

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

In re

Case No. 02-30265

CLIFFORD EDWARD BARBOUR, JR.

Debtor

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*NOTICE OF APPEAL FILED:* October 8, 2003

*DISTRICT COURT No.:* 3:03-cv-685

*DISPOSITION:*

1. March 31, 2004 United States District Judge James H. Jarvis AFFIRMED the bankruptcy court's decision and the appeal was DISMISSED.
2. April 28, 2004 a Notice of Appeal to United States Court of Appeals for the Sixth Circuit was filed.

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**MEMORANDUM ON  
TRUSTEE'S MOTION FOR TURNOVER**

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**RICHARD STAIR, JR.  
UNITED STATES BANKRUPTCY JUDGE**

This contested matter is before the court on the Motion for Turnover filed by the Trustee, Ann Mostoller, on June 18, 2003, requesting an order directing the Debtor (1) to turnover all income he has received as beneficiary of a spendthrift trust since January 18, 2002, (2) to turnover all future income to be received throughout the pendency of this bankruptcy case, and (3) to provide the Trustee with an accounting of all funds received since the filing of the bankruptcy petition.

Facts and documents essential to the resolution of the Motion for Turnover are before the court on the joint Stipulations filed on August 14, 2003. The Trustee's Brief in Support of Motion for Turnover was filed on August 15, 2003, and the Debtor's Brief in Opposition to Motion for Turnover was filed on August 26, 2003. Pursuant to the Agreement to Submit Motion for Turnover on Stipulations and Briefs filed by the parties on August 15, 2003, an evidentiary hearing is not required.

This is a core proceeding. 28 U.S.C.A. § 157(b)(2)(A), (E), and (O) (West 1993).

## I

The Debtor is the beneficiary of an *inter vivos* trust (the Trust) by virtue of an Agreement executed by George H. Taber, the Debtor's grandfather, on December 21, 1935. The Agreement provides, in material part:

The beneficiaries hereunder shall have no power to anticipate or assign their interest, either in the principal or income of the trust fund, nor shall the same be in any manner liable for their debts or obligations or subject to legal process therefor; and the principal and net income of this trust fund shall be paid over and distributed by the Trustees to the beneficiaries in person and to no one else, except as otherwise provided herein, without diminution for the payment of any debts or liabilities whatever in transit from said Trustee to them.

The parties agree that these provisions created a valid spendthrift trust under the laws of the Commonwealth of Pennsylvania.<sup>1</sup>

The Debtor filed the voluntary petition commencing his Chapter 11 bankruptcy case on January 18, 2002, and the Trustee was appointed on March 20, 2003. The Debtor, who is 75 years old, has received, since the commencement of his Chapter 11 case, the following periodic payments from the Trust, totaling \$138,758.60: (1) \$25,121.08 in March 2002; (2) \$25,513.98 in June 2002; (3) \$21,161.97 in September 2002; (4) \$25,250.74 in December 2002; (5) \$21,577.99 in March 2003; and (6) \$20,132.84 in June 2003.

The Trustee contends that the distributions received by the Debtor from the Trust are property of the bankruptcy estate under 11 U.S.C.A. § 541(a)(1), (6), and/or (7) (West 1993), and that they are therefore subject to turnover by the Debtor to the Trustee under 11 U.S.C.A. § 542(a) (West 1993). Additionally, she seeks an accounting of all income received by the Debtor since January 18, 2002, the date upon which he filed for bankruptcy. In opposition, the Debtor argues that 11 U.S.C.A. § 541(c)(2) (West 1993) expressly excludes as property of a bankruptcy estate income received from a spendthrift trust, regardless of the chapter of the Bankruptcy Code under which the Debtor has proceeded.

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<sup>1</sup> The Trustee stipulates only that the Trust is a valid spendthrift trust in this contested matter. She has reserved the right to dispute the nature and status of the Trust in other matters, if necessary.

## II

At the commencement of a bankruptcy case, an estate is created, which includes, among other things, the following property:

(a)(1) Except as provided in subsection[] . . . (c)(2) of this section, all legal or equitable interests of the debtor in property as of the commencement of the case.

. . . .

(6) Proceeds, product, offspring, rents, or profits of or from property of the estate, except such as are earnings from services performed by an individual debtor after the commencement of the case.

(7) Any interest in property that the estate acquires after the commencement of the case.

11 U.S.C.A. § 541. Under the provisions of 11 U.S.C.A. § 542(a), a debtor is required to turnover all property of the estate to the Trustee and to provide an accounting therefor.<sup>2</sup>

Even though the scope of § 541 was intended to be broad, *see Forbes v. Lucas (In re Lucas)*, 924 F.2d 597, 600 (6<sup>th</sup> Cir. 1991), there are still restrictions upon what property is to be included within the bankruptcy estate. *See In re Taronji*, 174 B.R. 964, 969 (Bankr. N.D. Ill. 1994) (“Although this definition is quite broad, including interests of all types and degrees of contingency, it is limited to interests in existence at the outset of the bankruptcy case.”). One such restriction is found in § 541(c)(2), which

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<sup>2</sup> (a) . . . [A]n entity, other than a custodian, in possession, custody, or control, during the case, of property that the trustee may use, sell, or lease under section 363 of this title, or that the debtor may exempt under section 522 of this title, shall deliver to the trustee, and account for, such property or the value of such property, unless such property is of inconsequential value or benefit to the estate.

11 U.S.C.A. § 542(a).

provides that “[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.” 11 U.S.C.A. § 541(c)(2). “[P]roperty of a debtor falling within the definition of this exception is excluded from the bankruptcy estate.” *Lucas*, 924 F.2d at 600; *see also Drewes v. Schonteich (In re Schonteich)*, 31 F.3d 674, 676 (8<sup>th</sup> Cir. 1994). The term “applicable nonbankruptcy law” includes “all laws, state and federal, under which a transfer restriction is enforceable.” *Lucas*, 924 F.2d at 601 (quoting *Anderson v. Raine (In re Moore)*, 907 F.2d 1476, 1477 (4<sup>th</sup> Cir. 1990)); *see also Patterson v. Shumate*, 112 S. Ct. 2242, 2246 (1992). “As a result, spendthrift and support trusts are excluded from a debtor’s bankruptcy estate to the extent they are protected from creditors under applicable state law.” *Menotte v. Brown (In re McLean)*, 303 F.3d 1261, 1265 (11<sup>th</sup> Cir. 2002); *Shubert v. Katz (In re Katz)*, 220 B.R. 556, 565 (Bankr. E.D. Pa. 1998) (“[I]t is well established that spendthrift trusts are excluded entirely from bankruptcy estates under § 541(c)(2).”).

Because the Trust at issue in this case is governed in accordance with the laws of the Commonwealth of Pennsylvania, the questions of whether the Trust income paid to the Debtor is property of the bankruptcy estate and whether the Trustee is entitled to turnover of the Trust income received by the Debtor since the filing of his Chapter 11 case in the amount of \$138,758.60, plus the turnover of all quarterly disbursements to be made to the Debtor from the Trust while his Chapter 11 bankruptcy case is pending, are matters of Pennsylvania state law.

### III

The validity of spendthrift trusts has long been recognized under Pennsylvania law, and Pennsylvania courts generally interpret spendthrift provisions broadly. *Katz*, 220 B.R. at 564; *Spencer v. Blanchard (In re Blanchard)*, 201 B.R. 108, 124-25 (Bankr. E.D. Pa. 1996).

There is no question but that a spendthrift trust may validly be created to protect from creditors and from alienation the income to be paid to a beneficiary during a period of life or years. Likewise there is no doubt but that the principal of such a trust may be similarly safeguarded during such period, it being obvious that otherwise the payment of income to the beneficiary could not be assured.

*Sproul-Bolton v. Sproul-Bolton*, 117 A.2d 688, 690 (Pa. 1955). Spendthrift trusts are generally upheld unless they violate public policy. *Blanchard*, 201 B.R. at 125. Under Pennsylvania law, "it is against public policy for one so to limit his property in trust that he retains to himself the beneficial incidents of ownership therein and yet places it beyond the reach of those to whom he is or may become indebted." *In re Mogridge's Estate*, 20 A.2d 307, 309 (Pa. 1941).

By their very nature, spendthrift clauses are used to insulate a trust's assets from creditors "until such time as those assets, either as principal or income, are delivered into the hands of the beneficiary[,] and a beneficiary's use of those funds are left to his own judgment." *In re Trust Under Agreement of John H. Ware, III*, 814 A.2d 725, 732 (Pa. Super. Ct. 2002); *see also Katz*, 220 B.R. at 564 ("[T]he effect of a valid spendthrift provision is that the income can be attached, if at all, only in the hands of the beneficiary.") (quoting *Widener & Bigelow Trusts*, 16 Fiduciary Rptr.2d 159, 161 (Montgomery County, C.P.)); *Sproul-Bolton*, 117 A.2d at 692 (holding that once a beneficiary has receipt of trust income, it is subject to attachment by creditors).

## IV

The Trustee first argues that the income received by the Debtor should be brought into the bankruptcy estate under § 541(a)(6), as a proceed or profit from property of the estate, or as being outside the scope of § 541(a)(6)'s earnings exception because the post-petition income of a Chapter 11 debtor becomes property of the bankruptcy estate when it is sufficiently related to the Debtor's pre-petition activities. Additionally, the Trustee argues that the income payments from the Trust are not the result of personal services performed by the Debtor.

Section 541(a)(6) expands [the] basic definition of property of the estate to include certain property interests that are acquired after the commencement of the case." *Taronji*, 174 B.R. at 969; see also *In re Cooley*, 87 B.R. 432, 437 (Bankr. S.D. Tex. 1988). This allows the debtor to exclude from his estate any compensation or salary he might earn after the date of the petition." *Andrews v. Riggs Nat'l Bank of Washington, D.C. (In re Andrews)*, 80 F.3d 906, 910 (4<sup>th</sup> Cir. 1996). "[I]f a debtor first obtains an interest in any property—including wages—after the case commences, that property will not be part of the estate under Section 541(a)(1), simply because it does not fit within the general definition." *Taronji*, 174 B.R. at 969.

In the case of an individual debtor with earnings from services, the interplay between Section 541(a)(1) and (a)(6) creates, in substance if not in legal form, two estates as of the commencement of the case. One consists of property of the estate while the other consists of property of the debtor. This result follows from the fact that an individual debtor and his estate are separate entities.

*Cooley*, 87 B.R. at 437 (citations omitted). “Property acquired by the estate after the commencement of the case . . . together with ‘proceeds . . . or profits of or from property of the estate’ . . . is property of the estate. But property acquired post-petition by the debtor does not enter the estate; it remains the separate property of the debtor.” *Bell v. Bell (In re Bell)*, 225 F.3d 203, 215 (2d Cir. 2000) (internal citations omitted). The creation of these two estates accomplishes the basic purposes of the Bankruptcy Code: (1) to provide protection for a debtor’s creditors; and (2) to allow the debtor to make a “fresh start.” *Roland v. UNUM Life Ins. Co. of Am.*, 223 B.R. 499, 503 (E.D. Va. 1998); *see also Local Loan Co. v. Hunt*, 54 S. Ct. 695, 699 (1934); *In re Krohn*, 886 F.2d 123, 125 (6<sup>th</sup> Cir. 1989).

[B]y creating a bright line rule in 541(a)(6), Congress created a distinction between estate property, which must be used for the protection of creditors, and non estate funds, which may be disposed of as the debtor “sees fit, without having to further account to the bankruptcy estate, his creditors, or any subsequently appointed trustee . . . [and can be used] to buy food, shelter, clothing, or, if he chose, to unwisely invest in penny stocks in gold mine ventures.”

*Roland*, 223 B.R. at 504 (quoting *Lowe v. Yochem (In re Reed)*, 184 B.R. 733, 740 (Bankr. W.D. Tex. 1995)).

The Trustee’s arguments that the Trust payments fall outside the post-petition earnings exception and qualify as property of the estate must fail for a fundamental reason. The Trust is expressly excluded from the Debtor’s bankruptcy estate under § 541(c)(2). As the Trust has been excluded from the bankruptcy estate, likewise, any post-petition income received by the Debtor from the Trust cannot be brought into the estate under § 541(a)(6). This subsection is inapplicable because it includes “[p]roceeds . . . or profits of or from property of the estate” as property of the estate. The income received by the

Debtor from the Trust cannot be property of the estate as a "proceed" or a "profit" because the Trust itself is not property of the estate.

Moreover, "there is no statutory requirement to pay future [income] to a creditor, [and the court] cannot create such a requirement simply because it feels the debtor has no other choice but to use such funds." *Roland*, 223 B.R. at 504 (citing *Toibb v. Radloff*, 111 S. Ct. 2197, 2202 (1991) ("[T]here is no . . . provision in Chapter 11 requiring a debtor to pay future wages to a creditor[.]"); see also *Fitzsimmons v. Walsh (In re Fitzsimmons)*, 725 F.2d 1208, 1211 (9<sup>th</sup> Cir. 1984) (stating that Congress expressly removed the earnings exception from Chapter 13 cases, and if it had intended to make the earning exception inapplicable to Chapter 11 cases, it would have explicitly done so).<sup>3</sup> The Trustee is not entitled to turnover of the post-petition Trust income received by the Debtor under § 541(a)(6).

## V

The remaining issue is whether the post-petition Trust income can be included as property of the estate and subject to turnover under § 541(a)(7) because the Debtor acquired it post-petition. "[Section

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<sup>3</sup> In a Chapter 13 case,

(a) Property of the estate includes, in addition to the property specified in section 541 of this title.

(1) all property of the kind specified in such section that the debtor acquires after the commencement of the case but before the case is closed, dismissed, or converted to a case under chapter 7, 11, or 12 of this title, whichever occurs first; and

(2) earnings from services performed by the debtor after the commencement of the case but before the case is closed, dismissed, or converted to a case under chapter 7, 11, or 12 of this title, whichever occurs first.

11 U.S.C.A. § 1306(a) (West 1993).

541(a)(7)] clarifies that any interest in property that the estate acquires after the commencement of the case is property of the estate; for example, if the estate enters into a contract, after the commencement of the case, such a contract would be property of the estate.” *Gallucci v. Grant (In re Gallucci)*, 931 F.2d 738, 743 (11<sup>th</sup> Cir. 1991) (citations omitted); *see also Trinity Gas Corp. v. I.R.S. (In re Trinity Gas Corp.)*, 242 B.R. 344, 350 (Bankr. N.D. Tex. 1999) (“[T]he obvious purpose of § 541(a)(7) is to include property and rights which are acquired in the **estate's** normal course of business in property of the estate.”); *Allen v. Levey (In re Allen)*, 226 B.R. 857, 862-63 (Bankr. N.D. Ill. 1998) (“To ensure that ‘anything of value’ becomes part of a debtor's estate, Congress enacted § 541(a)(7), which provides that any interest in property that the estate collects or perfects post-petition is also property of the estate.”).

“While subsection (a)(7) includes property acquired by the estate after the commencement of the case, property of the estate generally does not include property acquired by the debtor after the commencement of the case.” *DeNadai v. Preferred Capital Mkts., Inc.*, 272 B.R. 21, 28 (D. Mass. 2001) (quoting 3 WILLIAM L. NORTON, JR., NORTON BANKRUPTCY LAW & PRACTICE 2D §51:1, at 5 (1994 & Supp. 2001)). “After the commencement of the case, the bankruptcy estate has an existence that is completely separate from that of the debtor, and § 541(a)(7) covers only property that the estate itself acquires after the commencement of the bankruptcy proceeding.” *Wade v. Bailey (In re Wade)*, 287 B.R. 874, 881 (S.D. Miss. 2001).

Again, the Trust is not property of the estate. The Debtor has not acquired or perfected an interest in the Trust that relates to any action or contract pre-petition. The Debtor instead receives income from the Trust that is protected from any alienation or assignment until it actually reaches the Debtor’s hands.

Under Pennsylvania law, the Debtor does not have any interest in the Trust income until it is actually in his possession. Under the Bankruptcy Code, because the Debtor had no interest in the income pre-petition, his receipt of any post-petition Trust income belongs to the Debtor personally and cannot be subject to turnover to the Trustee.

The court acknowledges the Trustee's argument that the Debtor has amassed additional property, post-petition, of \$138,758.60, while being allowed to retain his home and other pre-petition personal property. Nevertheless, Pennsylvania law makes it quite clear that

?It is always to be remembered that consideration for the beneficiary does not even in the remotest way enter into the policy of the law; it has regard solely to the rights of the donor. Spendthrift trusts can have no other justification than is to be found in considerations affecting the donor alone. They allow the donor to so control his bounty, through the creation of the trust, that it may be exempt from liability for the donee's debts, not because the law is concerned to keep the donee from wasting it, but because it is concerned to protect the donor's right of property. . . . We repeat, spendthrift trusts are allowed not because the law concerns itself for the donee; he may conserve or dissipate as he pleases; the law's only concern is to give effect to the will of the donor as he has expressed it."

*In re Grote Trust*, 135 A.2d 383, 390 (Pa. 1957) (quoting *In re Morgan's Estate (No. 1)*, 72 A. 498, 499 (Pa. 1909)). Section 541(a)(7) does not provide a basis for turnover of the Trust income received by the Debtor post-petition.

## VI

In summary, the Trust itself is excluded from the Debtor's bankruptcy estate pursuant to 11 U.S.C.A. § 541(c)(2). Accordingly, any post-petition income from the Trust is likewise excluded from the Debtor's bankruptcy estate and cannot be brought into the estate under either of § 541(a)'s after-

acquired property subsections, (a)(6) or (a)(7). The Trustee is not entitled to turnover of the \$138,758.60 paid to the Debtor since he commenced his Chapter 11 bankruptcy case on January 18, 2002, nor is the Trustee entitled to turnover of any future income to be paid to the Debtor from the Trust during the pendency of his bankruptcy case. Finally, because the Trustee is not entitled to turnover of any of the income received by the Debtor from the Trust, she is not entitled to an accounting under 11 U.S.C.A. § 542.

An order consistent with this Memorandum will be entered.

FILED: September 18, 2003

BY THE COURT

/s/ Richard Stair, Jr.

RICHARD STAIR, JR.  
UNITED STATES BANKRUPTCY JUDGE

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

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Debtor

**ORDER**

For the reasons stated in the Memorandum on Trustee's Motion for Turnover filed this date, the court directs that the Motion for Turnover filed by the Chapter 11 Trustee, Ann Mostoller, on June 18, 2003, is DENIED.

SO ORDERED.

ENTER: September 18, 2003

BY THE COURT

/s/ Richard Stair, Jr.

RICHARD STAIR, JR.  
UNITED STATES BANKRUPTCY JUDGE