to avoid double counting." HOUSE REPORT, *supra* note 12, at 381, 1978 U. S. CODE CONG. & AD. NEWS 6337; SEN. REPORT, *supra* note 12, at 95, 1978 U. S. CODE CONG. & AD. NEWS 5881. The natural reading of this passage suggests that the drafters of the statute and legislative explanation were thinking of the situation in which a partner was a debtor under the Bankruptcy Code before the partnership became one. It contemplates that the partnership creditors' claims may be filed and allowed against the partner's estate unless and until the partnership trustee's aggregate claim on behalf of all the partnership creditors becomes effective under § 723(c). The partnership creditors' claims then are disallowed only "to avoid double counting." If the partnership creditors' claims against the partner's estate filed prior to the commencement of the partnership case were to be subordinated (and in effect disallowed if the partner's estate was insufficient to pay all the separate creditors' claims), the significant effect of § 723(c) would not be the disallowance of the partnership creditors' claims to avoid double counting but rather a dramatic advance in their priority as a part of the partnership trustee's aggregate claim. The reading of the intent behind § 723(c)'s second sentence espoused here is also supported in the House Report: "Such a creditor [*i.e.*, a creditor of the partnership] may file a claim against a partner that is a debtor in a case under title 11, but as soon as the order for relief is entered in a case under Chapter 7 concerning the partnership, the creditor's claim is disallowed." HOUSE REPORT, *supra* note 12, at 200, 1978 U. S. CODE CONG. & AD. NEWS 6161.

The House Report, in discussing who may file an involuntary petition against a partner, declared that "holders of claims against the partnership would be holders of claims

II. CLAIMS AGAINST A PARTNERSHIP

A partnership may incur debts, including contractual obligations and liabilities in tort.[28] The allowability of a partnership creditor's claim generally depends on nonbankruptcy law but, like other claims against a debtor in a case under the Bankruptcy Code, is subject to section 502.[29] The partnership creditor is also subject to the same procedural requirements respecting the filing of a proof of claim as is the creditor of any other kind of debtor.[30] The trustee of the partnership may assert any

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against the partner for purposes of 11 U.S.C. 303." *Id.* at 198, 1978 U. S. CODE CONG. & AD. NEWS 6158-59. The Report further explained that "[t]his is true even though such claim would not be allowed under 11 U.S.C. 723(c) if the partnership were a debtor under Chapter 7." *Id.* (There is a reference in the House Report at this point to the provision in § 40 of the Uniform Partnership Act that "requires a partner to make contributions necessary for payment of all partnership liabilities," but this reference may be treated as gratuitous for present purposes.) The explicit recognition of the creditors of the partnership as creditors of the partners for the purposes of § 303 implies no negation of the right of a creditor of the partnership to standing as a creditor of the partner for other purposes of the Bankruptcy Code, including the filing of claims under § 501 and § 502. Neither does the recognition in § 502(a) that a partner's creditor is a party in interest for the purpose of objecting to a claim against the partnership estate imply any lack of standing on the part of a partnership creditor to object to a claim against a partner's estate. *See* HOUSE REPORT, *supra* note 12, at 352, 1978 U. S. CODE CONG. & AD. NEWS 6308; SEN. REPORT, *supra* note 12, at 62, 1978 U. S. CODE CONG. & AD. NEWS 5848; 124 CONG. REC. 32396 (Sept. 28, 1978) (Congressman Edwards' statement); 124 CONG. REC. 33996 (Oct. 6, 1978) (Senator DeConcini's statement). *See also infra* text accompanying notes 37-40.

It is generally stated or assumed in commentary on the Bankruptcy Code that the "jingle rule" has been abolished insofar as it protected the partner's separate property from claims of partnership creditors until the partner's separate creditors were paid in full. *See, e.g.*, 4 L. KING, COLLIER ON BANKRUPTCY ¶ 723.04[3] (15th ed. 1979); H. MILLER & M. COOK, A PRACTICAL GUIDE TO THE BANKRUPTCY REFORM ACT 92 (1979); Levit, *Creditors and Claims*, in THE BANKRUPTCY REFORM ACT OF 1978, at 124 (G. Holmes ed. 1979) ("Why the Code should depart from this long-standing practice is most difficult to understand."); Hanley, *Partnership Bankruptcy Under the New Act*, 31 HASTINGS L.J. 149, 177-79 (1979); *but see Structuring and Documenting Business Financing Transactions Under the Federal Bankruptcy Code of 1978*, 35 BUS. LAW. 1645, 1661 (1980) ("Direct claims by partnership creditors against bankruptcy estates of general partners would be disallowed, except to the extent that such claims are secured solely by property of a general partner.").

[28] Contractual obligations of a partnership typically are incurred by a partner or other agent of the partnership in the ordinary course of its business. *See* F. MECHEM, *supra* note 4, § 306. A tort committed by a partner or agent of the partnership in the ordinary course of its business may give rise to a liability of the partnership estate. *See* UNIFORM PARTNERSHIP ACT § 13; F. MECHEM, *supra* note 4, § 301.

[29] Section 502 prescribes certain limitations to the allowability of claims, but the validity and allowable amount of most claims depend on applicable nonbankruptcy law.

[30] The governing provisions are found in §§ 501 and 502 and Rules 301-307 of the Rules of Bankruptcy Procedure to the extent the rules do not contravene the Bankruptcy Code. The Rules of Bankruptcy Procedure were originally promulgated by the Supreme Court pursuant to 28 U.S.C. § 2075, as enacted by Pub. L. No. 88-623, § 1, 78 Stat. 1001 (1964), to govern practice and procedure under the Bankruptcy Act. By § 405(d) of the Bankruptcy Reform Act, Pub. L. No. 95-598, § 405(d), 92 Stat. 2685 (1978), Congress provided that these rules shall apply to cases under the Bankruptcy Code to the extent not inconsistent with the Code until these rules are superseded by rules prescribed pursuant to 28 U.S.C. § 2075 (1976

defense against a claim that would have been available to the partnership under nonbankruptcy law.[31]

The holder of a claim against a partner does not on that account hold a claim against the partnership.[32] His claim may be asserted against the partner's share in any surplus remaining after administration of the partnership estate.[33] That surplus may be distributed to the partner's creditors in the course of a joint administration of the partnership and partner's estates, but otherwise the partner's creditor's recourse will be outside the bankruptcy court or perhaps in a partner's case administered independently in another bankruptcy court.

As under the Bankruptcy Act, a creditor holding a secured claim is secured only to the extent of the value of the property of the debtor.[34]

& Supp. III 1979) *as amended by* § 247 of the Bankruptcy Reform Act, Pub. L. No. 95-598, § 247, 92 Stat. 2672 (1978). This amendment deleted a sentence in 28 U.S.C. § 2975 which gave paramount effect to rules in conflict with other laws, including congressional enactments.

In the meantime, Interim Rules suggested by the Advisory Committee on Bankruptcy Rules of the Judicial Conference of the United States have been widely adopted by district and bankruptcy courts to govern practice and procedure in areas where neither the previously promulgated Rules of Bankruptcy Procedure nor the Bankruptcy Reform Act provided any guidance. The effect of the amendment of 28 U.S.C. § 2075 and the Interim Rules is discussed in Kennedy, *Some Comments About the Rules of Bankruptcy Procedure Under the Bankruptcy Reform Act*, 85 COM. L.J. 125 (1980). Proposed Bankruptcy Rules 3001-3008 have been submitted for consideration by the Supreme Court for ultimate promulgation pursuant to 28 U.S.C. § 2075 (Supp. III 1979). When promulgated, they will supersede the current Rules of Bankruptcy Procedure 301-307 insofar as practice under the Bankruptcy Code is concerned.

[31] *See* § 541(e). But the trustee may not invoke as a defense that the claim is unenforceable under nonbankruptcy law because contingent or unmatured. *See* § 502(b)(1).

[32] *See* Mead v. City Nat'l Bank of Clinton, 232 Iowa 1276, 8 N.W.2d 417 (1943); Shirk v. Caterbone, 201 Pa. Super. 544, 193 A.2d 664 (1963); F. MECHEM, *supra* note 4, § 443; HOUSE REPORT, *supra* note 12, at 197, 1978 U. S. CODE CONG. & AD. NEWS 6158 ("[H]olders of claims against the partners but not against the partnership obviously do not qualify as petitioning creditors against the partnership.").

Whether a claim against a partner is that of a partnership creditor or a claim against the partner as an individual frequently depends on a resolution of a factual dispute. *See, e.g., In re* 765 Assoc., 21 Bankr. 867 (Bankr. D. Hawaii 1982) (claim on promissory note against partnership rejected in the absence of any showing that the note was executed on behalf of the partnership or that it had received any benefit from the money lent).

[33] *See* UNIFORM PARTNERSHIP ACT § 28(1); *cf. In re* Urban Dev. Co. & Assoc., 452 F. Supp. 902, 906 (D. Md. 1978) (judgment creditors of general partners do not have judgment liens against partnership realty held in the name of partners and must compete with other unsecured creditors of partners in partners' share of partnership property). The legislative history of the Bankruptcy Code indicates an intent to adhere to this view of the partner's claim vis-a-vis the partnership property. "[T]he jingle rule still applies in principle with respect to the partners interest in the partnership. The partners interest is worthless until all administrative expenses and partnership claims have been paid." HOUSE REPORT, *supra* note 12, at 201, 1978 U. S. CODE CONG. & AD. NEWS 6161.

[34] *See* § 506(a). The value of the security interest is determined by the court pursuant to FED. R. BANKR. P. 306(d). Since the rule is consistent with the Bankruptcy Code, it continues to apply under the new law. *See supra* note 30. Proposed Bankruptcy Rule 3012 is substantially to the same effect as Rule 306(d) but makes explicit the requirement of a hearing on notice to the holder of the secured claim.

Section 506(a) clarifies the law governing the determination of the rights of such a creditor by declaring that his claim is an unsecured one to the extent that the value of the creditor's interest in the debtor's property is less than the amount of the creditor's allowed claim. A question unsettled under the Bankruptcy Act was whether a partnership creditor secured only by property of a partner was required to deduct its value in filing a claim against the partnership estate. There is less basis under the Bankruptcy Code than there was under the Bankruptcy Act for regarding a partner's property as part of the estate of the partnership.[35] Accordingly, it appears that the partnership creditor may ignore his right to security in a partner's separate property when filing a claim against the partnership.[36]

Although a creditor of a partner may not file a claim against the partnership estate,[37] section 502(a) explicitly recognizes that such a creditor has standing to object to a claim filed by a creditor of the partnership against the partnership estate. The version of section 502(a) in H.R. 8200 as originally passed by the House did not contain any reference to this special standing of a partner's creditor,[38] but both the House and Senate Reports pointed out that the category of parties in interest would be expanded under the new law as a result of the change in the liability of a general partner's estate for the debts of his partnership.[39] It was thereafter concluded that such a subtle change in the law of standing should not be left to legislative history, and the inclusion of "a creditor of a partner in a partnership" in the term "party in interest" in a partnership case was made in the final draft of the Bankruptcy Code as it emerged from the conference of the managers of the House and Senate bills. Their joint statement explained: "Since the trustee of the partnership is given an absolute claim against the estate of each general partner

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[35] *See* HOUSE REPORT, *supra* note 12, at 199-200, 1978 U. S. CODE CONG. & AD. NEWS 6160.

[36] The nature and the validity of the lien are irrelevant. A postpetition payment or transfer of property by a partner in discharge of a lien securing a partnership creditor's claim does not affect the creditor's right to continue to receive distribution from the partnership estate. *Cf.* § 508(b) discussed in the text accompanying notes 127-36 *infra*. The partnership creditor, of course, would not be allowed to receive or retain any distribution in excess of the amount of his allowed claim. *Cf.* Swarts v. Fourth Nat'l Bank of St. Louis, 117 F. 1, 12-13 (8th Cir. 1902) (if dividends on a creditor's claim plus payments received from a surety aggregate more than entire amount of claim plus interest, creditor holds surplus in trust for surety).

The value of security in the partner's property, of course, must be deducted from the partnership creditor's claim against the partner's estate. A special problem arises in the administration of the partner's estate because of the risk of double proof of a claim of the partnership creditor. *See infra* text accompanying notes 61-73 (discussion of second sentence of § 723(c)).

[37] *See supra* text accompanying note 32.

[38] *See* H. R. 8200, 95th Cong., 1st Sess. § 502(a) (1977), 123 CONG. REC. 35652 (Oct. 28, 1977).

[39] *See* HOUSE REPORT, *supra* note 12, at 352, 1978 U. S. CODE CONG. & AD. NEWS 6308; SEN. REPORT, *supra* note 12, at 62, 1978 U. S. CODE CONG. & AD. NEWS 5848.

under section 723(c), creditors of the partner must have standing to object to claims against the partnership at the partnership level because no opportunity will be afforded at the partner's level for such objection."[40] Other partnership creditors may, of course, make objections to any claim made against the partnership estate, but "the demands of orderly and expeditious administration have led to a recognition that the right to object is generally centered in the trustee as provided in subdivision (a)" of Rule 306.[41] If a partner is also a debtor in a case under the Bankruptcy Code, the trustee of the partner's estate should likewise be recognized as an appropriate party in interest to object to a claim against the partnership estate. It is not to be inferred from the recognition of the standing of the partner's creditor in section 502(a) that he may vote for a trustee of the partnership[42] or for or against a plan of reorganization for the partnership under Chapter 11.[43] On the other hand, the statutory status should enable him to appear and be heard in a partnership case whenever he can show that the determination of an issue may adversely affect his interest.[44]

May a partner file a claim against the partnership? A partner may have three varieties of claims against the partnership: (a) claims arising from advances and payments beyond the amount of capital which he agreed to contribute;[45] (b) claims for return of capital;[46] and (c) claims for profits.[47] All three categories of claims appear to be embraced by the broad definition of "claim" in section 101(4),[48] though this reading was disavowed by a House Report comment on the eligibility of partners as

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[40] 124 CONG. REC. 32396 (Sept. 28, 1978) (Congressman Edwards' statement); 124 CONG. REC. 33996 (Oct. 5, 1978) (Senator DeConcini's statement).

[41] FED. R. BANKR. P. 306(c) Advisory Committee Note. A statement to the same effect is included in the Advisory Committee Note to proposed Rule of Bankruptcy Procedure 3007.

[42] Only creditors of the partnership may vote for a trustee of the partnership estate, but the law governing the eligibility to vote in elections of trustees for partnerships and partners has been and remains confusing. *Compare* FED. R. BANKR. P. 210(a) & (e) *with* proposed Rule of Bankruptcy Procedure 2009.

[43] Only holders of claims against the debtor may vote for or against a plan of reorganization of a partnership. *See* § 1126(a).

[44] Whenever a creditor of a partner asserts a standing as a party in interest, pursuant to § 502(a) or otherwise, in a partnership case where the same person is serving as a trustee of the partnership and the partner's estates, the court should be alert to the possibility of a conflict of interest on the part of the trustee. *See* FED. R. BANKR. P. 117(b), 210(d) and Advisory Committee Note; HOUSE REPORT, *supra* note 12, at 198, 1978 U.S. CODE CONG. & AD. NEWS 6159. In any case where there is a deficiency of partnership assets and a partner debtor has both nonexempt property and separate creditors, a conflict of interest is practically unavoidable.

[45] *See* UNIFORM PARTNERSHIP ACT § 40(b)(II).

[46] *See id.* § 40(b)(III).

[47] *See id.* § 40(b)(IV).

[48] The definition of "claim" in § 101(4) of the Bankruptcy Code includes a "right to payment, whether or not reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured . . . ."

petitioners on an involuntary petition.[49] Without disclosing any authority or the process for reaching its conclusion, the House Report indicated that a partner may independently hold a claim against the partnership but is not a holder of a claim by virtue of his partnership interest.[50]

Section 5h of the Bankruptcy Act cryptically authorized the court to "permit the proof of the claim of the partnership estate against the individual estates, and vice versa."[51] This provision was given little effect or attention in the reported cases or by the commentators except as part of a general grant of authority to "secure the equitable distribution of the property of the several estates."[52] There is no counterpart in the Bankruptcy Code of this provision of the Bankruptcy Act, but, as discussed below,[53] section 723(d) provides for "an equitable distribution" whenever the trustee of a partnership estate recovers a surplus pursuant to subsections (b) and (c) of section 723. Moreover, section 510(c) authorizes the court, under the principles of equitable subordination, to subordinate for the 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." Rules governing distribution in the dissolution of a partnership are equitable in origin, and they have consistently subordinated partners' claims, including those arising out of advances and the assumption of liabilities of the firm, to the claims of outside creditors.[54] There has never been any doubt about the propriety of adhering to these equitable rules in distributions under the Bankruptcy Act,[55] and there is no evidence in the Bankruptcy Code or its legislative history of any intent to depart from these equitable rules.

An argument may nevertheless be made, particularly where the Revised Uniform Limited Partnership Act applies,[56] that the partner's

[49] *See* HOUSE REPORT, *supra* note 12, at 197, 1978 U. S. CODE CONG. & AD. NEWS 6158.

[50] *Id.* Only two sentences later and on the same page the same House Report declared mysteriously that "[l]imited partners that independently hold non-contingent unsecured claims may qualify as claimholders for purposes of 11 U.S.C. 303(b)(2), though general partners may not." *Id.*

[51] The legislative drafters were apparently thinking of concurrent administrations of the partnership and partners' estates and that the trustee of each estate might file a claim on behalf of the creditors he represented against the estate of the partnership or the partners' estates. When a partner was not undergoing administration, he would ordinarily have been the only appropriate person to file a proof of claim against the partnership estate in respect to any of the three types of claims he might have held against the partnership.

[52] *See, e.g.*, 1A J. MOORE & L. KING, *supra* note 16, ¶¶ 5.22, 5.24, 5.25; J. CRANE & A. BROMBERG, *supra* note 6, at 544, 551, 556; J. MACLACHLAN, *supra* note 2, at 426-27.

[53] *See infra* text accompanying notes 137-49.

[54] *See* Wallerstein v. Ervin, 112 F. 124 (3d Cir. 1901); *In re* Hess, 1 F.2d 342, 344 (W.D. Pa. 1923); *In re* Effinger, 184 F. 728, 729-35 (D. Md. 1911); *In re* Rice, 164 F. 509 (E.D. Pa. 1908); J. CRANE & A. BROMBERG, *supra* note 6, at 550-51; F. MECHEM, *supra* note 4, § 451.

[55] *See* Hecker, *supra* note 2, at 14; *cf.* J. MACLACHLAN, *supra* note 2, at 427.

[56] Arkansas, Connecticut, Maryland, Minnesota, Washington, West Virginia, and Wyoming have adopted the Revised Uniform Limited Partnership Act. *See* 6 U.L.A. 159 (Supp. 1982).

claim for any advances beyond contributed capital should be allowed and accorded the same priority as the claim of a nonpartner creditor. Section 804(1) of the Revised Uniform Limited Partnership Act explicitly accords the same priority to general and limited partners and outside creditors for claims other than for return of capital and distribution of profits.[57] A suggested rationale for the rule subordinating a partner's claim against the partnership to the claims of creditors other than partners is that the distribution to the partner would have to be applied to the payment of partnership creditors' claims in any event until their claims have been paid in full. The rationale has been criticized as a distortion in principle because the distribution to the partner should first be applied to separate creditors' claims.[58] The force of the criticism is considerably diminished under the Bankruptcy Code, at least insofar as liquidations of partnership estates are concerned, since the distribution to the partner would be applied to claims of the creditors of the partnership and the partner on a pro rata basis.[59] The criticism may nevertheless have influenced the drafters of the Revised Uniform Limited Partnership Act in their elimination of the subordination of a partner's claims, except for distributive shares, to other creditors' claims.

III. CLAIMS AGAINST A PARTNER

A. *Concurrent Administration of a Partner's and the Partnership Estate:*

1. The Partnership Trustee's Claim

Claims that may be filed and allowed against a partner in a case under the Bankruptcy Code include those held by partnership creditors as well as those held by separate creditors.[60] If the partnership is a debtor

[57] This change is questioned in Kessler, *The New Uniform Limited Partnership Act: A Critique*, 48 FORDHAM L. REV. 159, 172-73 (1979). *See also* Hecker, *supra* note 2, at 16-17.

[58] *See* J. CRANE & A. BROMBERG, *supra* note 6, at 550.

[59] This is the implication of § 723. *See* HOUSE REPORT, *supra* note 12, at 381, 1978 U. S. CODE CONG. & AD. NEWS 6337; SEN. REPORT, *supra* note 12, at 95, 1978 U. S. CODE CONG. & AD. NEWS 5881. Distribution of a partner's estate is discussed at the text accompanying notes 60-99 *infra*.

[60] This proposition is based more on legislative history and implications of the Bankruptcy Code than on any explicit language in it. *See* the excerpt in note 27 *supra* quoted from the HOUSE REPORT, *supra* note 12, at 200, 1978 U.S. CODE CONG. & AD. NEWS 6161. *See also id.* at 198, 1978 U.S. CODE CONG. & AD. NEWS 6158-59: "Since section 40 of the Uniform Partnership Act requires a partner to make contributions necessary for payment of all partnership liabilities, holders of claims against the partnership would be holders of claims against the partner for purposes of 11 U.S.C. 303." Later the House Report declared that "[t]he final sentence of 11 U.S.C. 723(c) makes clear that the jingle rule is abolished with respect to the partnership creditor's rights in the assets of a partner," and that "[t]his recognizes the traditional rights of creditors of the partnership to share on an equal basis with other creditors of a partner under some nonbankruptcy laws adopted before the

in a Chapter 7 case under the Bankruptcy Code, the trustee of the partnership has a claim against the estate of the general partner for the full amount of all claims of creditors allowed in the partnership case.[61] The trustee's claim is automatically entitled to distribution; it need not be filed or allowed.[62] "Also, the claim preempts the claims of creditors of the partnership that have filed claims against the partnership on account of the partnership's liability."[63] The claim of a partnership creditor against the partner's estate is ordinarily limited to the amount of his claim against the partnership. A qualification on this limitation is recognized

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Uniform Partnership Act." HOUSE REPORT, *supra* note 12, at 200-01, 1978 U.S. CODE CONG. & AD. NEWS 6161. *See also* discussion of § 502(9) in HOUSE REPORT, *supra* note 12, at 352, 1978 U.S. CODE CONG. & AD. NEWS 6308; SEN. REPORT, *supra* note 12, at 62, 1978 U.S. CODE CONG. & AD. NEWS 5848.

Explanations of an amendment to § 723(c) of the Bankruptcy Code, added at a very late stage of the legislative process, confusingly suggested that, as under prior law, the several sections of the Bankruptcy Code applicable to codebtors and sureties apply to "the relationship of a partner with respect to a partnership debtor." 124 CONG. REC. 32401 (Sept. 28, 1978) (Congressman Edwards' statement); 124 CONG. REC. 34001 (Oct. 5, 1978) (Senator DeConcini's statement). The reference to "a partnership debtor" was undoubtedly intended to refer to "the partnership as a debtor." There is some authority for treating a partner under the Bankruptcy Act as a codebtor or surety for the partnership on a partnership debt in the absence of an explicit assumption of a separate obligation by the partner. *See In re* Helmwood Apts., 2 BANKR. CT. DEC. 1151, 1157 (Bankr. N.D. Ga. 1976). Professor MacLachlan has observed: "Since under the entity theory the partner is still liable upon the firm debts, his position becomes like that of a surety. Indeed, he has an equity of exoneration out of the firm assets, if they suffice, which conforms to the surety-like nature of his obligation. The liabilities of a surety are not and should not be deferred to his other liabilities." J. MACLACHLAN, *supra* note 2, at 425. *But cf.* Francis v. McNeal, 228 U.S. 695, 699-700 (1913) (per Holmes, J.): "But the fact remains as true as ever that partnership debts are debts of the members of the firm, and that the individual liability of the members is not collateral like that of a surety, but primary and direct, whatever priorities there may be in the marshalling of assets." *See also infra* notes 92 & 135.

[61] *See* § 723(c) (first sentence). The first sentence of § 723(c) is in a section that applies only in liquidation cases under Chapter 7. *See* § 103(b). By its terms the sentence applies whenever the partnership is a debtor in a case under title 11, but a technical amendment that passed the Senate but not the House would have limited the sentence to the situation where the partnership is a debtor under Chapter 7. *See* S. 863, 97th Cong., 1st Sess. § 64(a) (1981), 127 CONG. REC. S7900 (daily ed. July 17, 1981). As has been noted in the text accompanying notes 19 and 20 *supra*, however, any plan proposed under Chapter 11 must assure to each creditor or equity security holder as much as he would receive or retain if the debtor were liquidated under Chapter 7. *See* § 1129(a)(7)(A)(ii). In consequence, the debtor or other proponent of a plan must make a provision for each creditor or limited partner of a general partnership that takes into account potential recoveries or distribution from the partners' estates.

[62] *See* HOUSE REPORT, *supra* note 12, at 200, 1978 U. S. CODE CONG. & AD. NEWS 6161.

[63] *Id.* The quoted sentence is confusing in its reference to "filed claims against the partnership." The context suggests that the intention was to refer to claims of creditors of the partnership that had been filed against the partner on account of his liability for the partnership debts. *See supra* note 27. Section 723(c) cannot conceivably be read to pre-empt the claims of the creditors of the partnership against the partnership estate, whether or not they have filed their claims against the partnership.

when the creditor has a security interest in the property of the partner but not in the partnership's property.[64] The purpose of requiring the disallowance of the claim against the partner is to protect the partner's estate against double proof of what is essentially a single claim by the partnership creditor.[65] The result is that the partnership creditor who has taken the precaution to obtain the personal obligation of a partner has no advantage over any other partnership creditor in the event of concurrent administration of the partnership and partner's estates.[66] Difficulties of administration are engendered by the prescription of the amount of the trustee's claim in section 723(c) as the "full amount of all claims of creditors allowed in the case concerning such partnership," particularly when the partnership case is commenced after the partner's case. Until the time for filing claims in the partnership case has elapsed and most if not all objections to the claims that are filed have been resolved,[67] distribution of any dividends in the partner's case would be hazardous in view of the uncertainty pending the arrival of that time when the amount of what will ordinarily be the largest claim against the estate has been determined.

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[64] *See infra* text accompanying notes 84-85.

[65] "Claims of partnership creditors who may have filed against the partner will be disallowed to avoid double counting." HOUSE REPORT, *supra* note 12, at 381, 1978 U. S. CODE CONG. & AD. NEWS 6337; SEN. REPORT, *supra* note 12, at 95, 1978 U. S. CODE CONG. & AD. NEWS 5881.

[66] The construction suggested here is not ineluctable or inexorable. When it applies, the second sentence of § 723(c) does nevertheless literally preclude any allowance of the unsecured claim of a partnership creditor against the partner's estate, without regard to whether the creditor relies on the liability of the partner as a member of the partnership or on a separately contracted obligation. To allow a partnership creditor with a separate obligation obtained from a partner to file and compete with the partnership trustee would permit double proof on a single claim. It would be highly inequitable not only to the separate creditors of the partner but also to the partnership creditors who did not obtain separate obligations from the partner. It comports with the policy of the reform embodied in § 723 to give a partnership creditor one and only one claim against the partner's estate, whether or not the creditor obtained a collateral obligation from the partner.

[67] Time limits are prescribed for filing claims by the Rules of Bankruptcy Procedure. Most claims in Chapter 7 cases may be filed anytime within six months after the first date set for the meeting of creditors convened pursuant to § 341 of the Bankruptcy Code, but that time may be later or extended for particular claimants. *See* FED. R. BANKR. P. 302(e). Proposed Rule of Bankruptcy Procedure 3002(c) would require claims in a Chapter 7 case to be filed within 90 days after the first date set for the first meeting of creditors subject to exceptions comparable to those in current Rule 302(e). It is to be noted that the trustee or debtor in possession of a partnership in a Chapter 11 case has an automatic claim against the estate of any partner of the partnership who becomes a debtor in a Chapter 7 case. A claim need not be filed in a Chapter 11 case under § 1111(a) unless it is scheduled as disputed, contingent, or unliquidated or is not scheduled at all. Unless the court prescribes a different time, a claim may be filed at any time prior to approval of the disclosure statement in a Chapter 11 case. *See* INTERIM BANKR. R. 3001(b)(3). Proposed Rule of Bankruptcy Procedure 3003(b)(3) simply vests authority in the bankruptcy court to fix the time for filing claims in a Chapter 11 case.

Since the partnership trustee's claim against the estate of a partner is fixed by section 723(c) as the "full amount of all claims of creditors allowed in the case concerning such partnership," it is to be determined as of the time of the filing of the petition by or against the partnership.[68] The claims of the creditors of the partner will, on the other hand, be determinable as of the time of the filing of the petition by or against the partner. So far as the language of the statute bears on the matter, distributions to the partnership creditors from the partnership estate do not diminish the amount of the partnership trustee's claim against the partner's estate, whether they occur before or after the commencement of the partner's case.[69] It does not even matter that the distributions may have included funds derived from a recovery from the partner pursuant to section 723(a) and (b). No new claims can be acquired against the partnership estate after the commencement of the partnership case, whereas, if the partner's case commences later, the partner's estate may continue to incur liabilities to separate creditors during the pendency of the partnership case and until the commencement of the partner's case. Administrative claims against the partnership estate[70] are not included in the partnership trustee's claim against the partner's estate. If the partner's case commences before the partnership case, however, distributions to the partnership creditors in the partner's case prior to the commencement of the partnership case diminish the partnership trustee's claim.[71]

When the partnership and partner's cases commence at different times, the differences in the dates of reference for determining claims have an impact on the accrual of interest on unsecured claims against the two estates. When the partnership case is commenced first, interest continues to run on the claims of unsecured creditors of the partner until the commencement of his case, whereas interest on the unsecured claims of the creditors of the partnership terminates, at least for most purposes,[72] on the commencement of the partnership case.[73] When the partner's case commences before the partnership case, however, interest on the claims of the creditors of the partnership and the separate creditors of the partner against the partner's estate terminates simultaneously,

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[68] *See* § 502(b).

[69] Section 508(b), which requires equalization of distributions to partnership creditors when payments or transfers are received from general partners who are not debtors in Chapter 7 cases, does not apply to the administration of the estate of a partner. *See infra* text accompanying notes 127-36. A court might undertake to apply this provision by way of analogy, of course.

[70] *See infra* note 80 and accompanying text.

[71] *See infra* note 135 and accompanying text.

[72] Interest on allowed unsecured claims against the partnership (or any other debtor) would continue to accrue at the legal rate from the date of the filing of the petition and to the holders of such claims under § 726(a)(5) if the holders of claims under the preceding four paragraphs of § 726(a) had been paid in full.

[73] *See* § 502(b)(2).

but interest on the partnership creditor's claim against the partnership estate continues to accrue until the commencement of the partnership case.

2. The Secured Claim of a Partnership Creditor

When the partnership and partner's estates are being concurrently administered, is the amount of the partnership trustee's claim given him by section 723(c) inclusive or exclusive of the value of security held by the partnership creditors? When the security interest is in the property of the partnership, section 506(a) requires no deduction of the value of such security from a claim against the partner's estate, and thus the trustee's aggregate claim should be unaffected by the existence of security in the partnership property. If a partnership creditor has a claim secured by property of the partner, however, section 723(c) is clear, in its second sentence,[74] that the creditor's claim against the partner is not subject to disallowance to the extent of the security in the partner's property. Congress can hardly have intended for the trustee of the partnership to share in the partner's unencumbered estate to the extent of the claim secured by the partner's property. It is therefore submitted that the partnership trustee's aggregate claim should be reduced by the value of the property in the partner's estate securing the partnership creditor.

Suppose now that the partnership creditor is secured by both partnership property and by property of the partner. The second sentence may and should be limited in its effect to simply recognizing the enforceability of the partnership creditor's lien against the property in the partner's estate. The partnership creditor's claim against the partner is not allowable to the extent that it is unsecured or to the extent that it is secured by partnership property. The partnership trustee's aggregate claim against the partner's estate should nevertheless include the partnership creditor's claim to the extent it is not secured by the partner's property, even though it is or may be secured by the partnership property or another partner's property.

3. Priority Claims of Partnership Creditors

The last sentence of section 723(c) declares that the claim of the trustee under the subsection is entitled to distribution under section

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[74] The second sentence of § 723(c) contains a typographical error that requires a rereading and correction in order for the purpose and effect of the sentence to be perceived. As enacted, it reads as follows:

> Notwithstanding section 502 of this title, there shall not be allowed in such case a claim against such partner on which both such partner and such partnership are liable, except to any extent that such claim is secured only by property of such partner and not be property of such partnership.

Id. The word "be" in the last line should be "by".

726[75] "the same as any other claim of the kind specified in such section." This sentence reeks with ambiguity, and the legislative history does not dissipate the uncertainties. The legislative reports declare that "[t]he trustee will share equally with the partners' individual creditors in the assets of the partners' estate."[76] As has already been intimated,[77] a partnership creditor secured by property of the partner will presumably receive the proceeds realized from the sale of the property, without any participation by the partnership trustee in the distribution. But suppose the claim of the partnership creditor is entitled to priority under section 507 because, for example, it is a claim for wages, a consumer deposit, or a tax claim of recent vintage. Priority under section 507 typically depends on a particular relationship between the creditor and the debtor, and it is at best doubtful that the fact that a claim is entitled to priority in the distribution of a partnership estate should support a claim for priority in the distribution of the partner's estate.[78]

4. Administrative Expenses

In any event it is clear that administrative expense claims entitled to priority in the partnership case are not allowable at any level in the partner's case. The amount of the partnership trustee's claim is deliberately fixed by reference in section 723(c) to the "full amount of all claims of creditors allowed in the case concerning such partnership." The version of section 723(c) in H.R. 8200 as originally passed by the House included "all claims allowed in the case,"[79] but, as stated in the legislative explanation of the changes made in the finally enacted version of the bill, "[b]y restricting the trustee's rights to claims of 'creditors,' the trustee of the partnership will not have a claim against the general partners for administrative expenses or claims allowed in the case concerning the partnership."[80]

The implication of section 723(c) is that distribution of dividends on the claim of the trustee of the partnership should be made to the trustee rather than directly to the partnership creditors. Like the proceeds of any recovery by the trustee under section 544(b) or any other section of the Bankruptcy Code, the distribution from the partner's estate becomes

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[75] The last sentence of § 723(c) refers to distribution under § 726(a), but a technical amendment passed by the Senate but not acted on by the House would have deleted the reference to subsection (a). *See* S. 863, 97th Cong., 1st Sess. § 64(b)(3) (1981), 127 CONG. REC. S7900 (daily ed. July 17, 1981). There is no apparent reason the other subsections of § 726 should not apply in the distribution of the partner's estate to the partnership trustee.

[76] HOUSE REPORT, *supra* note 12, at 381, 1978 U. S. CODE CONG. & AD. NEWS 6337; SEN. REPORT, *supra* note 12, at 95, 1978 U. S. CODE CONG. & AD. NEWS 5881.

[77] *See* the discussion in the preceding two paragraphs of the text.

[78] *See infra* text accompanying notes 86 & 87.

[79] H.R. 8200, 95th Cong., 1st Sess. § 723(c), 123 CONG. REC. 35659 (Oct. 28, 1977).

[80] 124 CONG. REC. 32401 (Sept. 28, 1978) (Congressman Edwards' statement); 124 CONG. REC. 34000-01 (Oct. 5, 1978) (Congressman DeConcini's statement).

part of the partnership estate, and its distribution is governed by section 726. Accordingly, although the partner's estate is not liable to the trustee of the partnership for the amount of the administrative expenses allowed or allowable in the partnership case, the dividends distributed from the partner's estate to the partnership trustee may be devoted in large part to the payment of those administrative expenses.

Section 5f of the Bankruptcy Act required administrative expenses to be paid from the partnership property and the individual property in such proportions as the court should determine. This provision was part of a statutory scheme that made the trustee elected by the creditors of the partnership the trustee of the separate estate of each debtor being jointly administered.[81] While joint administration may still be authorized pursuant to Rules 117 and 210 of the Rules of Bankruptcy Procedure,[82] the clear implication of the statute is that the expenses of adminstration of the partnership estate are not to be imposed on the partner's estate. At the same time it is to be emphasized that administration of the partner's estate is now for the benefit of the partnership creditors as well as the partner's creditors. Except when a single trustee serves both estates, apportionment of administrative expenses between the estates should not be necessary; *i.e.*, the expenses incurred in the administration of each debtor's estate should be identifiable and charged accordingly without apportionment.

B. *Independent Administration of the Partner's Estate*

1. Dual Claims Against the Partnership and the Partner's Estate

If the partner, but not the partnership, is a debtor under the Bankruptcy Code, may the partnership creditor holding a partner's personal obligation file two claims? This question arose under the Bankruptcy Act, and the solution was to apply the jingle rule as if the creditor had two different claims. The partnership creditor was allowed to share in the distribution of the partner's estate with other separate creditors of the partner to the extent he held the personal obligation of the partner.[83] The partnership creditor who had no claim against the partner was thus at a significant disadvantage in the administration of the partner's estate as compared with the position of the partnership creditor who had obtained the separate obligation of the partner. The elimination by the Bankruptcy Code of this disadvantage undermines any justification for dual filing against the partner's estate. The partnership creditors of course retain their right to resort to the partnership

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[81] *See* FED. R. BANKR. P. 210(e) (superseding but incorporating the substance of the first sentence of § 5c of the Bankruptcy Act).

[82] *See* FED. R. BANKR. P. 117 & 210. Proposed Bankruptcy Rule 1015(b) tracks current Rule 117(b), and proposed Rule 2009(e) tracks current Rule 210(e).

[83] *See* 1A W. COLLIER, BANKRUPTCY ¶ 5.35, at 751-52 n.8 (14th ed. 1962); F. MECHEM, *supra* note 4, § 458.

property for the unpaid balances of their claims, free of any competition by the separate creditors of the partners. While section 723 does not purport to deal with the distribution of a partner's estate when there is no concurrent administration of the partnership estate, the inequity of allowing two bites at the apple by a creditor who has a single claim is too patent to be seriously entertained. Confining the partnership creditor to his claim in that capacity and disallowing his claim as a separate creditor will tend to harmonize the result in the situations when the partnership estate is being administered concurrently and when it is not.

2. The Secured Claim of a Partnership Creditor

If a partner, but not the partnership, is a debtor under Chapter 7, a partnership creditor who has obtained the partner's personal obligation may nevertheless prefer to file or enforce his claim as a separate creditor. Thus, he may be secured by the partner's separate property but be unsecured as a partnership creditor. Should he be entitled to file as an unsecured partnership creditor without diminution on account of his security in the partner's estate? It is submitted that, as when the partner's and partnership estates are being administered concurrently,[84] the allowable unsecured claim should be reduced to the extent of the value of the security. It would be anomalous for his entire claim to be allowed as unsecured and for the same claim to be allowed as secured by the property of the partner's estate. On the other hand, if the partnership creditor has security only in the property of the partnership, it appears that he may claim as an unsecured creditor of the partner, whether or not he has obtained a separate obligation of the partner.

What rule applies if the partnership creditor is secured by property of both the partnership and the partner? A logical application of the rules just stated would require reduction of the allowable claim against the partner's estate only to the extent of the security held in the partner's estate.[85] The solutions here suggested are consonant with the objective of harmonizing the treatment of partnership creditors' and separate creditors' claims in the administration of partners' estates, irrespective of whether their partnership's estate is being concurrently administered. Inequities, confusion, and needless litigation should be reduced to the extent the distributive rights of the creditors of partnership and the partners' estates can be assimilated, whether the estates of their debtors are concurrently administered under the Bankruptcy Code or only one of the estates is being administered.

3. Priority Claims of Partnership Creditors

When a partner, but not the partnership, is a debtor under the Bankruptcy Code, does a partnership creditor entitled to priority as an

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[84] *See supra* text accompanying note 74.

[85] *See id.*

employee, consumer-depositor, or tax claimant have the same priority in the distribution of the partner's estate as he would have in the distribution of the partnership estate? The answer should be the same as that given when the partnership creditors' claims are pre-empted by the trustee of the partnership during the course of concurrent administration.[86] The creditors entitled to priority under the several paragraphs of section 507(a) should have the relation to the debtor defined in these paragraphs. The conclusion that the Bankruptcy Code authorizes partnership creditors to file claims against the partner's estate falls considerably short of merging the identity of the partner with that of the partnership or eliminating differences between the rights of partnership and partners' creditors to share in distribution from the partner's estate.[87]

C. *The Partnership as a Creditor of the Partner's Estate*

May the partnership file a claim against a partner's estate? Although the first clause of section 5h of the Bankruptcy Act declared that the court could permit the proof of the claim of the partnership estate against the individual estates,[88] the occasions for applying this provision were rare. The undoubted reason for this paucity of case law was that the jingle rule required application of the separate estate to the payment of separate creditors' claims in full before the partnership's creditors were entitled to share in the separate partner's estate, and the partnership was viewed as having no better standing to compete with separate creditors than the partnership creditors. Section 40(a)(II) of the Uniform Partnership Act includes as an asset of the partnership the contributions of the partners necessary for the payment of all the liabilities of the partnership.[89] The right of a partnership to contribution under section 40(a)(II) of the Uniform Partnership Act fits easily within the broad

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[86] *See supra* text accompanying notes 75-78.

[87] The statement in the text is believed to be correct although the legislative reports declare that when the partnership and a partner are both debtors under the Bankruptcy Code, the partnership trustee will share equally with the partners' individual creditors in the assets of the partner's estate. *See* HOUSE REPORT, *supra* note 12, at 381, 1978 U. S. CODE CONG. & AD. NEWS 6337; SEN. REPORT, *supra* note 12, at 95, 1978 U. S. CODE CONG. & AD. NEWS 5881. The legislative history does not concern a case where there is no partnership trustee, but arguably the presence of the trustee should make no difference. If priority were accorded to a partnership creditor in the distribution of a partner's estate by virtue of the creditor's status as an employee or a consumer debtor or tax obligor of the partnership rather than of the partner, the result would be a distortion of the distribution scheme of the Bankruptcy Code. The jingle rule would not have been merely repealed; it would have been turned on its head at the expense of separate creditors of the partner's estate.

[88] *See supra* note 51 and accompanying text.

[89] This provision seems to have been regarded in the legislative history of the Bankruptcy Code as a prime basis for recognizing the general partner's liability for partnership debts. *See* HOUSE REPORT, *supra* note 12, at 198, 1978 U.S. CODE CONG. & AD. NEWS 6158-59.

definition of a claim in section 101(4).[90] Section 541(a)(3) provides that "any interest in property" recovered by the trustee under section 723 is property of the estate, and section 704(1) continues the statutory duty of the trustee to collect the property of the estate.[91] When the partnership and the partner are both debtors in cases under the Bankruptcy Code, the trustee of the partnership has a claim against the partner's estate under section 723(c) for the full amount of the allowed claims of the creditors of the partnership. This provision is not and should not be exclusive of the right of the trustee to assert a claim for contribution or indemnity against the partner's estate, particularly if the partnership has paid all or the bulk of the partnership creditors' claim.

Since the abolition of the jingle rule permits the partnership creditors to compete *pari passu* with the separate creditors in a Chapter 7 case, it should enable the partnership to share on the same basis with the separate creditors to the extent that the firm, having paid the partnership creditors, is entitled to contribution from the partner on account of the payment. On the other hand, if some partnership creditors remain unpaid, the partnership as the primary obligor of the partnership creditors should not be able to compete *pari passu* with the partnership creditors. An equitable solution in such a situation would permit the partnership nonetheless to file its claim for contribution against the partner's estate but would require any distribution to the partnership on its claim to be applied to the payment of claims of creditors of the partnership.[92] Any surplus remaining after payment of the partnership

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[90] *See supra* note 48 (definition of "claim" in § 101(4) of the Bankruptcy Code).

[91] Section 704(1) directs the trustee to "collect and reduce to money the property of the estate for which the trustee serves." Under § 723 the trustee may recover the deficiency of the property of the partnership to pay in full the allowed claims of the partnership creditors from each partner's estate, but the partnership trustee is directed "[t]o the extent practicable," to seek recovery from any general partner whose estate is not being administered in a case under the Bankruptcy Code. When a partner and the partnership are both debtors under the Bankruptcy Code, however, § 723(c) gives the partnership trustee no option respecting the pursuit of the partnership creditors' claims against the partner's estate. The partnership trustee's aggregate claim is automatically filed and allowed and entitled to a distribution without delay. This claim is not subject to reduction as a result of successful pursuit by the partnership trustee of the amount of the deficiency in the partnership estate referred to in § 723(a) & (b); nor is the claim subject to enlargement by virtue of a failure on the part of the partnership trustee to realize on any of the assets of the partnership estate, including the rights of recovery against nondebtor partners.

The right to recover a deficiency under § 723(a) or (b) or to receive a distribution under § 723(c) is apparently not included as property of the partnership estate under § 541(a)(3), but once recovery is effected, the proceeds become part of the estate. The dichotomy between the right to the recovery and the proceeds of the recovery does not appear to be significant for present purposes.

[92] Thus, suppose that there is $1000 in a partner's estate for distribution and that the claims against the estate include $1000 due a separate creditor of the partner, $500 due a partnership creditor, and $500 due the partnership by virtue of its payment of partnership creditors. The separate creditor and the partnership creditor would each receive $500, the $250 allocable to the partnership being distributed to the partnership creditor. This

creditors out of the distribution to the partnership should be redistributed to the members of the partnership in accordance with the equities, determined in the light of the partnership agreement and the partners' contributions to the payment of the partnership creditors. The right of the partnership or its trustee to file a claim for contribution against the partner's estate should not depend on whether the estates are being concurrently administered.

D. *A Copartner's Claim*

A partner may also be entitled to contribution from a copartner by virtue of a payment or transfer to partnership creditors.[93] Such a right fits easily within the definition of a claim.[94] It should be subject to the ordinary rules governing filing and allowance of claims, but, like a similar claim of the partnership,[95] a claim of a partner for contribution should be postponed after payment to partnership creditors.[96] If unpaid partnership creditors and a partner seeking contribution file claims against the estate of a copartner, the court should be assured that the distribution allocable to the claimant partner is applied to the satisfaction of unpaid creditors of the partnership. Any surplus remaining after such application may be retained by the partner entitled to the contribution.

E. *The Partner as a Chapter 11 Debtor*

If a partner is a debtor in a Chapter 11 case, the schedules filed by the debtor or the trustee serve as a substitute for the filing of claims by creditors except those who have disputed, contingent, or unliquidated claims. Unless excepted, the claim as scheduled is deemed filed under section 1111(a) and allowed under section 502(a). The debtor or the

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distribution would be generally consonant with treatment of the partnership as a codebtor under §§ 501(b) and 509(c) of the Bankruptcy Code. For reasons suggested in note 135 *infra*, however, it is inappropriate to assume or construe the provisions of the Bankruptcy Code that refer to codebtors to be directly applicable to partners, either in their relationship to the partnership or to each other. Conventional suretyship law has recognized that a retiring partner who obtains a promise on the part of the partners remaining in the partnership to assume partnership obligations is a surety in respect to those obligations. *See* RESTATEMENT OF SECURITY § 83, comment d, and § 104, comment g (1941); L. SIMPSON, HANDBOOK ON THE LAW OF SURETYSHIP 210 (1950); LINDLEY ON PARTNERSHIP 269 (E. Scamell ed. 13th ed. 1971) [hereinafter cited as LINDLEY ON PARTNERSHIP]. The rules of law governing partnership and suretyship have otherwise generally developed independently of each other. Contrary to the suggestions in 124 CONG. REC. 32398 and 32401 (Sept. 28, 1978) and 124 CONG. REC. 33998 and 34001 (Oct. 5, 1978), the provisions of the Bankruptcy Act applicable to codebtors and sureties were not applied to the relationship of a partner to the partnership of which he was a member.

[93] *See* F. MECHEM, *supra* note 4, § 187; LINDLEY ON PARTNERSHIP, *supra* note 92, at 390.

[94] *See supra* note 48.

[95] *See supra* note 92 and accompanying text.

[96] *See* UNIFORM PARTNERSHIP ACT § 40(i)(III).

trustee may and ordinarily should schedule the claims of the partnership and the separate creditors in the same way.[97] Although they may be classified separately for the purpose of a reorganization plan, there is nothing in Chapter 11 to require or warrant preferential treatment of either class in the distribution of a partner's estate. Preferential treatment of partnership creditors would be vulnerable to objection as unfairly discriminatory within the contemplation of section 1129(b)(1) in the light of what has traditionally been regarded as equitable treatment of separate creditors. Preferential treatment of separate creditors may be justified as permissible in light of the failure of the Bankruptcy Code to negate continuing applicability of the jingle rule in the situation presented, but the burden may plausibly be placed on the proponent to justify differentiating treatment to creditors whom section 723 treats as similar.[98] The right of the partnership to contribution from the partner's estate, for the reason indicated above,[99] should be subordinated to the claims of the unpaid partnership creditors but need not be subordinated to claims of separate creditors. The partnership claim may be scheduled and allowed along with the claims of creditors of the partnership as well as the separate claims of the creditors of the partner. No prejudice need accrue to the rights of the partnership creditors if the distributions allocable to the partnership are applied to the unpaid claims of partnership creditors.

IV. TAX CLAIMS

There are two federal sources of tax law applicable to a partnership or a partner who becomes a debtor under the Bankruptcy Code.[100] The Bankruptcy Reform Act of 1978 contains special tax provisions limited primarily to state and local tax consequences of becoming a debtor under the Code.[101] Consideration of federal tax consequences was postponed until the next Congress, when the Bankruptcy Tax Act of 1980[102] was

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[97] Section 1122(a) of the Bankruptcy Code requires all claims in a particular class in a plan to be substantially similar to the other claims of the class but does not require all substantially similar claims to be in the same class. While the section may carry an implication that separate classification of different kinds of claims is the norm, inclusion of all unsecured creditors having the same priority in a single class minimizes litigation of the fairness of the classification and permits administrative economy.

[98] As indicated in the in text accompanying note 14 *supra*, § 723 does not apply directly in a Chapter 11 case, and accordingly the jingle rule arguably constitutes no constraint on the formulation of any Chapter 11 plan. So long as each holder of a claim is receiving as much as would be received in a liquidation of the partner's estate under Chapter 7, the standard of § 1129(a)(7) is complied with.

[99] *See supra* text accompanying note 92.

[100] *See* Thompson & Tenney, *Partnership Bankruptcy—The New Entity and Individual Tax Consequences*, 35 TAX LAW. 89 (1981).

[101] *See, e.g.*, §§ 346, 728, and 1146 of the Bankruptcy Code.

[102] *See* Pub. L. No. 96-589, 94 Stat. 3389 (1980).

passed. Despite differences in focus, the two Acts provide consistent rules for administering the tax affairs of partners and partnerships in bankruptcy.

When a partnership is a debtor in a voluntary or involuntary case, the Bankruptcy Code provides that any state or local income tax imposed on the partnership continues to apply to the estate of the partnership as if no petition had been filed.[103] Similarly with respect to federal income taxes, the Internal Revenue Code now directs that "no separate taxable entity shall result from the commencement of a case under Title 11" in which a partnership is the debtor.[104]

In contrast, when an individual partner is a debtor under Chapter 7 or 11, the Bankruptcy Code makes his estate a separate taxable entity.[105] Any income of the partner's estate is taxable under state or local law only to the estate and not the partner. Thus any gain or loss resulting from a distribution of partnership property, and any distributive share of income, gain, loss, deduction or credit distributed after commencement of the partner's case, is attributed to the partner's estate.[106] With respect to federal taxes, the Internal Revenue Code implicitly recognizes the existence of two taxable entities when it specifies that upon the transfer of an individual debtor's assets to his estate, "the estate shall be treated as the debtor would be treated."[107]

While consistent in administrative procedure, the Bankruptcy Code and the Internal Revenue Code appear to be inconsistent in providing rules for the allowance and distribution of tax claims against a partner's distributive share of partnership income not withdrawn from the partnership. Outside of bankruptcy, such retained income is taxed as income of the partner, both under federal tax law and under state revenue codes

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[103] *See* § 346(c)(1). The trustee of the partnership is required by §§ 346(c)(2) and 728(b) to make any tax return that state or local law requires of the partnership. Section 728(b) excuses the trustee of an individual or a corporation in a case under Chapter 7 from any duty to file an income tax return if the debtor does have a net taxable income for the entire period after entry of the order for relief in the case. The excuse does not apply to the trustee for a partnership in such a case.

[104] I.R.C. § 1399 (1976), *as amended by* Bankruptcy Tax Act of 1980, Pub. L. No. 96-589, § 3, 94 Stat. 3389, 3400-01 (1980). Heretofore, the Internal Revenue Service treated the estate of a bankrupt partnership as a separate taxable entity. *See* Rev. Rul. 68-48, 1968-1 C.B. 301. Section 1399 does not apply to any case to which I.R.C. § 1398 applies. Section 1398, also amended by § 3 of the Bankruptcy Tax Act of 1980, applies to any case under Chapter 7 or Chapter 11 in which an individual is the debtor. *See* I.R.C. § 1398 (1976), *as amended by* Bankruptcy Tax Act of 1980, Pub. L. No. 96-589, § 3, 94 Stat. 3389, 3397 (1980).

[105] *See* HOUSE REPORT, *supra* note 12, at 276, 1978 U.S. CODE CONG. & AD. NEWS 6232-33 (citing §§ 346(b)(1), 728(a), and 1146(a) of the Bankruptcy Code).

[106] *See* § 346(b)(1). Prior law was silent on this issue, and § 346(b)(1) is thus clarifying rather than operative to shift any tax incidence. *See* HOUSE REPORT, *supra* note 12, at 279, 1978 U.S. CODE CONG. & AD. NEWS 6236-37.

[107] I.R.C. § 1398(f)(1) (1976). Section 346(g) of the Bankruptcy Code is to the same effect, but the Internal Revenue Code's § 1398(f)(1) is nonetheless reassuring in light of the "subject to the Internal Revenue Code" proviso in § 346(a) of the Bankruptcy Code.

which follow the federal approach to partnership taxation.[108] Tax claims against this income would be claims against the partner's estate. Thus a taxing authority that attempts to satisfy its claim against partnership assets, including the retained income, would be subordinated to partnership creditors.[109]

The Bankruptcy Code prevents this result with respect to state or local taxes. When the partner and his partnership are both debtors in separate cases under Chapter 7,[110] any state or local tax liability of a partner for retained earnings gives rise to "a claim only against such partnership."[111]

There is no comparable provision in the Bankruptcy Tax Reform Act. That Act makes no distinction between retained and distributed earnings in providing that "the interest in a partnership of a debtor who is an individual shall be taken into account . . . in the same manner as any other interest of the debtor."[112] By defining the gross income of an individual debtor's estate to include "gross income of the debtor to which the estate is entitled,"[113] the Act suggests that a claim for federal taxes on retained income is a claim against the partner's estate and thus subordinated to partnership creditors when asserted against partnership assets. This result was avoided under the Bankruptcy Act by a resort to equity in *In re Brezin*.[114] The federal tax claim was called an equitable lien on the partnership estate's retained earnings and was thereby allowed priority in the distribution of partnership assets. When the Commission of Bankruptcy Laws proposed the retained earnings provision now embodied in section 728(c) of the Bankruptcy Code with respect to state or local tax claims, it had in mind the codification of this equitable solution.[115] While that is the effect of the Bankruptcy Code's state or local tax claim provision, there is no basis for inferring that the drafters of the Bankruptcy Tax Reform Act intended the same result

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[108] *See* I.R.C. § 702(c) (1976).

[109] *See supra* text accompanying notes 32-33.

[110] The provision of § 728(c) converting the partner's tax liability into one against the partnership does not apply when either the partnership or the partner alone is a debtor in a case under title 11, or even when both the partnership and partner are debtors in concurrently pending cases, one of which is a Chapter 11 case.

[111] The "only" language is curious, since the partnership trustee has a claim against the estate of any debtor-partner for the taxes due under § 723(c), which applies notwithstanding § 728(c). *See infra* note 119 and accompanying text. The legislative reports advise tax collectors that "[n]o burden is placed on the taxing authority: the taxing authority should file a complete proof of claim in each case and the court will execute the marshalling." HOUSE REPORT, *supra* note 12, at 386, 1978 U.S. CODE CONG. & AD. NEWS 6342; SEN. REPORT, *supra* note 12, at 100, 1978 U.S. CODE CONG. & AD. NEWS 5886.

[112] I.R.C. § 1398(b)(2) (1976).

[113] I.R.C. § 1398(e)(1) (1976).

[114] 297 F. 300, 306 (D. N.H. 1924).

[115] The provision is derived from § 5-104(d) of the Bankruptcy Act proposed by the Commission of the Bankruptcy Laws. *See* COMMISSION REPORT II, *supra* note 9, at 187-88.

with respect to federal tax claims. Moreover, the Supreme Court refrained from endorsing the equitable solution in *United States v. Kaufman.*[116] Thus the question of the allowance and distribution of federal tax claims for retained earnings is apparently left in limbo.

The legislative history of section 728(c), containing the provision that pertains to state or local tax claims for retained earnings, suggests the likely, though arguably irrelevant, view of the Code drafters on the federal tax question. The legislative reports characterized the provision as "a marshalling rule only for purposes of allowance and distribution."[117] There is no reason to believe that the drafters supposed that such a rule should differentiate between federal and nonfederal tax claims.

However, the relevant legislative reports are confusing in their explanations of the role of section 728(c). According to these reports, if partnership assets are insufficient to satisfy partnership debts, section 723(c) will "allow any *unsatisfied* tax claim to be asserted by the partnership trustee against the estate of the partner,"[118] notwithstanding the apparently exclusive rule of section 728(c). This statement ignored the full reach of section 723(c), which gives the trustee a claim against the partner's estate "for the full amount" of the tax claim and which applies "notwithstanding section 728(c)."[119] It is irrelevant for the purposes of section 723(c) whether or not the partnership estate suffices to pay partnership debts. The legislative history suggested that an effort was made to retain one branch of the jingle rule for state or local tax claims against retained earnings by requiring that the claims be satisifed from partnership assets first. Clearly, however, the language of the Code does not accommodate such an exception for tax claims.

The legislative history of section 728(c) concluded with the equivocal observation that, as a result of section 723(c), "the tax claim may be nondischargeable with respect to an individual partner."[120] This statement is consistent with the characterization of section 728(c) as "a marshalling rule only," but the subsection as enacted contains no intimation that it has such a limited purpose. There is no attempt to provide for or against the nondischargeability of such a tax claim in section 523.

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[116] 267 U.S. 408 (1925).

[117] HOUSE REPORT, *supra* note 12, at 386, 1978 U.S. CODE CONG. & AD. NEWS 6342; SEN. REPORT, *supra* note 12, at 100, 1978 U.S. CODE CONG. & AD. NEWS 5886.

[118] *Id.* (emphasis added).

[119] Similarly confusing is the statement in the HOUSE REPORT, *supra* note 12, at 280, 1978 U.S. CODE CONG. & AD. NEWS 6237, that if the partnership estate does not satisfy the claim of the partnership creditors, § 723(c) permits the partnership trustee to file a claim against the partner's estate for the *deficit.* The passage fails to recognize that the partnership trustee's claim against the partner's estate under this subsection is "for the full amount" of the tax claim. Moreover, it fails to recognize that § 723(c) does not merely permit the partnership trustee to file a claim but establishes such a claim as a matter of right.

[120] HOUSE REPORT, *supra* note 12, at 386, 1978 U.S. CODE CONG. & AD. NEWS 6342; SEN. REPORT, *supra* note 12, at 100, 1978 U.S. CODE CONG. & AD. NEWS 5886.

V. Setoff

The Bankruptcy Code modifies the right of setoff but generally continues the traditional policy of recognizing the right,[121] notwithstanding the resulting impairment of the theme of equality of distribution. The new law in several respects treats the creditor with a right of setoff as a species of secured creditor.[122]

One of the prime requisites for application of setoff is that the debts and credits be mutual.[123] If a partnership debtor in a case under the Bankruptcy Code has a claim against a partner, may the debtor of the partnership set off a separate claim he has against a copartner? Since the partner's creditor has no claim against the partnership but only a claim against the partner's share of a surplus if one materializes, there is no mutuality.[124] Accordingly, setoff is not permitted.

If, on the other hand, a partner has a claim against an obligor who has a claim against the partnership, mutuality appears to be present. The creditor of the partnership is entitled to compete *pari passu* with the partner's creditors in the distribution of the separate property of the partner.[125] No greater inequity results from allowing the partnership creditor to enforce its claim against the asset represented by the partner's claim than from allowing a separate creditor of the partner to assert the setoff. Recognition of the right of setoff in this situation arguably represents a change of the law, since allowance of the setoff to the partnership creditor gives him the right of a secured creditor in the partner's estate in contravention of the former right of the separate creditors to have the separate property devoted first to the payment of the separate debts. The separate creditors' right to first payment under the Bankruptcy Act seems to have been disregarded in *Rochelle v. United States*,[126] which allowed setoff in such a situation, but the result is consistent with that called for by the new law.

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[121] The principal section governing setoff in the Bankruptcy Code is § 553. It incorporates most of the features of § 68 of the Bankruptcy Act.

[122] Section 506(a), which governs the determination of "secured status," recognizes a claim subject to setoff under § 553 as a secured claim.

[123] The requirement of mutuality is explicit in § 553(a) as it was in § 68a of the Bankruptcy Act.

[124] To allow setoff in this situation would be to appropriate property of the partnership, in which the other partner has an interest, to the payment of one partner's debt. The effect is thus to take the other partner's share of the partnership claim for the benefit of the partner who is the only obligor without the consent of the other partner. The other partner may properly object to the setoff, whether the obligor of the partnership is seeking the setoff, as in *In re* T.M. Lesher & Son, 176 F. 650 (E.D. Pa. 1910), and *In re* Crystal Spring Bottling Co., 100 F. 265 (D. Vt. 1900), or the partner is seeking to pay his debt out of the partnership claim, as in Gray v. Rollo, 85 U.S. 629 (1873).

[125] *See supra* note 60 and accompanying text.

[126] 521 F.2d 844 (5th Cir. 1975), *cert. denied*, 426 U.S. 948 (1976), *mandate amended on rehearing*, 526 F.2d 405 (1976). The *Rochelle* court correctly pointed out that in this situation the other partner has no right to object because he is giving up nothing, the partner-

VI. Adjustments on Account of Distributions from More Than One Estate or Source

If a partnership is a debtor in a case under Chapter 7, the trustee of the partnership is authorized to seek collection of the partnership's debts from any partner-member of the partnership who is not a debtor under the Bankruptcy Code, but that authorization is conditioned on the existence of a deficiency of the partnership property to pay those debts and the costs of administration of the partnership estate.[127] If the bankruptcy court in which the partnership case is pending does not enjoin the partners from disposing of their property,[128] a partner-member may pay some or all of the partnership debts. Moreover, if the trustee of the partnership does not obtain an injunction against collection by partnership creditors out of a partner's property,[129] one or more of such creditors may sue a partner to judgment and obtain forcible collection out of the partner's property by levy and execution sale. As a result of such a payment or collection the partnership creditor may receive full payment of his debt or at least more than other partnership creditors of the same class.[130]

Section 508(b) of the Bankruptcy Code recognizes this possibility as a source of inequity among partnership creditors and attempts to ameliorate it under certain circumstances. If the partnership creditor receiving the payment is not secured by a lien on property of the partner, the creditor is precluded from receiving any distribution from the partnership estate until other creditors of the same class have "received payment under this title equal in value to the consideration received by

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ship creditor asserting the setoff is in no position to object to his own choice of obligor, and the partner against whom the setoff is asserted cannot object to being held liable to the partnership creditor. What the court ignored, however, was the frustration of the policy of the Bankruptcy Act to give the separate creditors of a partner the right to have the partner's assets devoted first to the payment of their claims before the partnership creditors could participate in any distribution of the proceeds from these assets. The court acknowledged that *In re* Phoenix Hotel Co. of Lexington, Ky., 20 F. Supp. 240 (E.D. Ky. 1937), was *contra* but found its reasons unpersuasive. *See* 521 F.2d at 854.

[127] *See* § 723(a). If any partner-member is a debtor in a case under the Bankruptcy Code, the trustee of the partnership has an automatic claim against the partner's estate. *See* § 723(c); *supra* text accompanying notes 61-73.

[128] *See* § 723(b).

[129] *See* House Report, *supra* note 12, at 198, 1978 U.S. Code Cong. & Ad. News 6159. Issuance of an injunction may be predicated on 11 U.S.C. § 105 (Supp. IV 1980) and 28 U.S.C. 1481 (Supp. IV 1980). The automatic stay of 11 U.S.C. § 362 (Supp. IV 1980) triggered by the filing of a petition concerning a partnership does not reach proceedings and acts to collect from the partners.

[130] The word "class," as used here and subsequently in the text, includes all those creditors who are entitled to receive distribution from the estate at the same rate if there is not enough to pay them in full. This usage is believed to be consistent with the congressional intent when the word "class" is used in the Bankruptcy Code. *See, e.g.*, §§ 1122(a), 1123(a)(4) (requiring "same treatment for each claim or interest of a particular class"), and § 1322(a)(3) (requiring "the same treatment for each claim within a particular class").

such creditor from such general partner." Section 508(a) contains a similar provision requiring equalization of distribution when a creditor of a debtor in a case under the Bankruptcy Code receives payment pursuant to a distribution in a foreign proceeding.[131] These provisions are not well drafted and undoubtedly should be read to suspend distribution to the creditor receiving payment from the outside source only until the other creditors have received a distribution of proportionate or pro rated value from the estate rather than one equal in value to the consideration received from the outside source. Thus, if a partnership creditor receives $1,000 from a partner, constituting fifty percent of the creditor's claim, the intent of the statute is that the creditor should receive no distribution from the partnership estate until other creditors of the same class have received, not $1,000, but fifty percent of their respective claims from the partnership estate.

Section 508 is clear that a transfer of property in discharge of a claim by a creditor as well as a payment in money triggers the suspen-

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[131] "Section 508b of the House amendment is new and provides an identical rule with respect to a creditor of a partnership who receives payment from a partner, to that of a creditor of a debtor who receives a payment in a foreign proceeding involving the debtor." 124 CONG. REC. 32398 (Sept. 28, 1978) (Congressman Edwards' statement); 124 CONG. REC. 33997 (Oct. 5, 1978) (Senator DeConcini's statement).

Section 508(a) is an adaptation of § 65d of the Bankruptcy Act. Section 65d dealt with potential problems arising from dual bankruptcies in this and another country by requiring those creditors for whom no foreign dividend had been paid or declared to receive from the bankruptcy court in this country a dividend equal to whatever had been paid or declared abroad in favor of creditors of the same class before the latter group should receive any amount from a distribution by the court in this country. Section 65d, which was part of the Bankruptcy Act of 1898 as originally enacted, was amended in 1952 to make clear that distribution to a creditor for whom a dividend has been declared though not yet paid should be suspended until other creditors of the same class had been paid an equal dividend in the case pending in this country. *See* H.R. REP. NO. 2320, 82d Cong., 2d Sess. 10, *reprinted in* 1952 U.S. CODE CONG. & AD. NEWS 1960; Nadelmann, *Revision of Conflicts Provisions in the American Bankruptcy Act*, 1 INT'L & COMP. L.Q. 484, 487-88 (1952), *reprinted in* 27 REF. J. 53, 54 (1953) [hereinafter cited as Nadelmann].

The Commission on the Bankruptcy Laws of the United States recommended a continuation and extension of the policy of what has been called the hotchpot rule to cover not only cases of concurrent bankruptcies but also cases in which rehabilitation was the objective in either or both of the concurrent proceedings. *See* COMMISSION REPORT II, *supra* note 9, at 111, 114-15. The Commission's proposal also contemplated equalization when any postpetition payment reducing a creditor's claim came from funds located outside the country.

As enacted, § 508 does not require equalization unless a creditor has received "in a foreign proceedings, payment of, or a transfer of property on account of, a claim that is allowed under this title." A "foreign proceeding" is defined in § 101(19) to include a proceeding for adjusting debts or effecting a reorganization as well as liquidating an estate.

Professor Nadelmann has pointed out that the hotchpot rule underlying former § 65d of the Bankruptcy Act and § 508(a) of the Bankruptcy Code has long been applied in England, France, and other, but not all, European countries, and that it may well be regarded as part of the common law as applied in the United States. *See* Nadelmann, *supra*, at 487, 27 REF. J. at 54; Nadelmann, *The National Bankruptcy Act and the Conflict of Laws*, 59 HARV. L. REV. 1025, 1048-49 (1946), *reprinted in* 21 REF. J. 43, 51 (1947).

sion of distribution to the creditor in the case under the Bankruptcy Code. A transfer by way of security is presumably to be given the same effect as a payment or transfer in satisfaction of the claim.[132] Otherwise the partnership creditor would avoid the effect of the section by accepting or taking a lien on the partner's property rather than an outright payment or transfer. On the other hand, if the creditor is already secured by a lien on the property of the partner, no suspension or equalizing adjustment is required by a partner's payment or transfer on account of the secured claim.[133] This limitation placed on the applicability

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[132] "Transfer" is defined in § 101(40) of the Bankruptcy Code to include any voluntary or involuntary disposition of or parting with an interest in property. While the declaration of a dividend abroad triggered the suspension of dividend payments to a creditor under § 65d of the Bankruptcy Act, *see supra* note 131, it may be doubted whether such a declaration constitutes either a payment or transfer of property within § 508(a) of the Bankruptcy Code.

[133] It is to be noted that, so far as the language of the relevant clause of § 508(b) indicates, the lien on the property of the debtor may be a consensual, judicial, statutory, equitable, or common-law lien; may have arisen before or after the filing of the petition concerning the partnership; and may even be unperfected, preferential, or voidable for an other reason under bankruptcy or nonbankruptcy law.

Arguably, payments are not suspended if the partnership creditor is secured in an amount insufficient to cover the claim on account of which the payment or transfer is made and although the payment or transfer exceeds the value of the security. The argument is not ineluctable, however, and may be met by recurring to § 506(a), which separates an undersecured claim into two claims for the purpose of allowance: the secured claim is limited "to the extent of the value of such creditor's interest in the estate's interest in such property," and the rest of the claim is an unsecured claim. Section 506(a) does not apply directly to the situation under consideration, because the partnership estate does not ordinarily include interests in the property of the partner. The analogy of § 506(a) is clear, however, as is the well-established rule that a payment or transfer to a creditor on the eve of bankruptcy is not voidable as a preference to the extent the creditor is secured. *See* Kennedy, *The Inchoate Lien in Bankruptcy: Some Reflections on* Rialto Publishing Co. v. Bass, 17 STAN. L. REV. 793 (1965). Undoubtedly, Congress intended to except from the operation of § 508(b) a payment or transfer on account of a claim only to the extent it is validly secured.

The intention to include every type of lien in the clause of § 508(b) under consideration was deliberate and is, in itself, no cause for criticism. The Bankruptcy Code defines "lien" broadly in § 101(28) and adds more particular definitions of "judicial lien" in § 101(27) and "statutory lien" in § 101(38). A "security interest" is limited by § 101(37) to a consensual lien. The statute does not define an "equitable lien" or a "common-law lien," but these varieties of liens are embraced by the language of § 101(28).

The undoubted intent of Congress in § 508(b) was to refer to a lien arising before the filing of the petition. If, as suggested in the text, a postpetition lien triggers the suspension of distribution, the lien that excludes a postpetition payment or transfer from the operation of the subsection is necessarily one that arose before the petition. If, on a contrary assumption as to the meaning of "transfer" in § 508(a), a payment or transfer in satisfaction of a postpetition lien would avoid the operation of the suspension of distribution otherwise prescribed by § 508(b), an easy way to circumvention of its effect would be afforded by the simple stratagem of creating a lien before making a payment or absolute transfer.

It will not be so easy for the trustee of the partnership to avoid the exclusionary effect of § 508(b) by challenging the validity of the lien. As pointed out in text accompanying note 136 *infra*, the trustee of the partnership is not supposed to have any powers of avoidance under the Bankruptcy Code respecting the property of the partners.

of the suspension of payments is consistent with the rule implicit in the partnership provisions of the Bankruptcy Code that a lien on a partner's property securing a partnership debt does not reduce the allowable claim of the creditor against the partnership estate.[134] If a partner should pay a partnership creditor out of his separate property before the filing of the petition concerning the partnership, the payment reduces pro tanto the creditor's claim against the partnership estate.[135] If so, and if a

[134] *See supra* text accompanying notes 34-36.

[135] Under nonbankruptcy law a prepetition payment of a partnership debt by a partner discharges the debt pro tanto so far as the creditor and all third persons are concerned. "The partnership must indemnify every partner in respect of payments made and personal liabilities reasonably incurred by him in the ordinary and proper conduct of its business, or for the preservation of its business or property." UNIFORM PARTNERSHIP ACT § 18(b). This right to indemnification is sometimes referred to as subrogation, contribution, or reimbursement, but it is enforceable only internally, typically by an accounting at dissolution. *See* J. CRANE & A. BROMBERG, *supra* note 6, at 371-73. The claim of the creditor who has been paid by the partner is not kept alive for the purpose of enabling the partner to compete with unpaid creditors of the partnership in a settlement of the affairs of the partnership. The partner who paid the partnership debt may or may not be entitled to indemnification by the partnership, depending on the partnership agreement and circumstances having nothing to do with the amount and the rights of the partnership creditor vis-a-vis the partnership. *See* Comment, 9 ILL. L. REV. 52 (1914).

The partner's relation to the partnership is thus not identical to that of a surety, whose partial payment of a debt before the bankruptcy of the principal debtor does not discharge the debt. The creditor who has received the partial payment, or the surety in his behalf, may file a claim undiminished by the payment, because the principal debtor's estate remains liable for the full amount of the debt. *See* §§ 501(b), 509(a); FED. R. BANKR. P. 304 and Advisory Committee Note; Proposed Bankruptcy Rule 3005(a). In order to protect the estate against the risk of double payment on what is essentially a single claim, only a single claim may be filed.

While a surety may file a proof of claim as a codebtor under § 501(b), a partner will not ordinarily be warranted in filing a claim as such a codebtor of the partnership. *Cf. supra* text accompanying notes 56-59. Gratuitous comments in the *Congressional Record* suggesting that "sections of the Bankruptcy Act [sic] applying to codebtors and sureties apply to the relationship of a partner with respect to a partnership debtor" must be taken with considerable qualification. *See* 124 CONG. REC. 32401 (Sept. 28, 1978); 124 CONG. REC. 34001 (Oct. 5, 1978); *supra* note 60.

Section 509(b) contains exceptions to the general rule recognized in § 509(a) that a surety or other codebtor who pays a claim against a debtor is subrogated to the creditor's claim. One of the exceptions bars subrogation to the extent that the codebtor received the consideration for the claim held by the creditor. Statements in the *Congressional Record* explain that "Section 509(b)(2) reiterates the well-known rule that prevents a debtor that is ultimately liable on the debt from recovering from a surety or a co-debtor." 124 CONG. REC. 32398 (Sept. 28, 1978) (Congressman Edwards' statement); 124 CONG. REC. 33998 (Oct. 5, 1978) (Senator DeConcini's statement). Similar statutory language appears in § 1301(c)(1), and is similarly explained in the *Congressional Record* as an effort to state an exception applicable to the party who ultimately bears the liability as between two codebtors. *See* Kennedy, *Automatic Stays Under the New Bankruptcy Law*, 12 U. MICH. J. L. REF. 1, 55-56 (1978). The party receiving the consideration is, of course, not necessarily the ultimately liable party, as the legislative history accompanying both passages acknowledges. *See* 124 CONG. REC. 32398, 32409, 33998, and 34009 (1978).

Added to this gloss on § 509(b)(2), however, is the following unilluminating reference to partners:

Although the language in section 509(b)(2) focuses in terms of receipt of considerapostpetition payment or transfer to the partnership creditor triggers suspension of distribution to the creditor favored by the transfer pending equalization of dividend payments, it is not readily apparent why a prepetition payment or lien, particularly one received or obtained on the eve of the filing of the petition, should be ignored in the equalization process. The House Report accompanying H.R. 8200 declared, however, that the avoiding powers of a partnership trustee do not reach transfers of a partner's property.[136] The thrust toward achieving equality in section 508(b) is not easily reconcilable with the conceptualization of the relation between the partnership creditors and the partner's estate in the House Report.

VII. DISTRIBUTION OF SURPLUS

Under the Bankruptcy Act the disposition of a surplus remaining after the administration of a partnership estate was a fairly simple matter. The third sentence of section 5g stated the applicable rule as follows:

> Should any surplus of the partnership property remain after paying the partnership debts, such surplus shall be distributed among the individual partners, general or limited, or added to the estates of the general partners, as the case may be, in the proportion of their respective interests in the partnership and in the order of distribution provided by the laws of the State applicable thereto.

The occasions when a surplus materialized to be disposed of arose so seldom that one encounters few instances of application of the sentence and little discussion of the procedure or problems that its application might conceivably have engendered.

Distribution of a surplus is not likely to be either so rare or simple in

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> tion, legislative history appearing elsewhere indicates that an agreement to share liabilities should prevail over an agreement to share profits throughout title 11. This is particularly important in the context of co-debtors who are partners.

124 CONG. REC. 32398, 33998 (1978). The legislative history "appearing elsewhere" presumably includes statements that relate to § 723(d) and § 1301(c)(1). The House Report's preference for the apportionment of liabilities rather than the apportionment of profits in connection with § 723(d) is referred to in the text accompanying note 145 *infra*. The legislative history relating to § 1301(c)(1) includes this statement:

> As with other sections in Title 11, the standard of receiving consideration is a general rule, but where two co-debtors have agreed to share liabilities in a different manner than profits it is the individual who does not ultimately bear the liability that is protected by the stay under section 1301.

124 CONG. REC. 32409 (Sept. 28, 1978) (Congressman Edwards' statement); 124 CONG. REC. 34009 (Oct. 5, 1978) (Senator DeConcini's statement).

The 15th edition of *Collier* does not attempt to explain or elaborate any of these excerpts from the legislative history quoted in this note, and it seems appropriate here to leave them at rest.

[136] *See* HOUSE REPORT, *supra* note 12, at 199, 1978 U.S. CODE CONG. & AD. NEWS 6160.

a partnership case under the Bankruptcy Code. The possibilities are only partially recognized in section 723(d):

> If the aggregate that the trustee recovers from the estates of general partners under subsection (c) of this section is greater than any deficiency not recovered under subsection (b) of this section, the court, after notice and a hearing, shall determine an equitable distribution of the surplus so recovered, and the trustee shall distribute such surplus to the estates of the general partners in such partnership according to such determination.

Section 723(d) only partially deals with the problem of disposition of a surplus because it ignores the possibility of a surplus when the partnership trustee recovers nothing under section 723(b), when he recovers nothing under section 723(c), and when he recovers nothing under either subsection. The statutory solution prescribed for the situation that is identified in section 723(d) is so general and so unexceptionable, however, that a court would be hard put to justify following any course other than that set out in the statute in disposing of a surplus generated by any concatenation of circumstances.

A surplus in the partnership estate may materialize without any recovery under either section 723(b) or 723(c) simply as a result of diligent collection of the property of the partnership, including recoveries on choses in action belonging to the debtor[137] and avoidance of preferential, fraudulent, and otherwise voidable transfers. It is to be noted that a petition may be filed by a partnership without regard to its financial condition, and an involuntary petition may be filed against it without alleging or proving insolvency or even inability to pay its debts as they mature.[138] It is thus entirely plausible for a partnership estate to yield a surplus without the necessity for drawing on any general partner's estate.

A surplus is more likely to be generated if the partnership trustee pursues the remedies provided by section 723(b). The drafters may have contemplated a single joint action for the deficiency of partnership property to meet partnership debts against all of the general partners who are not debtors in cases under the Bankruptcy Code, but there is no requirement that he proceed in this way. Indeed, the statute seems drafted on the contrary assumption that the trustee of the partnership will sue each general partner severally for the full amount of the defi-

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[137] The property of a partnership includes the right to collect unpaid contributions from limited partners.

[138] None of the grounds for an involuntary petition includes a financial condition of the debtor as an element. *See* Kennedy, *supra* note 26, at 1008-14. Financial stringency is likely to accompany each of the grounds specified in § 303(h), but for reasons indicated in the text, entry of an order for relief on an involuntary petition does not preclude the possibility that a surplus may be produced by a successful administration of the partnership estate.

ciency, in the same way that a partnership creditor may sue for the full amount of its claim against each partner severally under some state laws.[139] Whether the trustee obtains a joint or several judgment against two or more general partners, the bankruptcy court may limit the aggregate recovery from the partner to the amount of the deficiency. Until the time for filing claims has run out[140] and disputes regarding the amount and validity of the claims have been resolved,[141] however, the amount of the deficiency cannot actually be determined until the administration of the estate has proceeded to the point when the case is ready to be closed.

Although there is a greater likelihood that unanticipated costs of administration and the reconsideration of claims will render recoveries obtained pursuant to section 723(b) inadequate rather than excessive, discovery of partnership property or recovery on partnership causes of action may convert a deficiency into a surplus. The statutory direction of section 723(c) for an equitable distribution to be determined and followed is surely appropriate and applicable in such a situation.

If all the general partners as well as the partnership are debtors under the Bankruptcy Code, the partnership trustee's automatic right to share *pari passu* with separate creditors in each partner's estate, along with the partnership creditors' exclusive right to share in the distribution of the partnership estate, creates a greater likelihood that a surplus will result than in the situation dealt with by section 723(d).[142] Again, however, it is difficult to fashion a more appropriate statutory solution than that set out in the last clause of section 723(d), namely, an equitable distribution to the estates of the general partners.

While an equitable distribution cannot be questioned as the ideal objective in the abstract, what is equitable in particular circumstances is

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[139] *See* J. CRANE & A. BROMBERG, *supra* note 6, at 335 n.54; F. MECHEM, *supra* note 4, at 273; Campbell, *Partnership Obligations and Their Enforcement*, 32 CHI.-KENT L. REV. 127, 129-31 (1954); Hutchison, *Enforceability of Iowa Creditors' Judgments Against Partnership and Partners' Assets*, 44 IOWA L. REV. 643, 645, 649-50, 664-74 (1959).

[140] Under FED. R. BANKR. P. 302(e), which remains in effect under § 405(d) of the Bankruptcy Code until superseded by rules promulgated pursuant to 28 U.S.C. § 2075 (Supp. III 1979), the time for filing of claims runs for six months after the first date for the first meeting of creditors. The time may be extended for governmental units and certain other persons. The proposed Bankruptcy Rules that have been submitted for consideration and promulgation by the Supreme Court prescribes a 90-day period following the first date for the first meeting of creditors. *See* PRELIMINARY DRAFT OF PROPOSED NEW BANKRUPTCY RULES AND OFFICIAL FORMS, Rule 3002(c) (1982).

[141] It is to be noted that contingent, unliquidated, and disputed claims are allowable without respect to the difficulties of liquidating them. *See* HOUSE REPORT, *supra* note 12, at 180, 1978 U.S. CODE CONG. & AD. NEWS 6141. The delay that may be entailed by the process of determining the amount of any claim is no longer a basis for disallowance. *See* § 502(b)(1).

[142] If all the partners are debtors in cases under the Bankruptcy Code, the trustee of the partnership as the representative of all the partnership creditors will receive a dividend on their aggregate claim against each of the several partners' estates, even though there may be no deficiency in the partnership estate to meet partnership obligations.

likely to be quite controversial. The source of the surplus is of course a highly relevant factor, but timing may be important or at least a basis for conflicting claims. Thus, suppose that a partner makes a substantial advance to a general partnership shortly before a petition is filed by or against the partnership. If the advance is made as a loan, the partner is entitled to a repayment of the loan in full before any surplus can be found to exist.[143] On the other hand, if the advance is categorized as a contribution to the capital of the firm, it competes in the distribution of any surplus with contributions of other partners, whether made both before or after the filing of the petition.[144]

The House Report that accompanied the bill that became the Bankruptcy Code contained an elaborate discussion of the proper solution for disposing of a surplus. The Report stated at the outset of the discussion that an equitable distribution should recognize the responsibility of the partners for partnership liabilities under the partnership agreement. "This measure is used in lieu of profit sharing percentages because the redistributed surplus is directly mitigating a loss."[145] Another principle embodied in the House Report's solution is that of protecting the estate of each partner from being required to distribute a greater percentage to the partnership trustee than is distributed to the separate creditors of the partner's estate.[146] This principle is not made explicit in the statute but was apparently regarded by the drafters of the Report as a matter of fairness to the separate creditors, who are required by the statute to give up their traditional right to priority over the partnership creditors in the distribution of the separate estate. Without due concern for this principle a disposition of the surplus could result in a discriminatory impact on the separate partner's estate and its creditors. What was described as a "simple set of facts" was used in the House Report as a basis for explanation of a solution meeting the statutory command.[147] A simpler situation is posed here to illustrate the approach favored in the House Report.

A partnership *P* having liabilities of $100,000 has three partners, *A*, *B*, and *C*, with separate liabilities of $200,000, $300,000, and $400,000

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[143] *See* UNIFORM PARTNERSHIP ACT § 40(b).

[144] *Id.*

[145] *See* HOUSE REPORT, *supra* note 12, at 201, 1978 U.S. CODE CONG. & AD. NEWS 6161.

[146] *See id.* at 202, 1978 U.S. CODE CONG. & AD. NEWS 6162-63.

[147] The hypothetical problem and its solution are set out in the House Report. *See* HOUSE REPORT, *supra* note 12, at 201-03, 1978 U.S. CODE CONG. & AD. NEWS 6161-64. The problem involved the distribution of a surplus among the five members of a partnership, only four of whom were debtors in cases under the Bankruptcy Code. The discussion was predicated on a version of § 723(c) that has since been changed. The subsection as it read in the original version of H.R. 8200 gave the trustee of a partnership debtor a claim that included the administrative expenses of the partnership estate. *See* HOUSE REPORT, *supra* note 12, at 200, 1978 U.S. CODE CONG. & AD. NEWS 6161. As pointed out in text accompanying note 80 *supra*, § 723(c) as enacted restricts the partnership trustee's automatic claim to the allowed claim of creditors of the estate, exclusive of administrative expense claims.

respectively. The partnership and partners are all debtors in cases under the Bankruptcy Code. Administration of the partnership's property produces $50,000 above administration expenses, and administration of the property of the partners yields the following amounts in excess of the administration expenses chargeable to each estate: *A*, $100,000; *B*, $160,000; and *C*, $200,000. The partnership agreement allocated partners' responsibility for partnership liabilities not covered by partnership property according to the following percentages: *A*, 25%; *B*, 25%; and *C*, 50%.

Under section 723(c) the following allowable claims and initial distributions would be made:

Estate	Partnership Trustee's Claim	Separate Claims	Aggregate Claims	Estate	Initial Distribution to Partnership Trustee
A	$100,000	$200,000	$ 300,000	$100,000	$ 33,300
B	$100,000	$300,000	$ 400,000	$160,000	$ 40,000
C	$100,000	$400,000	$ 500,000	$200,000	$ 40,000
Totals	$100,000	$900,000	$1,200,000	$460,000	$113,300

Addition of the amounts initially distributable from the three partners' estates to the partnership trustee shows a sum of $113,300, whereas the aggregate of the partnership creditors' claims is only $100,000. The $50,000 obtained from the partnership property would reduce the amount required and allowed to be distributed from the partners' estates to the partnership trustee to $50,000. There would thus be a surplus of $63,300 to be distributed pursuant to section 723(d) to the partners. *A*, although responsible for only 25% of the partnership debts, has contributed 33.3% of the partnership trustee's claim to the initial distribution; *B*, likewise responsible for 25% of the partnership debts, has contributed 40% of the partnership trustee's claim to the original distribution; and *C*, although liable for half of the partnership debts, has contributed only 40% of the partnership trustee's claim to the initial distribution. It would be manifestly unfair to the creditors of *A* and *B* to allocate 50% of the surplus of $63,300 to *C*. On the other hand, it would be unfair to the separate creditors of *C*, who receive only 40% of their claims, to require any increase in the distribution from their debtor's estate to the creditors of the partnership. The statute does not permit the reduction of the percentage of distribution to the partnership trustee out of *A*'s and *B*'s estates, and the separate creditors of *A* and *B* are in no position to complain of a distribution of their respective debtors' estates that treats them and the partnership trustee in exactly the same way.

The solution proposed by the House Report would attempt to do equity among the creditors of the three partners by adjusting the distribution of the surplus. On the initial distribution, *C*'s estate had contributed a percentage of the partnership trustee's claim that was 10% less than its 50% share of the intrapartnership liability. This deficiency had to be picked up by *A*'s and *B*'s estates, which were equally responsible for 25% of the partnership's debts. Redistribution of the percentages resulted in an assignment of an intrapartnership liability of 30% each to *A* and *B*, leaving *C*'s portion at 40%. Application of these percentages to the $50,000 required from the partners' estates produced the following allocations: *A*—$15,000; *B*—$15,000; and *C*—$20,000. When these allocations are subtracted from the initial distribution set out in the table above, the surplus of $63,300 is distributed as follows: *A*—$18,300; *B*—$25,000; and *C*—$20,000.[148]

Notwithstanding the elaboration of a solution predicated on the several partners' liabilities for the partnership debts rather than their several shares in partnership profits, the House and the Senate Reports both summarized the effect of section 723(d) as follows:

> The determination will be based on factors such as the relative liability of each of the general partners under the partnership agreement and the relative rights of each of the general partners in the profits of the enterprise under the partnership agreement.[149]

[148] For the calculations used in reaching the results discussed in the text, see the Appendix.

[149] *See* HOUSE REPORT, *supra* note 12, at 381, 1978 U.S. CODE CONG. & AD. NEWS 6337; SEN. REPORT, *supra* note 12, at 95-96, 1978 U.S. CODE CONG. & AD. NEWS 5881-82. It is to be noted that the excerpt from the House Report quoted in the text is separated by nearly 200 pages from the discussion of the hypothetical solution predicated on the apportionment of liabilities. *See* Appendix.

VIII. APPENDIX

Chart Showing Distribution of Partnership Surplus

	Partner A	Partner B	Partner C	Total
1. Liability per agreement	25%	25%	50%	100%
2. Original percentage distribution	33.3	40	40	
3. Difference (1-2)	−8.3	−15	+10	
4. Recomputed ptshp. liability	50%	50%		100%
5. Allocation of positive (3 × 4)	5	5		
6. New partnership distribution	30	30	40	100%
7. 6 × money used ($50,000)	$15,000	$15,000	$20,000	
8. Amounts of original distribution	$33,300	$40,000	$40,000	$113,300
9. Final distribution (8 − 7)	$18,300	$25,000	$20,000	$ 63,300

The above table is comparable to that set out in the House Report.[150] The table and problem in the House Report are more elaborate, not only in that more partners are involved but one of them is not a debtor under the Bankruptcy Code and two additional recomputations of interpartnership liability are necessary to effect reallocation among the partners whose estates contributed more to the payment of the partnership trustee than was required by their original agreement.

Line one of the table represents each partner's liability under the partnership agreement. If any of the partners was not a debtor in an individual case under the Bankruptcy Code, the nondebtor partner's share would have to be reallocated to the debtor partners on a proportional basis. In the House Report, this is called the recomputed intrapartnership liability.[151] In the illustrative case set out in the text, there is no need for such recomputation since all partners are debtors.

Line two sets out the original percentage distribution of each partner's estate to all claim holders. Thus the partnership estate gets the indicated percentage of the aggregate of all partnership creditors' claims ($100,000) from each partner.

Line three gives the difference between the percentage in line two

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[150] *See* HOUSE REPORT, *supra* note 12, at 202, 1978 U.S. CODE CONG. & AD. NEWS 6163.

[151] *See id.*

and the percentage the partner is obligated to pay by agreement. Where the number is negative, the partner is paying more in the original distribution than his contract share, though he is not paying more at this stage than he is paying to his separate creditors. If the number is positive (as in the case of partner *C*), the partner cannot pay his full contract share without prejudicing his separate creditors. Consequently, partner *C's* share will be set at the line two percentage, and the other partners must allocate the excess payment.

Line four sets out the percentage allocation of the unmet need (the positive number of 10%) in line three. Line four will always sum to 100 because 100% of the unmet distribution must be allocated. The figures on this line are the percentages of the combined liabilities of *A* and *B* allocable each to *A* and *B* and are obtained simply by dividing the percentage allocable to each (25% as to *A* and 25% as to *B*) by the total of their combined liabilities (50%). *C* does not enter into the equation because it is *C's* excess liability that is being allocated.

The figures in line five represent the additional percentage of liability for the partnership claims that *A* and *B* must meet because of the equitable ceiling put on *C*. This allocation is obtained by multiplying the positive number in line three by the allocative shares in line four.

Line six represents the new partnership distribution. It is obtained by adding line five to the lower of line one or two for each partner. It is called a *test* distribution in the House Report because we are not yet sure if these shares are equitable until we compare them with the equitable ceilings in line two. The House Report contains an additional line seven which represents the figures of line six minus line two for each partner. In the case at hand, this line would appear:

7. Difference (6-2)	– 3.3	– 10	0

As long as there are no positive values in this line, there is no inequitable effect on any partner's individual creditors and consequently no need to allocate again. Because of the convenience of the example figures, only one allocation (or 'iteration') is necessary. The House Report example requires three allocation steps.

Line seven in the table represents the share each partner must bear of the actual unpaid partnership claims in dollars. These figures are obtained by multiplying the final line six shares by the amount of partnership claims required to be paid after application of the partnership property.

Line eight merely sets out the amounts the partnership trustee received from each partner's estate as a general creditor as a result of the original distribution.

Line nine gives the amounts each partner will receive from the surplus of $63,300. It is obtained by subtracting line seven (amount needed) from line eight (amount originally received from the several partners' estates).

To meet fully the equitable goals in the House Report, this entire process should be completed again until partner *C* is left without a returned surplus. At the completion of the above process, all three partners are given a returned surplus. Logically, these assets will go to increase the percentage pay-out of the separate partnership creditors. This is recorded as a general increase in the line two figures. On the next pass through the above process, the line two figures will be larger, the line three positive figure will be smaller, and the line six figures will be smaller for *A* and *B* and larger for *C*. Consequently, the line seven figures will be smaller for *A* and *B* and larger for *C* than in the first application. Ultimately, the line nine figure for *C* will equal 0.

Repeated applications of the iteration process comports with the House Report mandate not to prejudice the individual creditors of *A* and *B*. At the end of the first application, the individual creditors of *A* and *B* will get a larger distribution because of the returned surplus, but so will *C's* creditors. Why should *C's* creditors benefit because *C* could not satisfy his contract share and *A* and *B* had to step in? Repeated applications of this process will make *C* bear more of the reallocation through his surplus and keep *A* and *B* closer to their 25% shares.

In conclusion, additional applications of the House Report process are needed to achieve the twin goals of equitable distribution of surplus and avoidance of prejudice to individual partner creditors. Although a standard computer program could be created to perform these processes, it may be beyond the resources, if not the ken, of those courts which must handle the rare case of a surplus. Consequently, the same result may be approximated in the above example by allocating *C's* $20,000 surplus to *A* and *B* in a 3 to 4 ratio.