UNITED STATES BANKRUPTCY COURT
For the Southern District of Iowa

In the Matter of

DENNIS LEIGH SWEET, PAULINE MARIE SWEET, 'Debtors.	Case No. 88-793-C J Chapter 7
FRANCIS EARL SWEET, NORMA JEAN SWEET, Debtors.	Case No. 88-794-C J Chapter 7

ORDER ON OBJECTION TO DEBTORS' CLAIM OF EXEMPTIONS

On June 23, 1988 the court conducted a hearing on an objection to debtors' claim of exemptions filed by the Farmers Home Administration (FmHA). Pamela D. Griebel appeared on behalf of the debtors and Kevin R. Query, Assistant U.S. Attorney, appeared on behalf of the FmHA. The parties submitted the matter on briefs and a stipulation of facts. The court considers the matter fully submitted.

FACTS

1. Francis and Norma Sweet are husband and wife and the parents of Dennis Sweet. Dennis and Pauline Sweet are husband and wife.

2. Francis, Norma and Dennis Sweet farmed together for many years and Pauline began assisting in the farming operation with her marriage to Dennis in 1978.

3. Francis and Dennis Sweet operated as an informal partnership for a number of years commencing in 1972. They executed a formal partnership agreement in 1984. Francis Sweet suffered a heart attack in late 1986. He and Norma moved to the city shortly thereafter. Since Francis would no longer be as active in farming, the two families agreed to separate their farming operations. They agreed to dissolve and terminate the partnership in early 1987.

4. The partnership ceased operation in early 1987. Quit claim deeds were executed to distribute real property back to Francis and Norma Sweet and Dennis and Pauline Sweet as their separate property. Copies of the quit claim deeds were recorded in Union County, Iowa in March of 1987. Both deeds recite that they were prepared for the purpose of "dissolving the partnership".

5. At approximately the same time as the execution and recording of the quit claim deeds, the personal property of the partnership was distributed on an equal basis to the partners. This was accomplished by mutual consent of the partners and their spouses and in consideration of the partners and their spouses assuming responsibility for the partnership debts. It was the express intention of all four Sweets in early 1987 that the partnership be dissolved and terminated and that the farming operations thereafter be conducted separately for Francis and Norma Sweet and for Dennis and Pauline Sweet.

6. The final partnership tax return was prepared in April of 1988. It indicated that January 1, 1987 was the effective date of termination and dissolution.

7. At the time the final partnership return was prepared in April of 1988, a written agreement was prepared reciting the agreements with respect to the dissolution and termination of the partnership.

8. Between 1984 and 1987, certain promissory notes were executed in favor of the FmHA and signed by Francis, Norma, Dennis and Pauline Sweet as individuals and as partners in Sweet & Son. There were no notes executed to the FmHA solely by Sweet & Son, as a partnership. The farm equipment and machinery items at issue were all pledged to the FmHA by the four Sweets individually and by the partnership to secure the indebtedness of both the individuals and the partnership. Some of the farm machinery and equipment had been individually purchased and used in the partnership and some of the farm machinery and equipment had been purchased through partnership funds. When the property was redistributed to the individuals in early 1987, the partners agreed and consented to the distributions made to each other and it was acknowledged that the property distributed was subject to outstanding indebtedness secured by the property, which with respect to the FmHA included both partnership and individual obligations.

9. The security documents (mortgages, security agree-

ments and financing statements) prepared by the FmHA for the Sweets always referred to all four Sweets as signing individual as well as on behalf of the partnership.

10. All four Sweets filed Chapter 7 bankruptcy petitions in April of 1988 and each listed the respective real and personal property which had been distributed to them in early 1987. The court notes that the debtors in both cases claim a $20,000.00 farm equipment exemption pursuant to Iowa Code section 627.6(11)(a).

DISCUSSION

The FmHA asserts that partners in a partnership may not claim an individual right in partnership property, even under a claim of exemption, until the partnership is terminated. The FmHA maintains that the Sweet & Son partnership is not terminated.

State law controls a determination of the property rights in issue. Butner v. United States, 440 U.S. 48, 99 S.Ct. 914, 59 L.Ed.2d 136 (1979); Johnson v. First Nat. Bank of Montevideo, Minn. 719 F.2d 270, 273 (8th Cir. 1983); Matter of Gervich, 570 F.2d 247, 251 (8th Cir. 1978).

In 1971 Iowa enacted into law the Uniform Partnership Act (UPA). 1971 Iowa Acts ch. 251, sections 1-43 (now codified in Iowa Code chapter 544). In Matter of Van Vliet, Case No. 86-2409-C (Bankr. S.D. Iowa, filed February 19,

1987) this court ruled that individual partners can not exempt partnership property in bankruptcy. In so ruling the court cited to the Iowa UPA which provides in relevant part:

> A partner's right in specific partnership property is not subject to attachment or execution, except on a claim against the partnership. When partnership property is attached for a partnership debt the partners, or any of them, or the representatives of a deceased partner, cannot claim any right under the homestead or exemption laws.

Iowa Code section 544.25(c). The court also relied on Dixon v. Koplar, 102 F.2d 295 (8th Cir. 1939) and Brindle v. Hiatt, 42 F.2d 212 (8th Cir. 1930) for the proposition that individual partners may not claim ownership of partnership property until the partnership has ceased activity and all partnership debts have been paid. See also, Jensen v. Wiersma, 185 Iowa 551, 170 N.W. 780 (1919) ("After the payment of the debts of the co-partnership and division of the property between the parties, the right to claim the statutory exemption exists.").

The debtors maintain, in effect, that the property in question is not partnership property because the debtors dissolved and terminated the partnership and then distributed the property to the partners prior to filing bankruptcy. They contend that once the property is distributed, exemption claims are proper. In support of these arguments, the debtors rely primarily on two older Eighth Circuit Court of Appeals cases.

Sargent v. Blake, 160 F. 57 (Bth Cir. 1908) involved the transfer of partnership property from one partner to another who, in turn, used the property to satisfy a personal debt to his mother. The transfer occurred in connection with the dissolution of the partnership. Shortly after the transfer, the partners and the partnership filed bankruptcy. The trustee sued to recover the amounts paid to the partner's mother on grounds the transfer was preferential and made with the intent to defraud creditors. The district court found in favor of the trustee. The Eighth Circuit reversed. The court found that two rules of law applied to the disposition of partnership property. The court explained that the first rule permitted partners to transfer partnership property to individual partners, apply the property to individual debt in preference to partnership debt or otherwise dispose of the property as the partners deemed fit. The court contrasted this rule with the second rule that applied to partnership property in the custody of a court. The court explained that creditors of a partnership had the right to subject partnership property to partnership debt in preference to individual debt once partnership property came under the administration of a court. Crucial to the court's analysis was its finding that "[b]efore the partnership property is placed in custodia legis for administration, it is not held in trust for the payment of the partnership creditors in preference to the creditors of the individual

partners." Id. at 64.

In the second case, Crawford v. Sternberg, 220 F. 73 (8th Cir. 1915), partners withdrew assets from a partnership one day before filing bankruptcy. The partners claimed the assets exempt under Arkansas law. Relying heavily upon Sargent v. Blake, supra, the court determined that the exemption claim was proper since the partners had severed their interests in partnership property prior to the time partnership property came under custody of the law. The court noted that under Arkansas law, exemptions could be claimed out of partnership assets in situations where the interests of the partners had been ascertained and segregated. Crawford v. Sternberg, 220 F. at 76.

At the hearing, the debtors cited in support of their position In re Schmitt, 56 B.R. 708 (Bankr. N.D. Iowa 1986) (Bankruptcy Judge Margaret A. Mahoney sitting by designation). In that case, the partners both dissolved their partnership and divided partnership property in 1981. Four years later the partners filed bankruptcy and claimed farm equipment exemptions under Iowa law. A creditor objected to the exemption claim arguing that the equipment claimed exempt was partnership property rather than individual property. For the Schmitt court, determining whether the property was partnership or individual property hinged on the debtors' intent. The court found that the debtors intended to dissolve the partnership relationship in 1981. Thus, the

court concluded that the property was individual property and properly the subject of an exemption claim. The court found support for its analysis in Citizens' Loan & Trust Company of Mankato v. Eberhart, 298 F. 291 (8th Cir. 1924), which concerned two brothers who conducted a farming operation together. The record before the court indicated that the operation was conducted as a partnership. The brothers divided personal property ten months before one of the brothers filed bankruptcy. The debtor brother claimed certain personal property exempt. The trustee objected on the basis the property was partnership property and, therefore, not subject to exemption. Assuming for analysis that the partnership existed, the court found that it terminated at the time the brothers divided the property.

This court questions the applicability of the Sargent and Crawford decisions to the instant case. Neither case involved Iowa law. The "custodial legis" analysis found in Sargent was based principally upon the theory that partnership property is not held in trust for the payment of partnership debt unless the property comes under custody of a court. In Iowa, however, a partnership holds partnership property in trust for the payment of partnership debt. Jensen v. Wiersma, 170 N.W. at 780.

The court respectfully disagrees with the "intent analysis" set forth in Schmitt. Although intent may have a bearing on whether a partnership is dissolved, it does not

on whether a partnership is terminated. Iowa Code section 544.30 states that "[o]n dissolution the partnership is not terminated, but continues until the winding up of partnership affairs is completed." Winding up involves finishing old business, paying debts and finally distributing remaining assets to partners. Gibson v. Deuth, 270 N.W.2d 632, 635 (Iowa 1978). More importantly, as is clear from both the Iowa UPA and Iowa case law (including the Brindle decision which discussed Iowa law), individuals are not entitled to claim exemptions in partnership property until partnership debts have been paid. In this case the property in question is partnership property. Despite the fact the debtors dissolved their partnership, the partnership is not terminated. The debts of Sweet & Son have yet to be paid. Accordingly, the debtors are not entitled to claim exemptions in the property in question.

CONCLUSION AND ORDER

WHEREFORE, based on the foregoing discussion, the court finds that the property in question is partnership property.

THEREFORE, the FmHA's objection to debtors' claim of exemptions is sustained.

Signed and dated this 30th day of September, 1988.

LEE M. JACKWIG

CHIEF U.S. BANKRUPTCY JUDGE

D2

IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF IOWA
CENTRAL DIVISION

IN THE MATTER OF:

Bankr. No. 88-793-E

DENNIS LEIGH SWEET and
PAULINE MARIE SWEET,

CIVIL N0. 88-1629-E

Debtor

ORDER

IN THE MATTER OF:

FRANCIS EARL SWEET and
NORMA SWEET,

Bankr. No. 88-794-E

CIVIL NO. 88-1630-E

Debtors.

This -matter is before the court on appeal from the bankruptcy court's [1] final order disallowing a claim exemption for certain farm property. The Sweets contend that the bankruptcy court erred in disallowing an exemption for property they claim to have been a part of a partnership. Title 28 of the United States Code, section 158(a), vests this court with appellate jurisdiction to consider the Sweets' claim of error. AfteR careful consideration of the record and the parties' arguments, the court determines that the bankruptcy court's ruling is not erroneous.

[1] The Honorable Lee Jackwig, Chief United States Bankruptcy Judge, presiding.

I. STATEMENT OF THE CASE

The Farmers Home Administration's objection to exemptions, which the debtors claimed in certain farm machinery and equipment, forms the genesis of this case. Dennis and Pauline Sweet (husband and wife), and Dennis' parents, Francis and Norma Sweet, filed for chapter 7 bankruptcy on April 13, 1988. Both families claimed as exempt on Schedule B-4 certain farm machinery and equipment, pursuant to section 627.6(11)(a), Code of Iowa (1987). The Farmers Home Administration (hereinafter FHA), a creditor of the Sweets, filed an objection to the claimed exemptions. The FHA's objection was based upon, inter alia, the ground that the property could not be individually claimed as exempt because the property arguably belonged to a partnership. Whether the farm machinery and equipment constitutes partnership property is the only issue on appeal to this court. The bankruptcy judge sustained the FHA's objection and ruled that the property in question was still partnership property which precluded claims of individual exemptions.

II. STATEMENT OF THE FACTS [2]

Francis and Dennis Sweet operated informally as a partnership commencing in 1972, formally executing a partnership agreement in 1984. Between 1984 and 1987, Francis, Norma, Dennis, and Pauline sweet, individually and as partners in Sweet and Son, executed a series of promissory notes in favor of the FHA, but Sweet and Son never executed any promissory notes alone.

---

[2] The parties filed a stipulation of facts on June 21, 1988 and that stipulation forms the basis of the summary.

The Sweets, individually and through the partnership, pledged farm equipment and machinery to the FHA as security. The Sweets purchased some of the equipment and machinery individually for use in the partnership, and at other times used partnership funds for such purchases.

In late 1986, Francis Sweet suffered a heart attack, shortly after which he moved with his wife to town. After their move to town, Francis and Norma Sweet no longer actively participated in the farming operations, agreeing with their son in early 1987 to dissolve and terminate the partnership. The Sweets executed quit claim deeds in March of 1987 to distribute real property, reciting as the purpose "dissolving the partnership."

At approximately the same time the Sweets distributed real property, they similarly distributed the partnerships personal property on an equal basis by mutual consent, assuming responsibility for partnership debts. The Sweets all expressly intended that the partnership be dissolved and for each family to conduct separately all farming operations. All four Sweets filed chapter 7 bankruptcy in April 1988, and each listed their respective real estate and personal property which they had distributed in early 1987 from the partnership.

III. STANDARD OF REVIEW

This court reviews the issues in dispute as one of interpreting the law and therefore this court will take a de novo review of the issue. State law controls the bankruptcy court's determination of rights and property. See Butner v. United States, 440 U.S. 48 (1979); Johnson v. First National Bank of

Montevideo, Minnesota, 719 F.2d 270, 273 (8th Cir. 1983); Matter of Gervich, 570 F.2d 247, 251 (8th Cir. 1978). This court must evaluate legal issues independent of the bankruptcy court's determination.

IV. ANALYSIS

The issue before this court is whether the debtors may claim individual exemptions for certain farm property. The debtors claim that the property is not a part of the partnership debts. Creditors claim that the property is part of partnership liabilities to which individual exemptions cannot attach. Iowa partnership law must control.

Iowa partnership law is derived from two sources: the Iowa Uniform Partnership Act and Iowa case law. The Iowa Partnership Act, Iowa Code chapter 544, reads in pertinent part:

> A partner's right in specific partnership property is not subject to attachment or execution, except on a claim against the partnership. When partnership property is attached for a partnership debt, the partners, or any of them, or the representatives of a deceased partner, cannot claim any right under the homestead or exemption laws.

Iowa Code 544.25(c).

Iowa case law demonstrates that individual partners may not claim ownership of partnership property until the partnership ceases activity and all partnership debts are satisfied. See In the Matter of Van Vliet, No. 86-2409-C (Bankr. S.D. Iowa, filed Feb. 19, 1987). See also Dixon v. Koplar, 102 F.2d 295 (8th Cir. 1939); Brindle v. Hiatt, 42 F.2d 212 (Sth Cir. 1930). Cf. Jensen v. Wiersma, 185 Iowa 551, 170 N.W. 780 (1919) ("after the payment of the debts of the copartnership and division of the property

between the parties, the right to claim the statutory exemption exists.).

The debtors claim that the property in question became individual property when they terminated the partnership, transforming the partnership debt into individual debt. The law does not support this interpretation. When the Sweets terminated the partnership, assuming percentages of the partnership debt in accordance with the property taken, they determined for themselves their liability for partnership debts vis-a-vis each other. Their agreement binds themselves, but does not affect third-party creditors' rights vis-a-vis the partnership property.

The debtors rely on older Eighth Circuit cases, which Brindle and Dixon, in effect, overrule. See Sargent.v. Blake, 160 F.2d 57 (8th Cir. 1908); Crawford v. Sternberg, 220 F.2d 73 (8th Cir. 1915) (which relies as authority on Sargent). Two major difficulties mitigate against the persuasiveness of these cases. First, while state property law is the key to this analysis, neither Sargent, nor Crawford, involve Iowa law. Second, Sargent (upon which Crawford is based) rejects trust theory which Iowa appears to accept. In Jensen v. lqiersma, 170 N.W. at 780, the court ruled that a partnership holds partnership property in trust for the payment of partnership debt.

The Sweet partnership incurred debts not yet satisfied. Individual partners cannot, by unilateral action, [3] transform the

[3] At the hearing, and in a supporting letter submitted later at the court's request, the debtors intimate that the creditors somehow acquiesced in seeking to collect for partnership debt from individual partners when they issued a January 7, 1988 financing statement which identified only individual debtors.

nature of the debt the creditor expected to rely on, through the termination of the partnership. The partnership exists, vis-a-vis a partnership creditor, until the partnership debt is satisfied, regardless of the rights the individual parties themselves vis-a-vis each other.

V. CONCLUSION

Upon the foregoing;

IT IS THEREFORE ORDERED that the bankruptcy court's decision below disallowing the claimed exemptions is hereby affirmed.

April l4, 1989.

Donald E. O'Brien, Judge
UNITED STATES DISTRICT COURT

The court is not persuaded that this financial statement can serve as a waiver of rights by the creditors against partnership property. A financial statement is simply a notice and does not, itself, establish property rights.