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Consumer Track

Property of the Estate

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Property of the Estate Generally

Bankruptcy Code Section 541 creates an estate upon the filing of a bankruptcy petition and entrusts into that estate "all legal or equitable interests of the debtor in property as of the commencement of the case." The scope of this grant is broad and the underlying theory of the section "is to bring into the estate all interests of the debtor in property as of the date the case is commenced." *In re Jones*, 768 F.2d 923, 926 (7th Cir. 1985) (quoting 4 L.P. King, ed., Collier on Bankruptcy ¶ 541.06 at 541–28 (15th ed. 1985). "In practical terms, estate property will include within its grasp every conceivable interest held by a debtor in property - whether future, nonpossessory, contingent, speculative, or derivative." *In re Smith*, 310 B.R. 320, 322 (Bankr. N.D.Ohio 2004). The estate can also include property seized by a creditor prior to the filing of the bankruptcy. *U.S. v. Whiting Pools, Inc.*, 462 U.S. 198, 207-09 (1983). Regardless of the nature of the asset or interest, Section 541 defines the estate's property rights as of the petition date.

For Chapter 13 debtors, Section 1306 expands upon Section 541 by conferring into the bankruptcy estate all property identified in Section 541 that the debtor acquires post petition and earning for services performed by the debtor after the commencement of the case but before the case is closed, dismissed, or converted. Undistributed funds held by a Chapter 13 trustee are property of the bankruptcy estate and attempts of creditors to levy such funds is a violation of the automatic stay. *In re Montgomery*, 525 B.R. 682, 687-88 (Bankr. W.D.Tenn 2015); *Clark v. United States (In re Clark)*, 207 B.R. 559, 565 (Bankr. S.D.Ohio 1997).

Property of the Estate Upon Confirmation and Vesting of Assets in the Debtor

The expansion of the bankruptcy estate through operation of Section 1306 is tempered by Section 1327 which provides that, except as otherwise provided for in the plan, upon confirmation of a plan all of the property of the estate vests in the debtor, and those assets are free and clear of any claim or interest of any creditor provided for by the plan. Section 1327 provides bankruptcy judges with discretion to hold assets in the bankruptcy estate or to revest those assets into the debtor(s). *In re Steenes*, 918 F.3d 554, 557 (7th Cir. 2019). However, as set forth in *Steenes*, the exercise of judicial discretion requires the court to provide reason to exercise an exception to a general statute. "[T]he absence of a reason for departing from the statutory norm in any particular case makes it impossible for us to sustain the bankruptcy court's decisions." *Id.* The issue in *Steenes* arose through the use of a form confirmation order which maintained property in the bankruptcy estate for the duration of the plan. *Id*. at 556-57. The City of Chicago assess vehicle related fines, such as speeding, running red lights, and illegal parking, against the owner of the vehicle. *Id*. However, the City was unable to receive payment through the bankruptcy process because the plans did not provide for the payment of post petition vehicle tickets. Likewise, the City could not boot or tow the offending vehicles because those were still property of a bankruptcy estate. *Steenes* concludes that retention by a bankruptcy estate of property of the debtor must be through a "case-specific order, supported by good case-specific reasons", and absent such reasons the City was entitled to an order restoring the estates' assets to the debtors' personal ownership. Moreover, in the related case *In re Cherry*, 963 F.3d 717 (7th Cir. 2020), the Seventh Circuit held that compliance with Section 1327, and the vesting of estate property in the debtor, is a prerequisite to confirmation of a plan per Section 1325(a).

Whether, or when, property vests in a Chapter 13 debtor is not only important during the immediate bankruptcy case, and whether assets are owned by a debtor or a bankruptcy estate may impact a debtor's rights in subsequent bankruptcy proceedings, as illustrated in *In re Jividen*, 646 B.R. 257 (Bankr. C.D.Ill. 2022) which involves debtors filing multiple bankruptcy cases. In the second case filed by the debtors, the Internal Revenue Service filed a priority claim in the amount of $11,259.35 for taxes due in 2008 through 2011 and a general unsecured claim in the amount of $304.39. The priority portion of the claim was paid in full through the Chapter 13 plan and the debtors received a discharge. In the third case filed by the debtors, the IRS filed a claim asserting a priority claim for interest accrued on the taxes due 2008 through 2010 which accrued after the filing of the second case.

Prepetition interest which accrues on tax debt is nondischargble to the same extent the underlying tax debt itself in nondischargeable. *In re Larson*, 862 F.2d 112, 119 (7th Cir. 1988). However, interest which accrues post petition, and which is excepted from discharge, may nevertheless be dischargeable in subsequent bankruptcy cases pursuant to Section 523(b) and a new look-back calculation as set forth in Section 523(a)(1). Section 507 includes a similar structure in determining priority status where the applicable look-back period is to be applied separately in each case. Interest only tax claims are assigned a priority based upon the due date of the return or the date the tax was assessed per Section 507(a)(8), and if those dates precede the look-back period, then the interest is not entitled to priority status. Section 507(a)(8)(A)(i) sets forth a three year look-back period, and the hanging paragraph in that section tolls the running of time for periods during which the automatic stay was in effect or collection was barred by a confirmed plan.

The confirmation order in the debtors' second case provided that upon confirmation of the debtor's plan all property of the estate vested in the debtors. *Id*. at 263. Therefore, the post-confirmation estate would only be comprised of the portion of the debtors' income necessary to fulfill the terms of the plan. *Id*. No other income would be included in the estate. Interest arising post-petition for the debtor's prepetition tax obligations is a post-petition debt, and debts which arise post-petition are collectible from non-estate property of the debtor. See, *In re Kolve*, 459 B.R. 376 (Bankr. W.D.Wis. 2011). As such, collection upon the post petition obligation would be stayed prior to confirmation and vesting in the debtor of estate property; however, following entry of a confirmation order the IRS would be free from the stay against collection.

As the IRS was not prevented from collecting upon the interest component during the second bankruptcy case, it was dischargeable in the third bankruptcy case.

Property of the Estate Following Conversion of the Case to Chapter 7

Section 348 describes the effects when a case is converted from one chapter to another. Section 348(f) is specific to cases under Chapter 13, and subsection (1) defines property of the estate of the converted case to consist of the debtor's property as of the petition date, that remains in the possession of or is under the control of the debtor on the date of conversion. Section 348(f)(2) allows for an expansion of the estate of the converted case, should the conversion found to be in bad faith, to include in the converted case property of the case as of the date of conversion. The Supreme Court in *Harris v. Viegelahn*, 575 U.S. 510 (2015) reconciled a circuit split with respect to whether funds being held by a chapter 13 trustee should be distributed to creditors or the debtor upon conversion. The Court looked to the statutory construction of Section 348(f) and recognized that the bad faith conversion and retention of wages by an estate, and the administration of those wages in the converted proceeding, serves as a penalty for the ne'er-do-well debtor. Absent such bad faith, the statutory intent is clear that a debtor should retain any wages earned post-petition. However, this clearly begs the question of how to define bad faith in a conversion of a Chapter 13 case.

In *In re Bejarano*, 302 B.R. 559 (Bankr. N.D.Ohio 2003), the court considered whether the debtors' conversion following the disclosure of a post-petition automobile accident was made in bad faith. The Bankruptcy Code is silent with respect to the meaning of this term, and the court relied upon the basic statutory construction of using the everyday meaning of a term with providing deference to the statutory structure. See, *FDIC v. Meyer*, 510 U.S. 471, 476 (1994); *O'Connell v. Shalala*, 79 F.3d 170, 173 (1st Cir. 1996). The Sixth Circuit, in *U.S. v. True*, 250 F.3d 410 (6th Cir. 2001), requires more than bad judgment or negligence and the term bad faith "implies the conscious doing of a wrong because of dishonest purpose of moral obliquity." In the context of a conversion from Chapter 13, the *Bejarano*, court looked to whether the debtor was engages in 'nefarious planning', and as contemplated by *In re Siegfried*, 219 B.R. at 585, a determination that "there has been an unfair manipulation of the bankruptcy system to the substantial detriment of disadvantage of creditors."

Warren v. Peterson, 298 B.R. 322 (N.D.Ill. 2003) also considered what bad faith means in the context of Section 348(f)(2), and also looked to *Siegfried* and its attempt to define bad faith by referring to the term 'good faith' in Section 1325(a)(3). The Seventh Circuit decision *In re Love*, 957 F.2d 1350 (7th Cir. 1992) considered the concept of good faith with respect to Sections 1307 and 1325, and focused upon what "is fundamentally fair to creditors and, more generally . . . fair in a manner that complies with the spirit of the Bankruptcy Code's provisions." When considering 'good faith' the Seventh Circuit used a totality of the circumstances test and provided a non-exhaustive list of factors: the nature of the debt, including the question of whether the debt would be nondischargeable in a Chapter 7 proceeding; the timing of the petition; how the debt arose; the debtor's motive in filing the petition; how the debtor's actions affected creditors; the debtor's treatment of creditors both before and after the petition was filed; and whether the debtor has been forthcoming with the bankruptcy court and the creditors. *Love*, 957 F.2d at 1357. The appellate record in *Warren* did not support a finding, using the totality of the circumstances, that the debtor converted in bad faith and the matter was remanded for further proceedings.

Property of the Estate Following Dismissal Of The Case

Section 1326(a) provides that payments made to the Chapter 13 trustee shall be retained by the trustee until confirmation, or denial, of a plan. If a plan is not confirmed, then the trustee shall return payments to the debtor, after deducting any unpaid claim allowed under section 503(b). The question raised in *In re Fairnot*, 571 B.R. 767 (Bankr. E.D. Mi. 2017), is whether preconfirmation play payment can, and must, be used to pay allowed administrative claims. The court reconciles Section 3249(b)(3) and 13269(a)(2) by giving effect to 1326(a)(2) as controlling. See also, *Wheaton*, 547 B.R at 498-99; *In re Hightower*, 2015 WL 5766676 (Bankr. S.D. Ga. Sept. 30, 2015); *Kirk*, 537 B.R. 856, 860 (Bankr. N.D. Ohio 2015); *In re Merovich*, 547 B.R. 643, 648 (Bankr. M.D. Pa. 2016). The court authorized debtor's counsel to file a fee application after the case has been dismissed, and to the extent relief is granted, the trustee will be directed to pay the allowed fees from prior to paying funds back to the debtor.

Where a Chapter 13 case is dismissed post confirmation, but prior to the completion of the plan, a split exists as to whether funds held by the trustee should be returned to the debtor or disbursed to creditors. In *In re Carr*, 2017 WL 3025843 (Bankr. E.D. Wis. 2017), the trustee sought to distribute funds on hand to estate creditors and argues the Section 1326(a)(2), when read in conjunction with Section 349, which does not vacate orders of plan confirmation, provides for a situation wherein the confirmed plan is still enforceable following dismissal. See also *In re Parrish*, 275 B.R. 424 (Bankr. D.D.C. 2002). However, Section 349(b)(3) revests the property of the estate in which such property was vested immediately before the commencement of the bankruptcy case. According to *In re Hamilton*, 493 B.R. 31 (Bankr. M.D. Tenn. 2013), the effect of Section 349(b) is to return the parties to the positions they were in prior to the filing of the case. Estate property, per Section 1306(a) includes that income of the debtor sufficient to make plan payments in the estate, and Section 349 vests such income back in the debtor following dismissal of the case. To the extent that an argument can be made that trust law vests in estate creditors the right to such funds, *Carr* relies upon the reasoning provided in *Harris v. Viegelan*, 575 U.S. 510 (2015) which held that a confirmed Chapter 13 plan does not give creditors a vested right in funds held by a trustee. See also, *Williams v. Marshall*, 526 B.R. 695 (Bank. N.D. Ill. 2014) (holding that Section 1326 inapplicable and Section 349(b) requiring return of undisbursed funds to debtor and citing to *In re Michael*, 699 F.3d 305, 312-13 (3d Cir. 2012) for the proposition that debtors do not lose their vested interest in funds held by the trustee until the trustee affirmatively transfers the funds to creditors.

A different result was reached in *In re Marve*, 2020 WL 11622509 (E.D. MI. 2020). Prior to the dismissal of a Chapter 13 proceeding, debtor's counsel filed a fee application seeking post confirmation fees and requested an order awarding such fees and directing the Chapter 13 trustee to pay those fees from undisbursed funds. Looking to Section 349, the court considered whether cause existed to prevent the reinvesting of estate property in the debtor. In considering the fee petition, the court found that cause existed for two reasons: 1) the term 'for cause' does not require a demonstration of bad faith, only that a good reason exists for the court to provide the requested remedy and 2) debtor's counsel is not a 'typical' creditor with a claim that arose prepetition and the claim at issue arise as a direct consequence of the debtor filing a Chapter 13 case. The court could not 'put the parties in the positions that they were in before the case was filed' by denying fees that would not exist but for the Chapter 13 proceeding.

In considering whether undisbursed funds should vest in the debtor, the court in *In re Elms*, 603 B.R. 11 (Bankr. S.D. Ohio 2019) recognized that the effect of Section 349 was to undo the bankruptcy and restore property rights to the position in which they were found at the beginning of the case. However, in finding that such funds should return to the debtor, the court found support in the voluntary nature of Chapter 13 proceedings. Because a debtor can voluntarily dismiss a case at any time, it stands to reason that disbursement of estate property post dismissal would interfere with the debtor's right to dismissal because it exempts funds held by the trustee. *Elms* also provides a summary of "cause" for the estate to retain assets post dismissal: To allow the courts flexibility to issue appropriate orders to protect rights acquired in reliance on the bankruptcy case (*Viegelahn v. Lopez (In re Lopez)*, 897 F.3d 663, 672 (5th Cir. 2018); where the debtors have demonstrated gamesmanship or bad faith. (*Bateson*, 551 B.R. 807 (Bankr. E.D. Mi. 2016)); to disburse funds to debtor's counsel where an engagement letter allows for such a recovery (*In re Beaird*, 578 B.R. 643 (Bankr. D. Kan. 2017)).

A Debtor's Cause of Action: "Accrued" or "Sufficiently Rooted?"

The filing of a bankruptcy petition creates a bankruptcy estate comprised of "all legal or equitable interests of the debtor in property as of the commencement of the case," with only a few exceptions. *See* 11 U.S.C. § 541(a)(1). Almost all property interests of the debtor as of the time of the bankruptcy filing become property of the bankruptcy estate. *See Matter of Yonikus*, 996 F.2d 866, 869 (7th Cir. 1993); *see also United States v. Whiting Pools, Inc.*, 462 U.S. 198, 204, 103 S.Ct. 2309, 2313, 76 L.Ed.2d 515 (1983) (noting "Congress intended a broad range of property to be included in the estate").

While the bankruptcy code initially determines which of the debtor's property interests become estate property for purposes of section 541, state law governs whether the debtor has such an interest in the first place. *Barnhill v. Johnson*, 503 U.S. 393, 398 (1992); *Butner v. United States*, 440 U.S. 48, 54–55 (1979) ("Congress has generally left the determination of property rights in the assets of a [debtor's] estate to state law").

If the debtor has the right to bring a cause of action, those rights are considered property of the bankruptcy estate if the claim existed when the bankruptcy was commenced and the debtor could have asserted the claim on his or her own behalf under applicable state law. *Matter of Geise*, 992 F.2d 651, 655 (7th Cir. 1993). Property a debtor acquires postpetition, however, belongs to the debtor. *In re Wagner*, 530 B.R. 695, 701 (Bankr. E.D. Wis. 2015). *citing* 11 U.S.C. § 541(a) (defining property of estate by reference to debtor's interests as of petition date, except for limited types of property that debtor acquires within 180 days after petition date). Thus, whether a debtor's cause of action accrues prepetition or postpetition determines whether the cause of action is property of the bankruptcy estate. As noted above, state law applicable to the debtor's interest in property will determine whether a cause of action had accrued as of the commencement of the bankruptcy case.

The Bankruptcy Code does not indicate how a court should determine whether a claim is sufficiently matured as of "the commencement of a case" to constitute an "interest of the debtor in property." *Wagner*, 530 B.R. at 701, citing 11 U.S.C. § 541(a)(1). Consequently, courts and litigants have applied competing theories, generally encompassing (1) when the claim accrued and (2) whether or not the claim is "sufficiently rooted in the pre-bankruptcy past" of the debtor. *Id*., quoting *Segal v. Rochelle*, 382 U.S. 375, 380 (1966).

Bankruptcy courts deal regularly with "contingent" and "inchoate[1]" interests in property, and generally such interests in existence as of a bankruptcy filing are property of the estate. But as one bankruptcy court pointed out (though the decision was later overruled by the Circuit Court), there is no such thing as an "inchoate interest" in a cause of action:

[1]Defined in the Merriam Webster Dictionary as "being only partly in existence or operation," and in Dictionary.com as "not yet completed or fully developed."

> State law recognizes as valid interests in property such interests as contingent remainders, future interests in contract rights, executory springing interests, and many other contingent property interests. However, to this court's knowledge, state law does not recognize as a legitimate interest in property an inchoate interest in a cause of action that is yet to accrue. Until a cause of action accrues, it simply does not exist under state law. And if state law does not recognize it as an interest in property, neither does the Bankruptcy Code make it property of the estate.

In re Swift, 198 B.R. 927, 935 (Bankr. W.D. Tex. 1996).

This logic was too much for the Fifth Circuit Court of Appeals, which overruled the bankruptcy court's decision, criticizing the bankruptcy court's use of the "discovery rule" in determining whether the cause of action belonged to the bankruptcy estate.

> Under [the discovery] rule, the statute of limitations does not begin to run until the injured party "discovers" or with the exercise of reasonable care and diligence should have discovered that a particular injury has occurred. The result is that the statute of limitations may begin to run on a date other than that on which the suit could first be maintained. A classic example illustrates this. Consider a case of medical malpractice in which the treating physician has left a dangerous metal instrument inside the body of his patient. At the time the doctor finishes the surgery, the doctor has completed a tort. He has violated a legal duty owed to the patient, and the patient was injured by that violation. If the patient instituted suit at this moment, his suit would be viable. The statute of limitations has not begun to run, however. Under the discovery rule, the statute of limitations is tolled until the patient either discovers or should have discovered that an injury has occurred. This example shows that the dates of accrual and the start of the running of the statute of limitations may vary greatly. Unfortunately, many cases applying the principles of the discovery rule are written in terms of accrual.

Matter of Swift, 129 F.3d 792, 796 (5th Cir. 1997)

From this the 11th Circuit divined that "a cause of action can accrue for ownership purposes in a bankruptcy proceeding before the statute of limitations begins to run." *In re Alvarez*, 224 F.3d 1273, 1277 (11th Cir. 2000).

It appears that a central flaw in the Fifth Circuit's *Swift* decision (and its progeny *Alvarez*) is the misstatement that the discovery rule acts to "toll" the statute of limitation. The discovery rule does not "toll" any statute of limitations that is already underway; rather, the discovery rule describes one of the several conditions that must be met for the statute of limitations to begin running in the first place, i.e., that the tort victim tort has discovered (or that a reasonably prudent person could have discovered) the nexus between their injury, the tortious conduct, and the identify of the tortfeasor.

More recently, courts have rejected the notion that an undiscovered injury claim can become property of a bankruptcy estate.

> A bankruptcy debtor cannot be expected to predict and disclose possible future injury by each and every product he or she has previously used. To be rooted in the debtor's prebankruptcy past, there is no way of knowing how far back the root would go. Asbestos exposure may have been many years before the injury; a defective hip replacement, perhaps not as long. Property of the estate is generally what exists on the date of filing, and the claim is not compensable until there is an injury; it follows that the trustee has nothing to pursue when there is no discernable injury on the date of filing. The discovery rule provides that the claim arises when the claimant knew or should have discovered it, so the rule cannot be circumvented by the debtor who in bad faith puts off diagnosis or treatment for a known compensable injury until after the bankruptcy petition.

In re Wagner, 530 B.R. 695, 705 (Bankr. E.D. Wis. 2015).

And where courts continue to incorporate *Segal* into the analysis, they are typically finding ways to characterize claims such that they are excluded under both the *Segal* and "discovery" analyses.

> Recent decisions analyzing claims under *Segal*'s "sufficiently rooted in the prebankruptcy past" rubric all examine, in order of importance, what the evidence shows as to (i) whether and when the device caused injury to the debtor, (ii) when the debtor and medical community became aware of a potential defect in the device, and (iii) the motivation behind, and timing of, surgical removal of the device.

In re Vasquez, 581 B.R. 59, 72 (Bankr. D. Vt. 2018) (collecting cases).

Another bankruptcy court decision attempts to harmonize the discovery rule with *Segal*'s sufficiently rooted examination. Noting that a cause of action for products liability does not arise until a product causes an injury that is objectively ascertainable, it follows that if on "bankruptcy day," it remained a mere "nebulous possibility" that the product would cause the debtor injury, then no cause of action yet exists. *In re Bolton*, 584 B.R. 44, 55 (Bankr. D. Idaho 2018). Put another way, an undiscovered cause of action against the product's manufacturer was *not* "sufficiently rooted in the prebankruptcy past" so as to constitute property of the bankruptcy estate. *Id*.

The *Swift* hypothetical suggests an injury that is concrete yet undiscovered when the "danger metal instrument" was left inside the surgical patient's body. But if the injury has not manifested itself in the physical or mental perception of the victim, how is it in reality an injury? If the patient is fine immediately following the surgery, and the implications of the surgical error don't manifest themselves in symptoms until weeks later, prompting the discovery of the injury, how could it be said that the "injury" occurred before the symptoms appeared?

In mass-tort products liability cases, such as those involving defective implants of artificial hips and trans-vaginal mesh, not everyone who received those products sustained an injury (though many did). Once the defective nature of the products became clear; however, many physicians recommended removal of the device when no injury had yet occurred, and may never have occurred. Those patients would have claims for the costs and any pain and suffering associated with the removal or replacement of the defective devices, but how can it be said that they were "injured" until the follow-up procedure is performed?

Regardless of whether the "accrual" or "sufficiently rooted" (or some combination thereof) is applied, nearly all bankruptcy courts begin their analysis with state law interpretations of causes of action. Below is a summary of state law on when a cause of action accrues in nearby states.

Illinois – Discovery Rule

"The effect of the discovery rule…is to postpone the commencement of the relevant statute of limitations until the injured plaintiff knows or reasonably should know that he has been injured and that his injury was wrongfully caused." *Golla v. Gen. Motors Corp.*, 167 Ill. 2d 353, 360–61, 657 N.E.2d 894, 898 (1995).

Indiana – Discovery Rule

Indiana's application of the discovery rule means that a claim accrues when the plaintiff discovers, or in the exercise of ordinary diligence could have discovered, that his injury was caused by the tortious act of another. See Wehling v. Citizens Nat'l Bank, 586 N.E.2d 840, 842–43 (Ind. 1992) (extending the discovery rule to all tort claims). "[A] person knows or should have discovered the cause of his injury when he has or should have discovered some evidence that there was a reasonable possibility that his injury was caused by the act or product of another." Evenson v. Osmose Wood Preserving Co., 899 F.2d 701, 705 (7th Cir. 1990).

Kentucky – Discovery Rule

"[T]he statute begins to run on the date of the discovery of the injury, or from the date it should, in the exercise of ordinary care and diligence, have been discovered. This rule entails knowledge that a plaintiff has a basis for a claim before the statute of limitations begins to run. The knowledge necessary to trigger the statute is two-pronged; one must know: (1) he has been wronged; and, (2) by whom the wrong has been committed." Wiseman v. Alliant Hosps., Inc., 37 S.W.3d 709, 712 (Ky. 2000).

Michigan – Generally, action accrues "when the wrong is done" (with some exceptions)

MCL 600.5827: "Except as otherwise expressly provided, the period of limitations runs from the time the claim accrues. The claim accrues at the time provided in sections 5829 to 5838, and in cases not covered by these sections the claim accrues at the time the wrong upon which the claim is based was done regardless of the time when damage results."

The Michigan Supreme held that “[t]he wrong is done when the plaintiff is harmed rather than when the defendant acted.” *Trentadue v. Gorton*, 479 Mich. 378, 407 (2007).

600.5805. (1) A person shall not bring or maintain an action to recover damages for injuries to persons or property unless, after the claim first accrued to the plaintiff or to someone through whom the plaintiff claims, the action is commenced within the periods of time prescribed by this section.

(2) Except as otherwise provided in this section, the period of limitations is 3 years after the time of the death or injury for all actions to recover damages for the death of a person or for injury to a person or property.

Example exception to “when the wrong is done” rule for Michigan statute of limitations:

> Sec. 5838. (1) Except as otherwise provided in section 5838a or 5838b,1 a claim based on the malpractice of a person who is, or holds himself or herself out to be, a member of a state licensed profession accrues at the time that person discontinues serving the plaintiff in a professional or pseudoprofessional capacity as to the matters out of which the claim for malpractice arose, regardless of the time the plaintiff discovers or otherwise has knowledge of the claim.
>
> (2) Except as otherwise provided in section 5838a or 5838b, an action involving a claim based on malpractice may be commenced at any time within the applicable period prescribed in sections 5805 or 5851 to 5856,2 or within 6 months after the plaintiff discovers or should have discovered the existence of the claim, whichever is later. The plaintiff has the burden of proving that the plaintiff neither discovered nor should have discovered the existence of the claim at least 6 months before the expiration of the period otherwise applicable to the claim. A malpractice action that is not commenced within the time prescribed by this subsection is barred.

Minnesota – Discovery Rule & “Some damages” Rule

An action does not “accrue” until it may be brought without dismissal for failure to state a claim upon which relief may be granted. *Molloy v. Meier*, 679 N.W.2d 711, 720 (Minn. 2004)

Under Minnesota law…the claim accrues and the statute of limitations begins to run when the plaintiff has suffered some damage as a result of the alleged negligence… a claim involving personal injuries allegedly caused by a defective product accrues when two elements are present: “(1) a cognizable physical manifestation of the disease or injury, and (2) evidence of a causal connection between the injury or disease and the defendant’s product, act, or omission.” *Klempka v. G.D. Searle & Co.*, 963 F.2d 168, 170 (8th Cir. 1992).

Minnesota law recognizes only one general equitable tolling exception, which arises when the plaintiff can demonstrate that the defendant engaged in fraudulent concealment. *DeCosse v. Armstrong Cork Co.*, 319 N.W.2d 45, 51–52 (Minn. 1982).

Ohio – Discovery Rule

Ohio applies the discovery rule, and the cause of action accrues when the plaintiff is informed by competent medical authority that her injury was related to the exposure to the product, or when, by the exercise of reasonable diligence, the claimant should have known that her injury was related to the exposure to the product. Ohio Rev. Code § 2305.10.

Wisconsin – Discovery Rule

Wisconsin adheres to the "discovery rule" for the accrual of a cause of action in tort. Under the discovery rule, the statute of limitations begins to run when the potential plaintiff discovers the injury, or in the exercise of due diligence should have discovered the injury. *Hansen v. A.H. Robins Co., Inc.*, 113 Wis.2d 550, 560, 335 N.W.2d 578, 583 (1983).

The Wisconsin supreme court added a further refinement to the discovery rule…the court held that discovery embraces two distinct concepts: a cause of action cannot be said to accrue until the claimant discovers both the nature of his or her injury and its cause-or at least a relationship between the event and injury. Moreover, the relationship between the injury and its cause must be more than a layperson's hunch or belief. *Borello v. U.S. Oil Co.*, 130 Wis.2d 397, 388 N.W.2d 140 (1986).

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Trust Issues Impacting Property of the Estate – Debtor as Trustee or Beneficiary

Statement of Financial Affairs, Official Form 107, Page 10, Part 9, Question 23:

> **Do you hold or control any property that someone else owns? Include any property you borrowed from, are storing for, *or hold in trust for someone*.**

Section 541(a)(1) provides that the "property of the estate" includes "all legal or equitable interests of the debtor in property as of the commencement of the case." Section 541(d) provides:

> "Property in which the debtor holds, as of the commencement of the case, only legal title and not an equitable interest ... becomes property of the estate under subsection (a) of this section only to the extent of the debtor's legal title to such property, but not to the extent of any equitable interest in such property that the debtor does not hold."

Section 541 does not give the debtor any greater rights to property than the debtor had before filing for Chapter 11. To the extent that an interest is limited in the hands of the debtor, it is, therefore, equally limited in the hands of the estate. *Matter of TTS, Inc.*, 158 B.R. 583, 585 (D. Del. 1993) (citing 4 Collier on Bankruptcy 541.01 (15th ed. 1983)). "[T]he rule is elementary that the estate succeeds to only the title and rights in the property that the debtor possessed." *Georgia Pacific Corp. v. Sigma Service Corp*., 712 F.2d 962, 968 (5th Cir.1983).

Because the debtor does not own an equitable interest in property he holds in trust for another, that interest is not "property of the estate." Nor is such an equitable interest "property of the debtor" *Begier v. I.R.S.*, 496 U.S. 53, 59, 110 S. Ct. 2258, 2263, 110 L. Ed. 2d 46 (1990).

When a debtor owns property in the capacity of a trustee, the corpus of the trust is not part of the debtor's estate. *Mid–Atlantic Supply, Inc. of Va. v. Three Rivers Aluminum Co.* (*In re Mid–Atlantic Supply Co.*), 790 F.2d 1121, 1124 (4th Cir.1986). Thus, when a debtor holds property as a trustee, "the sole permissible administrative act of the trustee or debtor-in-possession is to pay over or endorse over the property to the beneficiary or beneficiaries." *Id.* at 1126.

Examples of property which a debtor may hold in trust include express trusts (e.g., the types of trusts used for estate planning) and statutory trusts (e.g., where a statute creates a trust to enforce a specific policy, such as the collection and remittance of taxes).

There are innumerable trusts created by statute, including the following examples.

<u>Trust-fund taxes</u>.

Whenever any person is required to collect or withhold any internal revenue tax from any other person and to pay over such tax to the United States, the amount of tax so collected or withheld *shall be held to be a special fund in trust for the United States*.

26 U.S.C.A. § 7501 (emphasis added).

Perishable Agricultural Goods Act (PACA).

Perishable agricultural commodities received by a commission merchant, dealer, or broker in all transactions, and all inventories of food or other products derived from perishable agricultural commodities, and any receivables or proceeds from the sale of such commodities or products, *shall be held by such commission merchant, dealer, or broker in trust for the benefit of all unpaid suppliers or sellers* of such commodities or agents involved in the transaction, until full payment of the sums owing in connection with such transactions has been received by such unpaid suppliers, sellers, or agents.

7 U.S.C.A. § 499e(c)(2) (emphasis added).

Theft-by-contractor

Wisconsin:

[A]ll moneys paid to any prime contractor or subcontractor by any owner for improvements, *constitute a trust fund* only in the hands of the prime contractor or subcontractor to the amount of all claims due or to become due or owing from the prime contractor or subcontractor for labor, services, materials, plans, and specifications used for the improvements, until all the claims have been paid.... The use of any such moneys by any prime contractor or subcontractor for any other purpose until all claims ... have been paid in full or proportionally in cases of a deficiency, is theft by the prime contractor or subcontractor of moneys so misappropriated and is punishable under s. 943.20.

Wis. Stat. § 779.02(5) (emphasis added).

Texas:

(a) Construction payments *are trust funds* under this chapter if the payments are made to a contractor or subcontractor or to an officer, director, or agent of a contractor or subcontractor, under a construction contract for the improvement of specific real property in this state.

(b) Loan receipts *are trust funds* under this chapter if the funds are borrowed by a contractor, subcontractor, or owner or by an officer, director, or agent of a contractor, subcontractor, or owner for the purpose of improving specific real property in this state, and the loan is secured in whole or in part by a lien on the property.

A contractor, subcontractor, or owner or an officer, director, or agent of a contractor, subcontractor, or owner, who receives trust funds or who has control or direction of trust funds, *is a trustee of the trust funds*.

(a) An artisan, laborer, mechanic, contractor, subcontractor, or materialman who labors or who furnishes labor or material for the construction or repair of an improvement on specific real property in this state *is a beneficiary of any trust funds* paid or received in connection with the improvement.

(b) A property owner *is a beneficiary of trust funds* described by Section 162.001 in connection with a residential construction contract, including funds deposited into a construction account described by Section 162.006.

Tex. Prop. Code Ann. § 162.001-003 (emphases added).

Absent a statutory scheme imposing trust duties, or an agreement between the parties to impose a trust, such claims will be treated as ordinary debts. *State v. Marshall*, 541 N.W.2d 330, 333 (Minn. Ct. App. 1995) (collecting cases).

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The debtor's interest in a trust as a beneficiary (or potential beneficiary) may also be excluded from property of the estate. Section 541(c)(2) provides that a restriction on the transfer of a beneficial interest in a trust enforceable under applicable non-bankruptcy law is enforceable in bankruptcy. Therefore, interests of the debtor subject to such enforceable transfer restrictions are not estate property. *McLean v. Cent. States, Se. & Sw. Areas Pension Fund*, 762 F.2d 1204, 1206 (4th Cir. 1985).

"When a bankruptcy debtor is a beneficiary of a trust containing spendthrift or anti-alienation provisions, whether that debtor's interest in the trust is property of the bankruptcy estate turns on whether the spendthrift provision is enforceable under applicable non-bankruptcy law." *In re McCoy*, 274 B.R. 751, 761–62 (Bankr. N.D. Ill. 2002), citing 11 U.S.C. § 541(c)(2); *In re Goldberg*, 98 B.R. 353, 357–8 (Bankr.N.D.Ill.1989).

Below is a summary of state law on trust spendthrift provisions.

<u>Wisconsin Spendthrift Provisions</u>

Wis. Stats. §§ 701.0502 – 701.0505 largely govern spendthrift clauses

- The requirements for a valid spendthrift provision are in Wis. Stat. § 701.0502(a) It states that a spendthrift provision is valid if either:
    - The beneficiary is a person other than the settlor and is not treated as the settlor under s. 701.0505(2), or
    - The trust is a trust for an individual with a disability.

- Wis. Stat. § 701.0502(2) states that a term of a trust providing that the interest of a beneficiary is held subject to a spendthrift trust, or words of similar import, restrains both a voluntary and involuntary transfer of the beneficiary's interest

- Wis. Stat. § 701.0502(3) states that a beneficiary may not transfer an interest in a trust in violation of a valid spendthrift provision and, except as otherwise provided in this subchapter, a creditor or assignee of the beneficiary may not attach, garnish, execute on, or otherwise reach the interest or a distribution by the trustee before its receipt by the beneficiary.

- Wis. Stat. § 701.0503 lists several exceptions to spendthrift provisions, including claims for child support and claims for public support
    - These exceptions do not apply to any trust for an individual with a disability or to assets of a trust that are exempt from claims of creditors under other statutes
- Wis. Stat. § 701.0505 details that rules that apply to claims of a settlor's creditors, whether or not the terms of a trust include a spendthrift provision

Minnesota Code Spendthrift Provisions:

Any challenge to a spendthrift provision is subject to Minn. Stats. §§ 501C.0502 – 501C.0506.

- The requirements for a valid spendthrift provision are in Minn. Stat. § 501C.0502(a). It states that a spendthrift provision is valid if either:
    - The trust includes a provision that restricts both voluntary and involuntary transfers of a beneficiary's interest, or
    - The settlor clearly manifests the intent to impose those restrictions.
- Minn. Stat. § 501C.0502(b) provides that a trust using the term "spendthrift trust" or similar words is sufficient to restrict both voluntary and involuntary transfers of the beneficiary's interest. For purposes of the validity of a spendthrift provision, neither a valid disclaimer nor exercise of a limited power of appointment constitutes a voluntary transfer.
- Under Minn. Stat. § 501C.0502(d), if a spendthrift provision is valid, a beneficiary cannot transfer an interest that violates the spendthrift provision. In addition, a creditor (or assignee) cannot access the interest or a distribution prior to the beneficiary's receipt.
- Minn. Stat. § 501C.0504 states that whether or not a trust includes a spendthrift provision, a creditor of a beneficiary cannot compel a distribution that is within the trustee's discretion.
    - This restriction applies even if the discretion is stated as a standard of distribution or the trustee abused the discretion.
    - The limitation does not limit a beneficiary's right to bring a court action against the trustee for abuse of discretion.
        - In addition, if a trustee or co-trustee has discretion to make distributions for his or her own benefit, a creditor can only compel distribution to the same extent as would be allowed if the beneficiary were not acting as trustee or co-trustee.

- Minn. Stat. § 501C.0506 provides that whether or not a trust contains a spendthrift provision, a creditor or assignee of a beneficiary can access a mandatory distribution of income or principal, if the trustee fails to make the distribution within a reasonable time after the set distribution date.
    - This provision includes a distribution on termination of a trust, but does not include any distribution subject to the trustee's discretion.

Illinois Spendthrift Provision

760 Ill. Stat. 3/502 – 3/503 govern spendthrift clauses

- Under § 502(a), a spendthrift provision is valid only if it prohibits both voluntary and involuntary transfer of a beneficiary's interest.

    - Under § 502(b), a term of a trust providing that the interest of a beneficiary is held subject to a "spendthrift trust", or words of similar import, is sufficient to restrain both voluntary and involuntary transfer of the beneficiary's interest
- § 503(b) covers several exceptions for spendthrift provisions. A spendthrift provision is unenforceable against:
    - (1) a beneficiary's child, spouse, or former spouse who has a judgment or court order against the beneficiary for child support obligations owed by the beneficiary as provided in the Income Withholding for Support Act, the Non-Support Punishment Act, the Illinois Parentage Act of 2015, the Illinois Marriage and Dissolution of Marriage Act, and similar provisions of other Acts that provide for the support of a child;

    - (2) a judgment creditor who has provided services for the protection of a beneficiary's interest in the trust; and

    - (3) a claim of this State or the United States to the extent a statute of this State or federal law so provides

- § 505 also explains that, whether or not the terms of a trust contain a spendthrift provision, there are several rules that apply to a creditor's claim against a settlor

Indiana Spendthrift Provisions

State of Indiana recognizes spendthrift trusts by statute [this section] and case law. *Matter of Cook*, N.D.Ind.1984, 43 B.R. 996.

Indiana's Spendthrift Provision statute is located at IC § 30-4-3-2.

- While it does not use the term "spendthrift clause", it does state that the settlor may provide in the terms of the trust that the interest of a beneficiary may not be either voluntarily or involuntarily transferred before payment or delivery of the interest to the beneficiary by the trustee.

The spendthrift provision prevents a creditor of the settlor from satisfying a claim from the settlor's interest in the trust estate when the settlor is also a beneficiary of the trust if the trust is one (1) of the following:

- (1) A trust that meets both of the following requirements:
  - (A) The trust is a qualified trust under 26 U.S.C. 401(a).
  - (B) The limitations on each beneficiary's control over the beneficiary's interest in the trust complies with 29 U.S.C. 1056(d).

- (2) A legacy trust established under IC 30-4-8.

However, according to IC § 30-4-3-36, unless a trust expressly provides otherwise, a trustee who has discretion under the terms of a trust (referred to in this section as the "first trust") to invade the principal of the trust to make distributions to or for the benefit of one (1) or more persons may instead exercise the power by appointing all or part of the principal of the first trust in favor of a trustee of another trust (referred to in this section as the "second trust") for the benefit of one (1) or more persons under the same trust instrument or under a different trust instrument as long as:

(1) the beneficiaries of the second trust are the same as the beneficiaries of the first trust;

(2) the second trust does not reduce any income, annuity, or unitrust interest in the assets of the first trust; and

(3) if any contributions to the first trust qualified for a marital or charitable deduction for purposes of the federal income, gift, or estate taxes, the second trust does not contain any provision that, if included in the first trust, would have prevented the first trust from qualifying for a deduction or reduced the amount of a deduction.

- This power is <u>NOT</u> prohibited by a spendthrift clause

<u>Michigan Spendthrift Provisions</u>

According to MCL § 700.7502, a spendthrift provision is valid and enforceable.

The Michigan law specifies narrow exceptions when the trust assets can be reached by a judgment creditor:

- The child or former spouse of the beneficiary has a judgment or court order against the beneficiary
- A judgment creditor provided services to "enhance, reserve, or protect" the beneficiary's trust interest
- The State of Michigan or the United States government has a claim against the beneficiary

If any of these exemptions apply, the court will order the trustee to pay the judgement out of distributions of income or principal as they become due. The exceptions do not apply to an interest of the beneficiary that is subject to discretionary distributions by the trustee.

However, in *Meoli v. Thrun*, et al. (In Re Frisch - Case No. DG11-12290) (Bankr. W.D. Mich., June 26, 2013), after review of Michigan law, the Court concluded that when the trust contains a provision that allows the beneficiary to withdraw the entire principal for his own benefit, despite the restriction included in the spendthrift clause, the restraint on the transfer is deemed invalid.

Ohio Spendthrift Provisions

Ohio's spendthrift provision statutes are located in Ohio Rev. Code Section 5805.01 – 5805.07.

The Trust Code provides that "a creditor or assignee of the beneficiary may not reach the interest or a distribution by the trustee before its receipt by the beneficiary." O.R.C. § 5805.01(C).

A beneficiary may be allowed to use real property or tangible personal property owned by the trust without that property being treated as distributed to the beneficiary, so long as that arrangement is within the trustee's authority under the trust terms. O.R.C. § 5805.01(C).

A spendthrift provision valid under the Trust Code should also be valid in bankruptcy proceedings. However, once trust assets are distributed to the beneficiary and in the beneficiary's hands, they can be pursued by the creditor. O.R.C. § 5805.01(C).

Kentucky Spendthrift Provisions

Kentucky's spendthrift provision statute is KRS § 386B.5-020.

Importantly, it states that if an instrument creating a trust provides that a beneficiary is entitled to receive income of the trust and that his interest shall not be alienable by him and shall not be subject to alienation by operation of law or legal process, the restraint on the voluntary and involuntary alienation of his right to income due and to accrue shall be valid.

Although a trust is a spendthrift trust, the interest of the beneficiary shall be subject to the satisfaction of an enforceable claim against the beneficiary:

(a) By the spouse or child of the beneficiary for support, or by the spouse for maintenance;

(b) If the trust is not a trust described in subsection (7)(b) of this section, by providers of necessary services rendered to the beneficiary or necessary supplies furnished to him; and

(c) By the United States or this Commonwealth for taxes due from him or her on account of his or her interest in the trust or the income therefrom.

Lastly, if a person creates for his or her own benefit a trust with a provision restraining the voluntary or involuntary alienation of his or her interest, his or her interest nevertheless shall be subject to alienation by operation of law or legal process

NOTE: The author wishes to acknowledge and thank DeWitt LLP's law clerk Connor Peterson for his work in compiling the survey of state law on spendthrift provisions.

Constructive Trust

The imposition of a constructive trust is commonly used as a form of relief for an unjust enrichment claim. The determination of whether a constructive trust should be imposed is a question of state law. *In re Howard's Appliance Corp*., 874 F.2d 88, 93–94 (2d Cir. 1989) (concluding that the law of the situs of the property governs the determination of whether to impose a constructive trust on property). In most states, a constructive trust may be imposed "when a person has obtained [property] to which he is not entitled, under such circumstances that in equity and good conscience he ought not to retain it … to avoid unjust enrichment." *Snuthberg v. Ill. Mun. Ret. Fund*, 735 N.E.2d 560, 565 (Ill. 2000); and *Kammer Asphalt Paving Co. v. E. China Twp. Sch.,* 443 Mich. 176, 186, 504 N.W.2d 635, 641 (1993).

A plaintiff seeking to impose a constructive trust must prove its interest in the *specific property* being held by the defendant. *In re CyberCo Holdings, Inc*., 382 B.R. 118, 129 n.9 (Bankr. W.D. Mich. 2008)(citing *Detroit Trust Co. v. Struggles*, 278 N.W. 385, 386 (Mich. 1938), for the proposition that Michigan law "unequivocally limits the imposition of a constructive trust to only those instances where the defendant is in possession or control of either the subject property itself or proceeds traceable to that property"); and *In re Mississippi Valley Livestock, Inc*., 745 F.3d 299, 307 (7th Cir. 2014) ("There can be no constructive trust without tracing a claimant's interest to specific property").

Unjust enrichment

The elements of a claim for unjust enrichment are "(1) receipt of a benefit by the defendant from the plaintiff, and (2) an inequity resulting to plaintiff from defendant's retention of the benefit." *Bellevue Ventures, Inc. v. Morang-Kelly Inv*., 836 N.W.2d 898, 901 (Mich. Ct. App. 2013) (citing *Dumas v Auto Club Ins Ass'n,* 473 N.W.2d 652, 663 (Mich. 1991)). See also, *Schlosser v. Welk*, 550 N.E.2d 241, 242 (Ill. Ct. App. 1990). Some states also require the defendant's appreciation and knowing acceptance of the benefit. *Dahl v. R.J. Reynolds Tobacco Co*., 742 N.W.2d 186, 195–96 (Minn. Ct. App. 2007) and *Ludyjan v. Cont'l Cas. Co*., 747 N.W.2d 745, 748 (Wis. Ct. App. 2008).

Michigan law also provides that a party is precluded from recovering under a theory of unjust enrichment pursuant to a gift relationship. *Buell v Orion State Bank*, 327 Mich 43, 56, 41 N.W.2d 472 (Mich. 1950) ("On[e] is not unjustly enriched, however, by retaining benefits involuntarily acquired which law and equity give him absolutely without any obligation on his part to make restitution.").

Case Law

The issues of unjust enrichment and the imposition of a constructive trust as a remedy have been brought by entrepreneurial chapter 7 trustees seeking to recover property for the bankruptcy estate. In most instances, the property is titled in the name of a non-filing third party; however, the debtor contributes(d) funds towards the purchase and/or expenses of the household.

However, a bankruptcy trustee's constructive trust claims are available through 11 U.S.C. § 541, as opposed to a fraudulent transfer claim which is available to a trustee through §§ 544 and 548. Section 541 provides that the commencement of a bankruptcy case creates an estate comprised of "all legal and equitable interests of the debtor in property." 11 U.S.C. § 541. If the trustee, as successor to the debtor's rights under § 541(a)(1), can show that, but for the bankruptcy, the debtor would have been entitled to the relief of a constructive trust, the trustee is entitled to that same relief. *In re CyberCo Holdings, Inc*, 382 B.R. at 130 n.10 (explaining that a trustee's constructive trust claim hinges on whether "a debtor had a claim immediately before the commencement of the case that justified imposing a constructive trust upon the third party").

Some recent decisions from bankruptcy courts addressing trustee's requests for the imposition of a constructive trust are below:

- *In re Short,* 625 B.R. 678 (Bankr. E.D. Mich. 2021)

In *Short*, the Chapter 7 trustee filed a complaint against the debtor and his wife seeking a constructive trust over the family home alleging fraud and unjust enrichment. The property had been purchased approximately 9 years before the petition date using a personal loan obtained by the debtor, his wife, and her parents. The debtor and the defendants asserted that the debtor was unable to attend the closing and for that reason, the property was titled solely in the name of the debtor's wife.

On the other hand, the trustee asserted that the Shorts intentionally omitted the debtor's name from the deed to defraud his creditors. The Shorts paid off the loan used to purchase the home with funds from their joint bank account and paid for significant repairs and improvements to the property from their paychecks. One significant fact was that the debtor was the primary wage-earner in the family and contributed the greater portion.

In his complaint, the trustee alleged that because the debtor provided most of the funds to purchase and improve the home, a constructive trust should be imposed on at least one-half of the equity in the property. The Shorts filed a motion to dismiss and for summary judgment.

The bankruptcy court denied the Shorts' motions concluding, *inter alia*, that a trustee, as successor to the debtor's interests, can assert a claim for the imposition of a constructive trust on real property titled in the name of a non-debtor if the state law requirements for a constructive trust are met. The bankruptcy court further concluded that fraud is not a required element of a constructive trust claim in Michigan and unjust enrichment alone will suffice. Finally, the court found that the trustee had pled sufficient alleged facts to state a claim for fraud as well as a claim for unjust enrichment, but there were genuine issues of material fact which prevented the Court from reaching a decision on these claims. Following the Court's opinion, the case settled.

- *Nathan v. DeBruin,* 2022 Bankr. LEXIS 699 (Bankr. E.D. Mich. Mar. 18, 2022), 2022 WL 828299 (Bankr. E.D. Mich. Mar. 18, 2022)

In *DeBruin*, the family home was purchased for $219,000 by the debtor's wife and her mother just over six years before the debtor filed bankruptcy, using a $190,000 mortgage and a $30,000 down payment. Because of his poor credit, the debtor could not be on the mortgage note or the deed. Similarly, the debtor's wife could qualify for the mortgage loan on her own, so her mother agreed to co-sign the note and mortgage. The mother also provided the $30,000 down payment. Once the home had been purchased, mortgage payments and other household expenses were paid from the debtor's joint bank account with his wife (where their paychecks were direct deposited). The two grossed almost the same income. As of the petition date, the home was worth $300,000 and the mortgage balance was approximately $170,000.

The trustee filed a complaint against the debtor, his wife, and the wife's mother alleging, *inter alia*, that the defendants fraudulently left the debtor off the deed to evade his creditors and that because the debtor's income paid at least 50% of the mortgage payments and other expenses associated with the home, the wife and mother had been unjustly enriched, and a constructive trust should be imposed on the home in favor of the trustee for at least half of the home's equity. The debtor's wife and her mother filed a motion for summary judgment on the unjust enrichment/constructive trust count of the complaint.

The court found no evidence of fraud, rejected the trustee's unjust enrichment claim, and granted the motion for summary judgment. Regarding the unjust enrichment claims, the court found:

There is nothing inequitable about [the mother's] entitlement to one-half of the equity—derived mostly from property appreciation—in the [] home as a legal co-owner; she is not unjustly enriched at [the debtor's] expense. But for her willingness to use her credit to obtain the home; her consent to be co-obligated on the mortgage debt; and her gratuitous contributions, [the deBruin family] would not enjoy the stability of living in the [] home.

DeBruin, 2022 Bankr. LEXIS 699, at *8; 2022 WL 828299, at *3.

The court went on to note that the debtor's wife (and not the debtor) obtained the down payment and was liable on the mortgage debt. Thus, the court found that the wife was not unjustly enriched by her home ownership. Finally, with respect to the alleged detriment suffered by the debtor, the court concluded: "the fact that [the debtor] made contributions to the household and mortgage payments for a home—he could never have qualified to purchase—does not make a constructive trust appropriate." And his expenditures were not out of proportion to the use of the home by the debtor and his children.

- *In re Combs,* 626 B.R. 300, 305 (Bankr. E.D. Mich. 2021)

In *Combs*¸ the Trustee filed an adversary proceeding seeking to avoid the debtor's prepetition transfer of real property to her parents eight (8) years prior to the petition date. The transfer was made in 2012 when the debtor executed a quit claim deed to her parents; however, the deed was never recorded. The trustee, therefore, filed suit alleging that because the 2012 transfer was not properly perfected as of the petition date, the transfer could be avoided under 11 U.S.C. § 544(a). In their attempts to defend themselves from the Trustee's claims, the parents claimed that they held "equitable title" to the property and that the court should impose a constructive trust in their favor in the home. The bankruptcy court rejected the defendant's argument relying heavily on the Sixth Circuit's decision in *XL/Datacomp, Inc. v. Wilson (In re Omegas Group, Inc.),* 16 F.3d 1443, 1451-53 (6th Cir. 1994), noting that a court is prohibited from imposing a constructive trust when the resulting effect would be taking away assets that would otherwise be property of the bankruptcy estate. "**The equities of bankruptcy are not the equities of the common law. Constructive trusts are anathema to the equities of bankruptcy since they take from the estate, and thus directly from competing creditors, not from the offending debtor**." (Emphasis in original).

- *In re Zagotta,* 2023 Bankr. LEXIS 379 (Bankr. W.D. Mich. Feb. 9, 2023), 2023 WL 1934024 (Bankr. W.D. Mich. Feb. 9, 2023)

As the court stated in its opinion, this was an "extremely complex" adversary proceeding dealing with a sophisticated businessman (creditor) who assigned certain rights to the chapter 7 trustee to pursue, including the right to seek to impose a constructive trust on the defendants' home in Michigan. The claims were based, in part, on the premise that the initial purchase of the home by the debtor's wife, a defendant in the proceeding, and subsequent transfer of the property to the wife's trust, another defendant, unjustly enriched the defendants. The court agreed with the decisions of *Short, DeBruin, and Omegas Group*, concluding that the imposition of a constructive trust to augment the bankruptcy estate is permissible and does not run afoul of the bankruptcy policy of ratable distribution. However, the Court declined to impose such a trust udner the factual circumstances of the case, finding that the trustee had not established the existence of an unjust enrichment claim on the facts of the case.

Faculty

Elliot G. Crowder is an attorney with Stevenson & Bullock, PLC in Southfield, Mich. He specializes in insolvency law practice, including the representation of fiduciaries, debtors and creditors in all facets of insolvency law, and litigation matters often requiring immediate attention. Mr. Crowder frequently is relied upon by businesses and equity-holders in complex disputes in the business courts and federal district courts across the State of Michigan. His representative fiduciary experience includes serving as counsel for chapter 7 trustees and liquidating trustees in complex bankruptcy matters and as counsel for receivers and assignees for the benefit of creditors. He also represents debtors and creditors in distressed situations, including in chapter 11 and subchapter V reorganizations. Mr. Crowder's experience spans from real estate to manufacturing, health care and service-based businesses. He is regularly recognized for his practice, being named one of *DBusiness*'s Top Lawyers in Bankruptcy & Creditor-Debtor Rights Law in 2022 and 2023. He also has been listed as a "Rising Star" by *Michigan Super Lawyers* since 2014. Mr. Crowder is a member of the State Bar of Michigan, the New York State Bar Association, ABI, the Consumer Bankruptcy Association of the Eastern District of Michigan, the Turnaround Management Association and the Brother Rice Warrior Bar Association. He is also a co-vice chair of the Debtor/Creditor Rights Committee for the Business Law Section of the State Bar of Michigan. Mr. Crowder received his B.S. from Syracuse University in 2006 and his J.D. from the University of Detroit-Mercy School of Law in 2010.

Hon. John T. Gregg is a U.S. Bankruptcy Judge for the Western District of Michigan in Grand Rapids, appointed on July 17, 2014. Previously, he was a partner with the law firm of Barnes & Thornburg LLP, where he focused on corporate restructuring, bankruptcy and other insolvency matters. Judge Gregg served as chair of the education committee of the National Conference of Bankruptcy Judges for 2022, serves on the ABI's Board of Directors, was recently inducted as a Fellow of the American College of Bankruptcy, and is a member of the American Law Institute. He is a frequent writer and speaker on bankruptcy and other commercial issues, and he has written and co-edited numerous secondary sources, including *Collier Guide to Chapter 11*, published by LexisNexis; *Strategies for Secured Creditors in Workouts and Foreclosures*, published by ALI-ABA; *Issues for Suppliers and Customers of Financially Troubled Auto Suppliers*, published by ABI; *Michigan Security Interests in Personal Property*, published by the Institute of Continuing Legal Education; *Handling Consumer and Small Business Bankruptcies in Michigan*, published by the Institute of Continuing Legal Education; *Interrupted! Understanding Bankruptcy's Effects on Manufacturing Supply Chains*, published by ABI; and *Receiverships in Michigan*, published by the Institute of Continuing Legal Education. Judge Gregg received his B.A. in 1996 from the University of Michigan and his J.D. in 2002 from DePaul University College of Law.

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