

**United States Bankruptcy Court
Western District of Wisconsin**

Cite as: [Unpublished]

In re Thomas M. Calaway, Jr., a/k/a Tom Calaway, Debtor
Bankruptcy Case No. 99-54197-7

United States Bankruptcy Court
W.D. Wisconsin, Eau Claire Division

June 30, 2000

Jared Redfield, Redfield Law Offices, LLC, Stevens Point, WI, for debtor.
Mark J. Wittman, Gorski & Wittman, S.C., Marshfield, WI, Chapter 7 Trustee.

Thomas S. Utschig, United States Bankruptcy Judge.

**MEMORANDUM OPINION, FINDINGS OF FACT,
AND CONCLUSIONS OF LAW**

The bankruptcy trustee in this case has filed a motion for turnover of assets. The debtor has objected, and the matter has been briefed to the Court. The essential facts are as follows. The debtor, Thomas Calaway, filed bankruptcy on September 14, 1999. On his schedules, he included as an asset his interest in the Catherine Paulson Grandchildren's Trust. Mr. Calaway is a beneficiary of the trust, and has valued his interest at \$215,000.00. Mark Wittman, the chapter 7 trustee, filed a motion requesting that the Court order the turnover of the trust principal when the debtor becomes eligible to receive the funds. He also objected to the debtor's claimed exemption of the beneficial interest in the trust.

The trust provides for an ultimate distribution of the trust res at the time the youngest grandchild attains the age of 30, an event which should take place in approximately 7 years. Article 1 of the trust specifically provides:

When there is no living grandchild of the Donor who has not attained the age of thirty (30) years, the entire principal of this trust shall be divided into as many equal shares as there shall be grandchildren of the Donor then surviving and deceased grandchildren of the Donor leaving issue then surviving.

The trust documents also provide for discretionary income distributions to the beneficiaries, although it is unclear whether any such distributions have in fact been made. In this regard, the debtor indicates that the primary asset of the trust is undeveloped real property.

The chapter 7 trustee contends that the debtor's interest in the trust constitutes property of the bankruptcy estate, and that he is therefore entitled to an order directing the turnover of the debtor's share of the trust at the time a distribution is actually made. 11 U.S.C. § 541(a)(1) provides that "all legal or equitable interests of the debtor in property as of the commencement of the case" become property of the

estate and subject to disposition by the bankruptcy trustee. The scope of this provision is broad and all encompassing. See In re Chappel, 189 B.R. 489 (B.A.P. 9th Cir. 1995); In re Brunswick Hosp. Center, Inc., 156 B.R. 896 (Bankr. E.D. N.Y. 1993); In re Miller, 16 B.R. 790, 791 (Bankr. D. Md. 1982). The intent of this provision is to include all property rights of the debtor, even if that property right is contingent. In re Palmer, 167 B.R. 579 (Bankr. D. Ariz. 1994). The existence and scope of the debtor's interest in property is determined by reference to state law. In re Miner, 185 B.R. 362 (N.D. Fla. 1995); In re Bridgepoint Nurseries, Inc., 190 B.R. 215 (Bankr. D. N.J. 1996).

In this regard, however, under 11 U.S.C. § 541(c)(2), "a restriction on the transfer of a beneficial interest of the debtor in a trust that is enforceable under applicable nonbankruptcy law is enforceable in a case under this title." This provision has been interpreted as a reference to state spendthrift law. Matter of Brown, 86 B.R. 944 (N.D. Ind. 1986). If trust property is subject to a valid spendthrift clause, it is excluded from the bankruptcy estate under § 541(c)(2). In re Conner, 233 B.R. 358 (Bankr. N.D. W. Va. 1999). The question in this case is whether there is any restriction upon the transfer of the debtor's receipt of the principal of the trust that is enforceable under "applicable nonbankruptcy law." The trustee contends that because the debtor has the absolute right to receive the principal payment, the spendthrift nature of the remainder of the trust fails to protect those funds from the reach of creditors. He points to Wis. Stat. § 701.06(2), which provides that a trust instrument may provide spendthrift protection for principal beneficiaries but that:

The interest in principal of such beneficiary cannot be assigned and is exempt from claims against the beneficiary, but a judgment creditor, after any payments of principal have become due or payable to the beneficiary pursuant to the terms of the trust, may apply to the court for an order directing the trustee to satisfy the judgment out of any such payments.

The trustee's essential argument is that the debtor holds an interest in the principal, and that creditors can seek to satisfy their claims from such payments. Accordingly, the trustee believes that under "applicable nonbankruptcy law" there is no restriction which prohibits the turnover of the principal when a distribution is to be made.

The debtor, however, argues that the language of § 701.06(2) is somehow overridden by language in the trust instrument which provides that a principal distribution should not be made to a beneficiary if creditors might attempt to reach the funds. The trust specifically provides that:

In the event that the Independent Trustee shall have notice or believe that the rights or interests of any beneficiary in or to any part of the income or principal of the trust . . . may be diverted from the purpose of providing for the personal protection and welfare of such beneficiary, whether by voluntary act or legal process, the trustee shall not pay such income or principal to such beneficiary.

In support of his contention, the debtor has supplied the Court with an affidavit of the trustee of the Paulson Trust. In the affidavit, the trustee asserts an intention to comply with this provision in the event the bankruptcy estate makes a claim for the funds.

As a result, the debtor contends that there is a "conflict" between the two provisions of the trust regarding principal distributions which can only be resolved by construing the trust in conformity with the intent of the drafter. See In re Estate of

Ganser, 79 Wis. 2d 180, 255 N.W.2d 483 (1977) (intent determined by language of document and surrounding circumstances). Article I of the trust indicates that the settlor desired to provide for the "personal protection and welfare" of the beneficiaries. The debtor reasons that the bankruptcy trustee must therefore fail in his attempt to collect the principal of the Paulson Trust.

The problem with this argument is that the real conflict in this case is between one provision of the trust and Wisconsin trust law. The debtor does not convincingly address how the trust language can overcome the express statutory directive in Wis. Stat. § 701.06(2) that creditors be allowed to pursue the trust principal. In the case of Meyer v. Reif, 217 Wis. 11, 258 N.W. 391 (1935), the Wisconsin Supreme Court held that a creditor's judgment could be satisfied from a beneficiary's interest in the principal of a trust. Despite the fact that the beneficiary would not receive the principal until age 25 and could receive only such income as was necessary for education and support in the interim, the court concluded that the creditor could pursue the trust corpus. According to the court, the case was one of equity, and equity has

[N]ever placed any limits to the remedies which it can grant, either with respect to their substance, their form, or their extent; but has always preserved the elements of flexibility and expansiveness, so that new ones may be invented, or old ones modified, in order to meet the requirements of every case.

217 Wis. at 20.

The Paulson Trust clearly creates an interest in favor of the debtor. Wis. Stat. § 701.06(2) permits a settlor to create a spendthrift interest in trust principal which cannot be assigned. However, whether the interest is vested or contingent, it is subject to attachment by creditors under the same provision of "applicable nonbankruptcy law." The Court concludes that the debtor cannot evade the impact of Wisconsin law simply by reference to another trust provision. State law dictates that when principal payments are due and payable under the trust, creditors may seek to have their claims satisfied from those funds. The Court must look to state law to define the scope of the debtor's interest in property for purposes of 11 U.S.C. § 541. Miner, 185 B.R. at 366. The restrictions found in the trust do not constitute a valid spendthrift clause that would exclude the debtor's interest in the trust principal from the bankruptcy estate under 11 U.S.C. § 541(c)(2). See Conner, 233 B.R. at 362 (trust property subject to valid spendthrift clause is excluded from bankruptcy estate).

Accordingly,

IT IS ORDERED that the chapter 7 trustee's motion for turnover is granted, and the objection to the debtor's exemption claim is sustained. At the time the debtor is entitled to receive a principal distribution from the trust, the funds shall be delivered to the trustee for the benefit of creditors.

This decision shall constitute findings of fact and conclusions of law pursuant to Bankruptcy Rule 7052 and Rule 52 of the Federal Rules of Civil Procedure.