IN THE UNITED STATES BANKRUPTCY COURT FOR THE
DISTRICT OF PUERTO RICO

IN RE:	:	
	:	
PUERTO RICO HOTEL/CASINO	:	
ASSOCIATES, L.P. DBA CONDADO	:	CASE NO. B-91-06031(ESL)
SAN JUAN HOTEL & CASINO	:	
Debtors	:	
	:	CHAPTER 7
MARIA LUISA CONTRERAS, TRUSTEE	:	
	:	
Plaintiff	:	
	:	ADV. NO. 93-0009
v.	:	
	:	
SHELDON BLITTNER	:	
	:	
Defendant	:	

OPINION AND ORDER

Before the Court is trustee/plaintiff's Motion for Summary Judgment (docket No. 24, filed on June 15, 1993) requesting that defendant, a general partner of the debtor partnership, be found liable for all remaining debts of the partnership subsequent to the liquidation of its assets pursuant to Chapter 7 of the Bankruptcy Code. Defendant cross-claimed for summary judgment (docket No. 26, filed on July 7, 1993) alleging that as a matter of law he is entitled to a setoff against the deficiency for funds extended to the partnership prior to its filing of bankruptcy and for mortgage note executed upon the partnership property in favor of the partner.

Subsequently, defendant reiterated its request for summary judgment (docket No. 30, filed on August 18, 1993) to which plaintiff opposed (docket No. 35, filed on September 1, 1993) and defendant replied (docket No. 37, filed on September 15, 1993).

Introduction

In this Chapter 7 proceeding, converted from a Chapter 11 on January 31, 1992, the trustee for Puerto Rico Hotel/Casino Associates, L.P. D/B/A Condado San Juan Hotel & Casino (PRHC), a limited partnership, is requesting summary judgment on the issue that the general partner be found liable for the deficiency in partnership assets after liquidation on March 27, 1992. Defendant, Mr. Sheldon Blittner, is the general partner of PRHC; the debtor partnership is organized under the New York Partnership Act. The trustee claims that the amount of the deficiency totals $1,735,786.85 (one million, seven hundred and thirty-five thousand dollars and eighty-five cents) although there remains a contested claim which, if she is not successful, would increase the partnership's indebtedness in excess of $11,000,000 (eleven million dollars).[1]

[1]The trustee is only seeking judgment as to defendant's liability for $1,735,986.85 with the proviso that she maintain the right to pursue future claims against defendant for any other deficiencies that arise.

Defendant counter-claims requesting that the Court set a cap for partner liability at $1,735,786.85 (one million, seven hundred and thirty-five thousand dollars and eighty-five cents). Furthermore, defendant asserts the affirmative defense that he is entitled to a setoff as the partnership owes him an amount which exceeds the deficiency sought by the trustee.[2] In conclusion, defendant alleges, he is not liable for the amount claimed and is entitled to summary judgment as a matter of law.

Discussion

The Bankruptcy Code as well as the New York Partnership Act serve as a basis for the trustee's contention that Mr. Blittner is personally liable to the creditors of the partnership for the debts owing. Section 11 U.S.C. § 723(a) of the Bankruptcy Code states:

> If there is a deficiency of property of the estate to pay in full all claims which are allowed in a case under this chapter concerning a partnership and with respect to which a general partner of the partnership is personally liable, the trustee shall have a claim against such general partner for the full amount of the deficiency.

A partner is jointly liable for the debts and obligations of the partnership under New York Law. N.Y. Partnership Law § 26

[2]Specifically, defendant states that from 1988 through 1991, he extended funds to the partnership for its benefit and use in the amount of $1,515,169.99 and the on March 19, 1986 partnership property was mortgaged, in his favor, for the amount of $600,000 with added interest totalling $232,000. Accordingly, defendant alleges that the partnership owes him $2,347,169.99, an amount exceeding the deficiency as requested by the trustee.

(McKinney 1993), which reads, in part:

> All partners are liable
>
> 1. ...
>
> 2. Jointly for all other debts and obligations of the partnership...

In addition, New York Law further provides that dissolution of a partnership does not discharge existing liability of any partner. N.Y. Partnership Law § 67(1) (McKinney 1993).

The law establishes that general partners are liable for any deficiency of the partnership that has filed for bankruptcy. Defendant has not raised any objections or presented disputed facts in this case to support any other conclusion. There being no genuine issue of material fact, the Court hereby finds that as the general partner for PRHC, Mr. Blittner is personally liable for the remaining debts of the dissolved partnership and summary judgment on this issue is hereby granted.

The next issue to be resolved is the amount of Mr. Blittner's liability. When filing its opposition to the trustee's motion for summary judgment, defendant raised an inexplicable objection to the amount requested by the trustee.[3] Subsequently, defendant reiterated

[3]Defendant objected to liability being set at $11,000,000, however, it is apparent from the filings that the trustee had never requested such relief but only asked that the partner be found liable for $1,735,986.85.

its cross-claim requesting that the Court cap the amount of liability at $1,735,986.85 (one million, seven hundred and thirty-five thousand dollars and eighty-five cents).

It is apparent from the undisputed facts that a deficiency remains subsequent to the dissolution of the partnership estate by the trustee. Defendant failed to raise a single objection to the amount of the deficiency presented in the trustee's motion, thereby, creating even a single doubt that it should be less than the amount requested.[4] Therefore, it appearing that no issue exists as to the amount of liability, it is further ORDERED that Mr. Blittner's liability for purposes of this action be set at $1,736,000 (one million, seven hundred and thirty-six thousand dollars).[5]

Even if there remained a genuine issue as to the actual amount of the deficiency, Rule 56(c) does not preclude the finding of partner liability. The trustee only need show, with reasonable certainty, that a deficiency of partnership assets exists prior to

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[4]In fact, in its own words, "defendant seeks a summary judgment denying any amount in excess of $1,735,986." See Replica of Defendant to Plaintiff's Late Reply to Defendant's Cross-Motions for Summary Judgment, docket No. 37, filed on September 16, 1993, p. 3 Memorandum of Defendant.

[5]This ruling does not preclude the trustee from subsequently requesting further relief from the Court should future claims arise nor does it preclude the trustee from collecting less than the amount set forth herein should other claims be disallowed.

bringing an action under § 723(a). See, e.g., In re Bell & Beckwith, 112 B.R. 863, 870 (Bankr. N.D. Ohio 1990); In re Massetti, 95 B.R. 360, 365 (Bankr. E.D. Pa. 1989). Partner liability is a separate and distinct issue and the Court may properly find liability absent judicial determination of the exact amount of deficiency. See also 3A Bankruptcy Service, L. Ed. § 38:55 (1993).

Turning to defendant's cross-claim, the Court must determine whether the defendant is entitled to summary judgment on the issue of setoff. The trustee objects to defendant's affirmative defense stating the following: (1) the copy of the general ledger attached to defendant's motion allegedly indicating monies owed by the partnership to the defendant are of unknown origin; (2) defendant has failed to move for relief from the automatic stay prior to exercising his right to a setoff; and (3) mutuality of debts between the creditor and debtor as required by the Bankruptcy Code is lacking.

Defendant's responds with the following: (1) defendant's claim is supported by affidavits and plaintiff failed to respond with affidavits or any other evidence rebutting the amounts owed as presented by defendant's supporting documentation; (2) when asserting a defense, defendant is not required to first seek relief from an automatic stay; and (3) the trustee's claim that mutuality does not

exist is not supported by evidence or the law.[6]

The only issue raised by the parties warranting discussion which proves to be dispositive to the application of defendant's affirmative defense is whether mutuality of debts exists.[7] The right to setoff is codified in the Bankruptcy Code, 11 U.S.C. § 553(a) and states in pertinent part:

> Except as otherwise provided in this section..., this title does not affect any right of a creditor to offset

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[6]Defendant first alleges that plaintiff's opposition should be stricken due to its late filing and, consequently, that summary judgment should be granted in defendant's favor. This conclusion is a legal fallacy. Failure to oppose a summary judgment motion does not automatically result in a finding in favor of the moving party. Jaroma v. Massey, 873 F.2d 17, 20 (1st Cir. 1989). The moving party maintains the initial burden to establish that it is entitles to summary judgment whether or not its motion is opposed. López v. Corporación Azucarera de Puerto Rico, 938 F.2d 1510, 1517 (1st Cir. 1991). Therefore, even if the Court were to strike or "not consider" plaintiff's reply, the defendant is not relieved from its burden. It follows that where the moving party has made an insufficient showing, no defense is required.

[7]The first two issues raised warrant minimal discussion. As to the first, it is apparent from a brief look at the copy of the ledger submitted by defendant that further explanation/evidence is required to substantiate the exact amount of the debt. Although the evidence submitted may be sufficient to defeat a motion for summary judgment, it is not sufficient to conclusively establish the amount of the debt for purposes of granting a summary judgment. Even if the defendant was successful in establishing that it is entitled to a setoff under the law, a genuine issue of material fact as to the actual amount of the alleged debt exists.

Secondly, whether defendant is required to request a relief from automatic stay is a procedural requirement to be met prior to attempting to effectuate a setoff and which has nothing to do with the facts in this case, i.e., whether setoff is a valid defense. In re Charter Co., 86 B.R. 280, 282 (Bankr. M.D. Fla. 1988). For discussions on the interrelation of the automatic stay provision and setoff, see United States Through Small Business Administration v. Rinehart, 88 B.R. 1014, 1018 (S.D. 1988) (an attempted setoff without obtaining relief from the automatic stay violates 11 U.S.C. § 362(a)(7)); In re Fulghum Construction Corp., 23 B.R. 147 (Bankr. M.D. Tenn. 1982) (filing of bankruptcy does not cut off right to setoff but only stays creditor's exercise of the right).

> a mutual debt owing such creditor to the debtor that arose before the commencement of the case under this title against a claim of such creditor against the debtor which arose before the commencement of the case...

This provision governing setoff in the Bankruptcy Code does not create a new right to setoff but validates whatever setoff rights exist under state law and adds some additional requirements. In re Bay State York Co., Inc., 140 B.R. 608, 613 (Bankr. D.Ma. 1992); In re Ingersoll, 90 B.R. 168, 171 (Bankr. W.D.N.C. 1987). Therefore, a creditor must possess a valid right of setoff under some applicable provision of either federal or state substantive law. In re Public Service Co. of New Hampshire, 884 F.2d 11, 14 (1st Cir. 1989).

The Supreme Court has defined the doctrine of setoff as an equitable tool which was intended to eliminate needless transactions between parties holding mutual debts. Studley v. Boylston National Bank of Boston, 229 U.S. 523, 528 (1913) (setoff, as a counterclaim, is based on the absurdity of making A pay B when B owes A). Application of setoff in the bankruptcy setting is permissive and lies within the equitable discretion of the trial court. In re Southern Industrial Banking Corp., 809 F.2d 329, 332 (6th Cir. 1987); In re Charter Co., 86 B.R. 280, 283 (Bankr. M.D. Fla. 1988). This discretion, however, is limited by the express provisions of the Bankruptcy Code. In re R.C.I. Enterprises Inc., 22 B.R. 549, 551

(Bankr. S.D. Fla. 1982). In re Lessig Construction, Inc., 67 B.R. 436, 441 (Bankr. E.D. Pa. 1986) (right to setoff as provided in Bankruptcy Code is restricted in its application by both legal and equitable principles).

The right to setoff is recognized in Chapter 7 proceedings. In re Sanchez, 75 B.R. 425, 426 (Bankr. D.P.R. 1987). However, this right is not mandatory. United States Through Small Business Administration v. Rinehart, 88 B.R. 1014, 1018 (S.D. 1988). In bankruptcy, setoff is applied restrictively in order to insure the basic principle that all creditors of the debtor be treated equally in disposition of their respective claims. Lessig, 67 B.R. at 441.

A creditor seeking to setoff his claim must establish that the debt owed by the creditor to the debtor as well as the claim of the creditor arose prior to the bankruptcy proceeding; that the debt and claim are mutual obligations; and, that the right to setoff exists under nonbankruptcy law. In re Academy Answering Services, Inc., 90 B.R. 294, 296 (Bankr. N.D. Ohio 1988).

The right to setoff is recognized under New York Law. Section 192 of the Debtor & Creditor Law states, in pertinent part:

> Where mutual credit has been given by any debtor ... and any other person, or mutual debts have subsisted between such debtor and any other person, the trustees may set-off such credits or debts, and pay the proportion or receive the balance due.

N.Y. Debtor & Creditor Law § 192 (McKinney 1993).

Defendant's liability did not arise prepetition and the facts indicate that the majority of the alleged debt owed to the partner from the partnership was the result of financial transactions which occurred prepetition. Debtor partnership filed a petition for Chapter 11 bankruptcy on September 6, 1991. The alleged debt consists of a mortgage which was executed in 1986 and various financial transactions from 1987 through 1991 as indicated by the ledger.[8]

Defendant is seeking to setoff this credit with its personal liability for partnership debts which is equal to the deficiency in partnership assets subsequent to Chapter 7 liquidation. Even though a general partner is legally liable for the debts of a bankrupt partnership, a trustee cannot file a claim and establish actual liability prior to the filing of the bankruptcy petition, the liquidation of the partnership assets and the determination that a deficiency existed. Only then can the trustee pursue a partner's obligations.

In bankruptcy law, the prepetition debtor and the postpetition

[8]Even though several transactions seemed to have occurred postpetition, i.e. during the final months of 1991, defendant would not be entitled to setoff for these amounts as other requisites remain unmet to substantiate setoff as is discussed herein.

entity are separate and distinct. Because the requisite mutuality of obligation is lacking, a postpetition obligation may not be setoff against a prepetition obligation. Academy, 90 B.R. at 297 Defendant's claim fails to meet the initial test that both debts occurred prepetition.

In addition, defendant has failed to establish that mutuality exists. The First Circuit has construed mutuality of debts for purposes of setoff. "It is hornbook law that to be considered mutual, 'debts must be in the same right and between the same parties, standing in the same capacity.'" WJM, Inc. v. Massachusetts Department of Public Welfare, 840 F.2d 996, 1011-12 (1st Cir. 1988) quoting 4 Lawrence King, et al., Collier on Bankruptcy ¶ 553.04 (15th ed. 1987).

In the case at bar, the facts reveal that the parties to the setoff, as requested by defendant, are not the same and hold different rights. The defendant's liability arose from the actual debts owed by the partnership to other creditors. Through operation of partnership law, the partner and the partnership are viewed as jointly liable for the debts of the partnership. A partner's obligations deriving therefrom are based upon the actual debt owed to creditors by the debtor partnership. In effect, the partner is funneling his personal funds through the partnership in order that

partnership creditors get paid. The undisputed facts show that a triangular relationship exists between the partner, the partnership and the partnership creditors; the differing status of each party is fatal to the mutuality requirement. See generally 4 Lawrence King, et al., Collier on Bankruptcy ¶ 553.04[2] (15th ed. 1993) and cases cited therein.

Furthermore, the parties to the setoff are not standing in the same capacity. The general partner is attempting to offset its personal liability to the partnership against the liability of the partnership to its creditors. Because the application of legal principles establishes that the partner and the partnership are one and the same as far as responsibility for the partnership debts, the partner's relationship with the partnership is not one of creditor. See In re Riverside-Linden Investment Co., 85 B.R. 107, 112-13 (Bankr. S.D. Cal. 1988) (general partners do not have the same status of creditors to a partnership estate); Massetti, 95 B.R. at 364 (same). A partner's different status is further exemplified in the established principle that payments from a partnership estate to general partners should only occur after all partnership creditors are paid in full. In re Rice, 164 F. 509, 513 (Pa. 1908); In re N.S. Garrott & Sons, 48 B.R. 13, 16 (Bankr. E.D. Ark. 1984); In re Bell & Beckwith, 44 B.R. 664, 666-67 (Bankr. N.D. Ohio 1984).

Defendant's claim would also fail under the principles of equity. The allowance of setoff of a partner's liability against the creditors of the partnership not only contravenes legal obligations arising under partnership law but, in effect, would provide the partner with double recovery while the creditors receive no compensation. See, e.g., Massetti, 95 B.R. at 365.

Without doubt, the funds provided by defendant to PRHC prepetition served to preserve the partnership and any benefits derived therefrom were enjoyed by the partner when the partnership assets were liquidated and the funds obtained as a result reduced defendant's personal liability for partnership debts. To allow the partner to setoff his past transactions with the partnership against partnership debts is, in actuality, a reduction of the partner's liability two-fold; double reimbursement would ensue should the Court grant defendant's request for setoff. Such an inequitable result must be rejected. Southern Industrial, 809 F.2d at 332 (equity warrants that setoff be disallowed when the result would unfairly favor one creditor over another).

In conclusion, defendant's affirmative defense that he is entitled to a setoff is not legally sustainable under the undisputed facts of this case. Therefore, Mr. Blittner's motion for summary judgment must be and is hereby denied.

Conclusion

The Trustee's Motion for Summary Judgment is hereby granted. Defendant is hereby found liable for PRHC's debts in the amount of $1,736,000 (one million, seven hundred and thirty-six thousand dollars). Furthermore, defendant's cross-claim for summary judgment is hereby denied.

It is further ORDERED that a status conference be and is hereby scheduled for **July 20, 1994 at 2:00 p.m.**

The Clerk of the Bankruptcy Court shall issue partial judgment upon receipt of this Order.

SO ORDERED.

San Juan, Puerto Rico, this _____ day of March, 1994.

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ENRIQUE S. LAMOUTTE
Chief, U. S. Bankruptcy Judge