

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE EASTERN DISTRICT OF TENNESSEE

In re

WILLIAM HENRY BIRCH,

Debtor.

No. 98-22785
Chapter 7

L. KIRK WYSS, TRUSTEE

Plaintiff,

vs.

Adv. Pro. No. 00-2021

WILLIAM HENRY BIRCH
and CHARLOTTE J. BIRCH,

Defendants.

M E M O R A N D U M

APPEARANCES :

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MARCIA PHILLIPS PARSONS
UNITED STATES BANKRUPTCY JUDGE

In this adversary proceeding, the chapter 7 trustee seeks a declaration of his rights in two inter vivos trusts created by the debtor and his wife, the defendants herein. The trustee and the defendants have filed cross motions for summary judgment. For the reasons discussed below, the trustee's motion will be denied and the defendants' motions granted. This is a core proceeding. See 28 U.S.C. § 157(b)(2)(A).

I.

The debtor filed for chapter 7 relief on November 2, 1998, and this adversary proceeding was commenced on May 25, 2000. As set forth in the complaint and admitted in the answer, the debtor, William Henry Birch, and his wife Charlotte J. Birch, as trustors, created the J.B. Irrevocable Trust on April 29, 1994. The trust document provides that all property transferred to the trust is property of the trustors and designates Charlotte Birch as trustee, with the debtor to be successor trustee in the event his wife becomes incompetent or otherwise unwilling or unable to serve. Article III of the trust agreement, entitled "Distribution of Income and Principal," states that during the lifetime of the trustors, the trustee shall pay the entire net income of the trust estate to the trustors, along with such amount of principal as the trustors may from time to time

request. Upon the death of either of the trustors, the trustee shall pay the surviving trustor "such amount of the net income and principal of the Trust Estate ... as the Trustee may from time to time deem advisable." Upon the death of both trustors, the trust will terminate and the trust property is to be divided equally among the trustors' six children. Exhibit B to the trust agreement sets forth certain "General Provisions" including paragraph E, entitled "Creditor's Rights and Assignment Privileges," which provides that "[t]he interest of any beneficiary in the principal or income of [the] Trust shall not be subject to claim of his or her creditors"

On May 11, 1994, within two weeks of creating the J.B. Irrevocable Trust, the debtor and his wife as trustors established the B.J. Trust. Like the J.B. Irrevocable Trust, the B.J. Trust provides that all of the property transferred to the trust is property of the trustors and designates Mrs. Birch as trustee, with the debtor as successor trustee. However, unlike the J.B. Irrevocable Trust, the B.J. Trust is revocable in that it expressly provides that the trustors reserve the right at any time to amend any of the provisions of the trust.

When originally created, the B.J. Trust provided that the net income was to be paid in equal annual installments to the grandchildren of the trustors, with the trustee having the

discretion to distribute all or any portion of the principal to or for the benefit of these same beneficiaries. However, the B.J. Trust has been amended twice, the first time to provide that during the period of January 1, 1996, through December 31, 1997, the trustee shall pay Mrs. Birch such amounts of principal and income as she may request. The second amendment extended this time period, directing the trustee to pay Mrs. Birch the amounts of principal and income requested by her from January 1, 1996, through December 31, 2001. Thereafter, distribution would go to the grandchildren with the trust to terminate when the youngest living grandchild attains the age of 30 years.

The B.J. Trust also contains a spendthrift provision, similar to that set forth in the J.B. Irrevocable Trust. Article IV of the B.J. Trust provides, *inter alia*, that no beneficiary shall have the power or authority to alienate, convey, or transfer any interest in the trust in advance of payment and no trust interest shall be subject to attachment, execution, or be levied upon for any debts of the beneficiaries.

At the time this adversary proceeding was commenced, the assets of the J.B. Irrevocable Trust included the residence of the debtor and his wife, appraised at \$285,000 and subject to a mortgage of approximately \$200,000, and two promissory notes, both of which will mature in October 2001 with balloon payments

then owing of \$424,293 and \$81,218. In the meantime, the notes produce monthly income to the trust of \$3,290.77. The asset of the B.J. Trust consisted of a promissory note in the face amount of \$110,945, which provides monthly income of \$875.57.

The chapter 7 trustee asserts that because the J.B. Irrevocable Trust permits the trustors to request distributions of principal, the "Trust or a portion thereof should be considered property of the bankruptcy estate." Similarly, the chapter 7 trustee contends that because the trustors have the right to amend the B.J. Trust, this trust is also property of the debtor's bankruptcy estate.

The defendants deny that the two trusts are property of the bankruptcy estate and deny that any property of the debtor was transferred into either trust. Specifically with respect to the J.B. Irrevocable Trust, the defendants assert that it is a spendthrift trust, that the express language of the trust requires both trustors to consent to distribution of the principal and the consent of Mrs. Birch cannot be compelled by the court, and that due to the ill health and advanced age of the debtor (age 76 compared to Mrs. Birch's age of 63), it is unlikely that the debtor will become a successor trustee. Regarding the B.J. Trust, the defendants note that only Mrs. Birch has the sole right to receive principal and interest under

the trust until December 31, 2001, and that after this date, the grandchildren are the sole beneficiaries. Because "the debtor has no present right to principal and/or income of the trust," the defendants contend that "no portion of the B.J. Trust is property of the estate."

On December 11, 2000, the defendants moved for summary judgment based on the assertion that the debtor "has no present alienable interest in either the J.B. Irrevocable Trust or the B.J. Trust." The motion is supported by the affidavit of Charlotte Birch, wherein she states, *inter alia*, that the trusts were created in Ohio, that she receives all of the income and intends to take all of the principal from the B.J. Trust before December 31, 2001, and that the debtor has received no income from the J.B. Irrevocable Trust.

The chapter 7 trustee has not filed a response to the defendants' motions for summary judgment other than his own summary judgment motion on January 25, 2001. The trustee asserts in his motion, as supported by answers to interrogatories that he propounded to Charlotte Birch, that there is no genuine issue of material fact and he is entitled to judgment as a matter of law. The trustee admits that each trust contains spendthrift language, but maintains that neither is a valid spendthrift trust since "self-settled" trusts, i.e., where

the settlors are also the beneficiaries, are void as against public policy. The trustee's argument continues that because the trusts are invalid, they are property of the bankruptcy estate.

In response, the defendants submit that the chapter 7 trustee's analysis is correct only if the property placed in the trusts belonged to the debtor. They assert that because the assets transferred to the trusts belonged to Charlotte Birch alone, neither the debtor's creditors nor his bankruptcy estate can attach any of the trust property. In support of this assertion, the defendants submit a second affidavit by Charlotte Birch, wherein she states that "all assets transferred to the B.J. Trust and the J.B. Irrevocable Trust were owned solely by me at the time of the transfer to the trust."

II.

A debtor's interest in a spendthrift trust is excluded from property of the debtor's bankruptcy estate to the extent the trust is protected from creditors under applicable state law. See 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."). In general, a spendthrift trust is one in

which the right of the beneficiary to distributions from the trust cannot be voluntarily transferred by the beneficiary or reached by his or her creditors. *Shurley v. Texas Commerce Bank—Austin, N.A. (Matter of Shurley)*, 115 F.3d 333, 337 (5th Cir. 1997). Both the B.J. Trust and the J.B. Irrevocable Trust were executed in Ohio and each specifically provides that "the validity, construction and interpretation of the Trust shall continue to be governed by the laws of the State of Ohio" regardless of the location of the trust corpus. Furthermore, all the parties agree that Ohio law controls the issues which they have presented. Accordingly, the determinative question is whether under Ohio law, the debtor's interests in the two trusts may be reached by his creditors. If so, these interests will be included in the debtor's bankruptcy estate.

As the chapter 7 trustee asserts, the law in Ohio is clear that "self-settled spendthrift trusts, where the grantor is also the beneficiary, are void as against public policy." *Miller v. Ohio Dep't of Human Serv.*, 664 N.E.2d 619, 621 (Ohio App. 1995). "[W]hen a spendthrift trust is created in which part or all of the beneficial interest is reserved in the creator of the trust, the restraint is invalid and the creditors of the creator may reach his interest." *Jensen v. Hall (Matter of Hall)*, 22 B.R. 942, 944 (Bankr. M.D. Fla. 1982) (construing Ohio law). Thus,

in *Hall*, a bankruptcy trustee was able to reach trust assets, notwithstanding spendthrift trust language in the trust agreement, where the trust had been established by the debtor and his wife and they were paid the trust income and such amounts of principal as was necessary for their support. *Id.* Similarly, in *Eisen v. Frangos (In re Frangos)*, 132 B.R. 723 (Bankr. N.D. Ohio 1991), the bankruptcy court held that a spendthrift trust provision was unenforceable, that the debtor's bankruptcy trustee succeeded to the debtor's interest in a trust, and the trust corpus was property of the estate. The debtor and his wife had created the trust prepetition and transferred their residence into the trust, to be held for their benefit and thereafter conveyed to their children upon their death. *Id.* at 723-34.

The defendants in the instant case acknowledge these decisions, but note that the decision in *Frangos* was modified in a second decision by that court on a motion to amend the original judgment. See *In re Frangos*, 135 B.R. 272 (Bankr. N.D. Ohio 1992). In the second *Frangos* decision, the bankruptcy court stated that "only the Debtor's interest in the real estate is an asset of the [bankruptcy] estate" and observed that the bankruptcy trustee intended to recognize the interest of the nonfiling settlor, i.e., the debtor's wife, if the property was

sold. *Id.* at 274. The defendants herein contend that the second *Frangos* decision establishes "the rule that when two parties contribute property to a trust, the creditors of one of the settlor/beneficiaries can only reach that property in the trust res which was contributed by that settlor/beneficiary." Because all of the property transferred into the trusts was that of Charlotte Birch, only her creditors can attach her beneficial interests in the trusts. And, because the debtor conveyed no property into the trusts, the spendthrift provisions are valid to protect his beneficial interests.

The defendants appear to be correct in their statement of the law. In *Shurley*, the Fifth Circuit Court of Appeals considered the issue of "whether the entirety of a beneficiary's interest in a spendthrift trust is subject to creditors' claims where the trust is only partially self-funded by the beneficiary." *Matter of Shurley*, 115 F.3d at 338. In *Shurley*, both the bankruptcy and district courts had concluded that the beneficiary's entire interest in the trust was included in her bankruptcy estate because she was one of the original settlors of the trust. Upon review, the court of appeals reversed the decisions of those courts, concluding that Texas courts would hold that creditors can reach only the self-settled portion of the trust. *Id.* The Fifth Circuit reasoned that this conclusion

is consistent with the spendthrift wishes of the other settlors to the trust, while still giving effect to the prohibition on self-settled trusts. *Id.* The appellate court noted that a court from another jurisdiction had agreed with such an approach. *Id.* n.13 (citing *McKeon v. Dep't of Mental Health (In re Johannes Trust)*, 479 N.W.2d 25, 29 (Mich. App. 1991) ("The self-settlor's creditors can reach the assets of the trust and compel payment in the maximum amount that would be in the trustee's discretion with respect to that portion of the assets that came from the self-settlor, but not with respect to any portion of the trust that came from other individuals.")).

Similarly, in a case from Missouri, a husband's creditor sought to have the judgment in its favor satisfied with real estate held in trust for the benefit of the husband, his wife and sons. See *Bolton Roofing Co. v. Headrick*, 701 S.W.2d 183 (Mo. App. 1985). The creditor argued that the spendthrift provision in the trust was invalid because the husband and wife were also settlors of the trust, in that they had conveyed the real estate to the trust. The court rejected the creditor's argument, noting that "'settlor' means one who furnishes the consideration for the creation of a trust." *Id.* at 184 (quoting BLACK'S LAW DICTIONARY 1539 (4th ed. 1968)). See also *Guaranty Trust Co. of New York v. New York Trust Co.*, 74 N.E.2d 232 (N.Y. 1947)

("the person who furnishes the consideration for the creation of a trust is the settlor"). The *Headrick* court noted that the husband and wife had owned the property prior to their conveyance to the trust as tenants by the entirety and as such, the creditor would have had no legal right to levy against the property for a debt owed solely by the husband. Thus, "the spendthrift clause used here in the trust agreement offends neither statute nor public policy, because it does not deprive [the creditor] of any rights it had before the conveyance in question was made." *Headrick*, 701 S.W.2d at 184-85.

This court realizes that these decisions are from jurisdictions other than that of Ohio, but concludes that an Ohio court presented with the issue would reach the same result. The law in these states is similar to Ohio law with respect to the general principle that self-settled trusts are void. See *Matter of Shurley*, 115 F.3d at 337 n.9 (citing *Daniels v. Pecan Valley Ranch, Inc.*, 831 S.W.2d 373, 378 (Tex. App. 1992))("In Texas, a settlor cannot create a spendthrift trust for his own benefit and have the trust insulated from the rights of creditors."); TEX. PROP. CODE ANN. § 112.035(d) ("If the settlor is also a beneficiary of the trust, a provision restraining the voluntary or involuntary transfer of his beneficial interest does not prevent his creditors from satisfying claims from his

interest in the trust estate.")); *Citizen Nat'l Bank of Maryville v. Cook*, 857 S.W.2d 502, 506 (Mo. Ct. App. 1993) ("It is hornbook law that a person may not create a trust for his own benefit and include a provision restraining the rights of his creditors."); Mo. REV. STAT. § 456.080.3(2) (spendthrift provisions in a trust instrument are unenforceable "[t]o the extent of the settlor's beneficial interest in the trust assets").

In the Hall case cited by the chapter 7 trustee, although the trust had been created by the debtor and his wife as trustors, the property conveyed to the trust had been owned by the debtor individually and his wife had "joined in the deed, as required by Ohio law, to relinquish her dower claim." Similarly, the second *Frangos* decision can be construed as consistent with the legal conclusion that a self-settled trust is invalid only to the extent of a trust interest to which the same person was both settlor and beneficiary.¹ Furthermore, Ohio statutory law on the subject is directed at insuring that

¹In actuality, the *Frangos* court made no distinction as to which of the cotrustors had actually conveyed the property to the trust. Instead, the court's ruling was that in light of the self-settled nature of the trust, the bankruptcy trustee succeeded to the debtor's beneficial interests in the trust unimpeded by the trust's spendthrift provisions. *In re Frangos*, 135 B.R. at 274. The clarification by the court appeared to be that the trustee succeeded only to the debtor's interest, not that of the debtor's wife.

persons do not make conveyances of property in trust for their exclusive benefit. See OHIO REV. CODE ANN. § 1335.01(A).² As reasoned by the *Shurley* court, if someone other than the beneficiary in question has made the gift or conveyance to the trust, then the policy behind the invalidation of self-settled trusts is no longer relevant. See *Matter of Shurley*, 115 F.3d at 337 ("The rationale for this 'self-settlor' rule is [that] a debtor should not be able to escape claims of his creditors by himself setting up a spendthrift trust and naming himself as beneficiary.").

The unrefuted second affidavit of Charlotte Birch establishes that all assets transferred into the two trusts belonged solely to her at the time of the conveyance.

²This subsection provides that:

All deeds of gifts, and conveyances of real or personal property, that are made in trust for the exclusive use of the person making the gift or conveyance are void, but the creator of a trust may reserve to himself any use of power, beneficial or in trust, that he might lawfully grant to another, including the power to alter, amend, or revoke the trust. A trust with a reserved use of power is valid as to all persons, except that any beneficial interest reserved to the creator may be reached by his creditors and except that, if the creator reserves to himself for his own benefit a power of revocation, a court, at the suit of any creditor of the creator, may compel the exercise of the power to the same extent and under the same conditions that the creator could have exercised the power.

Additionally, in another adversary proceeding between the same parties arising out of this bankruptcy case, this court granted the defendants summary judgment on the chapter 7 trustee's complaint to set aside the transfers as fraudulent conveyances based on the factual determination that the assets transferred into the two trusts were not "property of the debtor" but were instead the property of Charlotte Birch. *Wyss v. Birch (In re Birch)*, No. 99-2007 (May 3, 2000). This factual finding has collateral estoppel effect in the present proceeding. See *Wolstein v. Docteroff (In re Docteroff)*, 133 F.3d 210, 214 (3d Cir. 1997) ("Collateral estoppel prohibits the relitigation of issues that have been adjudicated in a prior lawsuit.").

Because all the property transferred into the trusts belonged solely to Charlotte Birch, the rule invalidating self-settled trusts provides no basis for inclusion of the debtor's beneficial interests in the trusts in his bankruptcy estate. The chapter 7 trustee's argument that neither trust is a valid spendthrift trust because they were "self-settled" by the debtor simply has no merit. Instead, the interests are excluded from property of the estate pursuant to 11 U.S.C. § 541(c)(2) because of the trusts' spendthrift provisions. See *Scott v. Bank One Trust Co., N.A.*, 577 N.E.2d 1077, 1084 (Ohio 1991) (spendthrift trusts are enforceable in Ohio). As stated by the Ohio Supreme

Court in *Scott*, "[t]he beneficiary owns no greater interest in the trust property than the settlor has given him. In the case of a spendthrift trust, the settlor has not given the beneficiary an alienable interest." *Id.* at 1084.

The only remaining issue to be resolved is whether the power to amend the B.J. Trust brings the trust within the debtor's bankruptcy estate. OHIO REV. CODE ANN. § 1335.01(A) provides that "if the creator reserves to himself for his own benefit a power of revocation, a court, at the suit of any creditor of the creator, may compel the exercise of the power to the same extent and under the same conditions that the creator could have exercised the power." It is well established that "any interest which a debtor retains in a trust is property of the estate, including the power to amend the trust and the power to revoke a revocable trust." *Osherow v. Porras (In re Porras)*, 224 B.R. 367, 370 (Bankr. W.D. Tex. 1998) (quoting *Askanase v. LivingWell, Inc.*, 45 F.3d 103, 106 (5th Cir. 1995)). "Thus, the bankruptcy estate, as represented by the bankruptcy trustee, gains not only the property interest but may also exercise any powers which the debtor could exercise for his benefit over the property." *Id.*

Based on this analysis, it is clear that the debtor's bankruptcy trustee may exercise any power which the debtor can

exercise under the trusts. The B.J. Trust states that "[t]he Trustors reserve the rights at any time or times during their lifetime to amend any of the provisions of this Trust in whole or in part, by an instrument in writing signed by the Trustors and delivered to the Trustee." Because this language of the trust refers to "Trustors" in the plural, the question arises as to whether either trustor may amend or whether both must agree. Exhibit B to the B.J. Trust contains a definition section, which in pertinent part provides that "[t]he masculine, feminine, or neuter gender, and the singular or plural number, shall each be deemed to include the others whenever the context so indicates." But this definition offers little guidance in deciding this issue since it simply substitutes a new question for the original one: that is, when does the context indicate that "Trustors" can be either singular or plural?

Unfortunately, there is very little case law on this issue. There are three California cases, all of which conclude that the cotrustor of a revocable trust cannot unilaterally revoke the trust. See *Witherspoon v. Wernicke (Estate of Wernicke)*, 20 Cal. Rptr. 2d 481 (Cal. App. 1993); *Khan v. Khan*, 214 Cal. Rptr. 109 (Cal. App. 1985); *Hill v. Conover*, 12 Cal. Rptr. 522 (Cal. App. 1961). Although there is no Ohio decision precisely on point, one case does cite with approval the treatise BOGERT ON

TRUSTS AND TRUSTEES for the proposition that:

A power to revoke or alter a trust must be executed in accordance with its terms. If it is a power to revoke by deed, it cannot be exercised by an undelivered deed; if a power to revoke by deed witnessed, neither an assignment nor a will are sufficient; if the instrument provides for revocation by deed, there is clearly no power to destroy the trust by will; if the power is to cancel the trust by will, a deed will have no effect; if by written notice to the trustee, a return of the trust instrument by the trustee to the settlor at the latter's request will not revoke; **if by two settlors acting jointly, one alone cannot revoke**; if by the settlor and trustee, the former cannot act alone; if by joint action of the trustee and cestui, the cestui is powerless to revoke by his several acts.

Magoon v. Cleveland Trust Co., 134 N.E.2d 879 (Ohio App. 1956) (quoting 4 BOGERT ON TRUSTS AND TRUSTEES (part 2) § 996 (emphasis added)).

The Supreme Court of Ohio has stated that "one of the fundamental tenets for the construction of a will or trust is to ascertain, within the bounds of the law, the intent of the testator, grantor or settlor." *Domo v. McCarthy*, 612 N.E.2d 706, 708 (Ohio 1993). In light of the fact that the power to amend would include the power to completely change all of the terms of the trust or even revoke them all, the court finds it difficult to believe that when the B.J. Trust was established, the trustors intended that either one of them could unilaterally amend the trust, especially since the trust had been settled with property owned solely by Charlotte Birch. It is more

probable that it was contemplated and intended that both trustors would have to agree to any amendments to the trust. Therefore, while the chapter 7 trustee does "step into the shoes of the debtor" with regard to the B.J. Trust, he has no greater power than that of the debtor to amend the trust. Since the debtor does not have the unilateral power to amend the B.J. Trust, neither does the chapter 7 trustee. Rather, because the amendment right must be exercised jointly by the cotrustors to the B.J. Trust and cotrustor Charlotte Birch has indicated her refusal to reach any agreement with the chapter 7 trustee in this regard, the chapter 7 trustee is unable to reach the asset held by the B.J. Trust.

III.

For the foregoing reasons, an order will be contemporaneously with the filing of this memorandum opinion denying the chapter 7 trustee's motion for summary judgment and granting the defendants' motions for summary judgment.

FILED: March 8, 2001

BY THE COURT

MARCIA PHILLIPS PARSONS
UNITED STATES BANKRUPTCY JUDGE