(Cite as: 1989 WL 90534 (Bankr.D.Vt.))

In re Neal H. GRAHAM, Debtor.

Gleb GLINKA, Trustee, Plaintiff,

v.

Neal H. GRAHAM, Defendant.

Bankruptcy No. 88-00099.

Adv. No. 88-0026.

United States Bankruptcy Court, D. Vermont.

May 25, 1989.

J. Meyers, White River Junction, Vermont, for Neal H. Graham, defendant (debtor).

G. Glinka, Cabot, Vermont, Trustee pro se (Trustee).

MEMORANDUM DECISION [FN1] ON CROSS-MOTIONS FOR SUMMARY JUDGMENT

FRANCIS G. CONRAD, Bankruptcy Judge.

***1** This matter is before us on the parties' cross-motions for summary judgment. The issues presented are whether the Debtor's interests in the income and principal of a trust fund are property of the Debtor's bankruptcy estate. Based on the facts and the memoranda of law, we hold that ten (10%) per cent of the income interests of the trust, plus any surplus over and above what is needed for the debtor's education and support, are alienable under N.Y.Civ. Prac.Law § 5205(d), N.Y.Real Property Law § 98 (current version at N.Y. Est. Power and Trust Law § 7-3.4), and New York case law, and are thus property of the estate. Furthermore, we hold that the estate includes the Debtor's contingent interest in the principal of the trust.

The Debtor filed a voluntary petition for relief under Chapter 7 of Title 11 of the U.S.Code, 11 USC §§ 101, et seq., on April 15, 1988. On Schedule B- 2, the Debtor listed as his personal property a "[c]ontingent interest as beneficiary of the Gertrude Lyons Trust" (Trust) and

stated that his interest in the Trust did not have any market value.

An adversary proceeding was commenced on May 26, 1988 by the Trustee to determine whether the Debtor's interests in the income and principal of the Trust is property of the estate.

At a pre-trial conference on October 17, 1988, the parties made cross-motions for summary judgment. The matter was set for briefing and taken under advisement.

The facts are undisputed. The Debtor is the grandson and a beneficiary of Gertrude Lyons' Will. Gertrude Lyons died in 1957. She was survived by two daughters, including Jean Lyons Graham, who is the 71-year-old mother of the Debtor.

The Will created two trusts which affect the Debtor. Under Article Eleventh, Part B(4)2 of the Will, the Debtor is given a life estate in the income of Trust Fund "D" and an interest in the principal of this trust which is contingent on his survival of his mother. [FN2]

Under Article Eleventh, Part B(2)(a) of the Will, the Debtor has an interest in the income of another trust (Trust Fund "B") which is also contingent on his survival of his mother. [FN3]

According to the Debtor's STATEMENT OF FINANCIAL AFFAIRS FOR DEBTOR ENGAGED IN BUSINESS, he receives $1,100 per month from Trust Fund "D". A review of Debtor's RESPONSES TO REQUESTS TO ADMIT, shows that the Last Will and Testament of Gertrude Lyons does not contain any specific provision restricting the alienability of the Gertrude Lyons Trust. [FN4]

The first issue we address is whether the Debtor's interests in the income of Trust Funds "B" and "D" are property of the estate under 11 USC § 541.

An estate is created upon the commencement of a case under 11 USC §§ 101, et seq. Under 11 USC § 541(a)(1), property of the estate includes "all legal or equitable interests of the debtor in property as of the commencement of the case."

Although property of the estate is defined broadly, § 541(a)(1) expressly limits the estate's property to exclude certain property interests of the Debtor: "Except as provided in subsections (b) and (c)(2) of this section...." Id. § 541(c)(2) states:

***2** (2) A restriction on the transfer [FN5] 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.

The legislative history indicates that Congress intended § 541(c)(2) to preserve the traditional restrictions on transfers of spendthrift trusts to the extent they are enforceable under

applicable nonbankruptcy law. H.R. 95-595, 95th Cong., 1st Sess., 369 (1977); S.Rep. No. 989, 95 Cong., 2d Sess. 83 (1978); Togut v. Hecht (Matter of Hecht), 54 BR 379, 382 (Bkrtcy. S.D.N.Y.1985) affirmed, Togut v. Hecht, 69 BR 290 (S.D.N.Y.1987). "A spendthrift trust is the term commonly used to designate a trust created to provide a fund for the maintenance of the beneficiary and at the same time to secure the trust against the beneficiary's improvidence or incapacity." In re Stephens, 47 BR 85 (Bkrtcy.D.Vt.1985); See, In re Caswell's Estate, 185 Misc. 599, 56 N.Y.S.2d 507, 510 (1944).

The validity of a trust is governed in cases of personalty by the applicable non-bankruptcy law where the trust was created or is to be administered according to circumstance. Spindle v. Shreve, 111 U.S. 542, 547, 4 S.Ct. 522, 525, 28 L.Ed. 512, 514 (1884). The Gertrude Lyons Trust was created under a Will executed in Brooklyn, New York. We are not told where the Will was probated but from the tenor of the briefs we assume New York law applies. See, In re Weinstein's Estate, 176 Misc. 592, 28 N.Y.S.2d 137 (1962). [FN6]

Both parties' memoranda cite N.Y.Est.Power and Trust Law § 7- 1.5(a)(1) (McKinney Supp.1987), stating that all trusts are spendthrift trusts unless the trust specifically provides otherwise. [FN7] N.Y.Est.Power and Trust Law took effect in 1967 and applies only to persons living on or after its effective date. [FN8] Because Gertrude Lyons died in 1957, the applicable law is governed by N.Y.Personal Property Law and Real Property Law. [FN9] The law in force at the time the Trust instrument was executed governs its construction. Fish v. Deady, 215 N.Y.S. 374, 127 Misc. 332 (Sup.Ct.1926).

In New York, the restrictions on an income beneficiary's right to alienate its interest in a trust of personal property was first applied in Graff v. Bonnett, 31 N.Y. 9, 12 N.Y.S.App. 3 (1865). It was adopted legislatively in § 15 of the N.Y.Personal Property Law. [FN10] An income beneficiary's right to alienate its interest in a trust of real property was legislatively adopted in § 103 of the N.Y.Real Property Law. [FN11] Therefore, for purposes of this case, N.Y.Pers. Prop.Law § 15 and Real Prop.Law § 103 renders all trusts in New York mandatory spendthrift trusts.

There are exceptions. The Trustee cites N.Y.Est.Power and Trust Law § 7-3.4, which gives the creditor a right to obtain all income due the beneficiary of a spendthrift trust over and above that required for his education and support. [FN12] This section simply re-enacts N.Y. Real Prop.Law § 98. Section 98 has been applied to personal property trusts by the New York Courts. See In re Brown's Estate, 35 N.Y.S.2d 646, aff'd 264 App.Div. 824, 35 N.Y.S.2d 738 (1941); Wetmore v. Wetmore, 149 N.Y. 520, 44 N.E. 169 (1896).

***3** The Trustee also cites N.Y.Civ.Prac.Law § 5205(e) [sic], which enables a judgment creditor to levy on ten (10%) per cent of the income due a debtor-beneficiary from a spendthrift trust. [FN13] Both parties agree that the Trustee may apply N.Y.Civ.Prac.Law § 5205(d) to attach at least ten (10%) per cent of the debtor's income from the trust accruing

on and after the date of bankruptcy. There is no election of remedies that preclude the Trustee from maintaining actions under both N.Y.Civ.Prac.Law § 5205(d) and N.Y.Est.Power and Trust § 7-3.4. In re Brown's Estate, supra. Therefore, the Trustee may also attach any portion of the remaining ninety (90%) per cent which is over and above the amount necessary for the education and support of the debtor.

Accordingly, we find the Debtor's life estate in the income interest of Trust Fund "D" and his future contingent interest in the income of Trust Fund "B" are inalienable under N.Y.Pers.Prop. Law § 15 and Real Prop.Law § 103 (current version at N.Y.Est.Power and Trust Law § 7-1.5). We also find the Trustee may alienate at least ten (10%) per cent of both trust funds' income under N.Y.Civ.Prac.Law § 5205(d) plus any surplus over and above what is needed for the debtor's education and support under N.Y.Real Prop.Law § 98 and New York case law. This amount that may be alienated must be determined, however, at an evidentiary hearing.

The second issue presented is whether the Debtor's contingent interest in the principal of Trust Fund "D" is property of the estate.

Although the income of a trust is inalienable under N.Y.Real Prop.Law § 103 and Pers.Prop. Law § 15, the statutes also state that: "... the right and interest of the beneficiary of any other trust in [personal/real] property may be transferred...." Id. (parentheticals express interchangeability). This interest includes the Debtor's contingent interest in the principal of Trust Fund "D".

New York has no statutory law restricting the alienability of the principal of a trust. [FN14] Moreover, under the now-repealed N.Y.Real Prop.Law § 59 and N.Y.Pers.Prop.Law § 11 (combined and carried forward in N.Y.Est.Power and Trust Law § 6-5.1), "[a]n expectant estate is descendible, devisable and alienable, in the same manner as estates in possession." Id.

Under New York case law, a future contingent interest in the principal of a trust is transferable, assignable and alienable. In re Estate of Vought, 25 N.Y.S. 163, 343 N.E.2d 343 (1969); In re Brand's Trust, 156 Misc. 312, 281 N.Y.S. 548 (1935); In re Bendheim's Estate, 124 Misc. 424, 209 N.Y.S. 141 (1924); Clowe v. Seavey, 208 N.Y. 497 (1913); Riker v. Gwynne, 201 N.Y. 143, 94 N.E. 632 (1911); Cohalen v. Parker, 138 App.Div. 849, 123 N.Y.S. 343 (1910); Moore v. Littel, 41 N.Y. 66, 16 N.Y.S. 23 (1869).

Moore v. Littel was the first authoritative decision on the effect of the Revised Statutes of 1830, which included the forerunner of N.Y.Real Prop.Law § 59, Pers.Prop.Law § 11, and currently, N.Y.Est.Power and Trust Law § 6-5.1. The Moore Court established the principle that a remainder, whether vested or contingent, could be alienated, even though it might be defeated by the remainderman's death before the life tenant. Moore, 41 N.Y. at 84, 16 N.Y.S. at 28-29.

***4** In Riker v. Gwynne, supra, the Court held that a future contingent interest in real property was alienable and therefore passed to the trustee in bankruptcy. For purposes of alienability, the Court found that the bankrupt's interest contingent upon survivorship became vested upon the death of the testatrix, even though the life tenant was still alive. Riker, 201 N.Y. at 150, 94 N.E. at 634.

It has also been held in Clowe v. Seavey, supra, that a future contingent interest in personal property was alienable and passed to the trustee in bankruptcy. The Court found as irrelevant whether the bankrupt's future interest was contingent or vested. Clowe, 208 N.Y. at 500.

Moreover, in In re Brand's Trust, supra, the Court found that the bankrupt's contingent interest in the remainder of the trust fund was property that was transferable and "though not vested in possession, was vested." Id. at 550. The Court concluded that whether vested or contingent, the bankrupt's remainder interest in the trust fund contingent upon her surviving her mother was descendible, devisable and alienable. Id.

In Cohalen v. Parker, supra, the Court cited to § 59 of the N.Y.Real Property Law (currently Est.Powers and Trust Law 6-5.1) and found that a future interest is descendible, devisable and alienable, whether or not the remainder interest was vested or contingent. The Court concluded that the bankrupt's future interest in the remainder of the trust estate was subject to levy and sale under execution on a judgment against the bankrupt. Id.

Since the trustee in bankruptcy has the same rights as a creditor outside of bankruptcy, the Debtor's contingent interest in the principal of Trust Fund "D" is also subject to levy and sale by the Trustee against the Debtor.

Therefore, under New York law, the Debtor's future contingent interest in the principal of Trust Fund "D" is alienable and must pass to the Trustee in bankruptcy. The Trustee is entitled, however, only to an interest in the remainder. Since the life tenant, Jean Lyons Graham, is still living at this time, the Trustee's interest is without value. [FN15] Thus, the Trustee is not entitled to a distribution of a present valueless remainder. See Matter of Gill, 92 Misc. 661, 155 N.Y.S. 1019 (1915).

The Debtor cites several cases which stand for the proposition that a contingent interest cannot be property of the estate. All of the cases, however, can be distinguished. The holdings in In re Ehle, 109 F. 625 (1901), Elberton v. Swift, 268 F. 20 (5th Cir.1920), and Luttgen v. Tiffany, 93 A. 183 (1915) are based on non-New York case law that recognizes a difference between a vested and a contingent interest--only the former being vested and transferable to a trustee in bankruptcy.

The Court in In re Brand's Trust, however, citing to, inter alia, Moore v. Littel, supra, and Clowe v. Seavey, supra, found that whether the contingency was vested or contingent was

irrelevant under New York law. In re Brand's Trust, 281 N.Y.S. at 550.

***5** Accordingly, we find the Trustee can attach as property of the estate the Debtor's contingent interest in the principal of Trust Fund "D".

An appropriate Order will be entered in accordance with this Memorandum Decision.

FN1. We have jurisdiction to hear this adversary proceeding under 28 U.S.C. § 1334(b) and determine it to be a 28 U.S.C. § 157(b)(2)(E) core matter. This Decision shall constitute findings of fact and conclusions of law under Rules Practice and Procedure in Bankruptcy Rule 7052, as made applicable by F.R.Civ.P. 52.

FN2. Article Eleventh, Part B(4)2 of the Gertrude Lyons' Will instructed the trustee of the trust:

To invest, reinvest and keep TRUST FUND "D" invested, to collect and receives the rents, issues and profits thereof, and after deducting all lawful charges and expenses, to pay or apply the balance of income to the use of the aforesaid children of my daughter, JEAN LYONS GRAHAM, or to the use of the survivors or survivor of them, during the life of my daughter, JEAN LYONS GRAHAM, and upon the death of my daughter, JEAN LYONS GRAHAM, the then principal of the trust fund shall be paid over to the issue of my daughter, JEAN LYONS GRAHAM, living at her death, in equal shares....

FN3. Article Eleventh, Part B(2)(a) states:

Part B: (1) To hold such part IN TRUST and to invest, reinvest and keep the same invested, to collect and receive the rents, issues, income and profits therefrom, and, after paying all proper charges and expenses, to pay or apply the net income therefrom to the use of my daughter, JEAN LYONS GRAHAM, during her life.

(2) Upon the death of my said daughter, JEAN LYONS GRAHAM, or if she shall have predeceased me, then upon my death, I direct my Trustees to divide in the former event the principal of such trust fund, or in the latter event the part of my residuary estate that would have been held in trust during the life of my daughter, JEAN LYONS GRAHAM, had she survived me, as the case may be, into as many equal shares as there shall be children of my daughter, JEAN LYONS GRAHAM, surviving at the time of such division and deceased children of my daughter, JEAN LYONS GRAHAM, leaving issue surviving at the time of such division, and dispose of such shares as follows:

(a) To hold the share of each child of Jean Lyons Graham living at my death and surviving at the time of such division IN TRUST and to invest, reinvest, and keep the

same invested, to collect and receive the rents, issues, income and profits therefrom, and after paying all lawful charges and expenses, to pay or apply the net income to the use of such child during his or her life....

FN4. Compare, In re Estate of Vought, 25 N.Y.S. 163, 343 N.E.2d 343 (1969) (Will of testator to make principal remainder inalienable during term of life estate should be given effect.).

FN5. 11 USC § 101(50) defines "transfer" to mean "every mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with property or with an interest in property, ..." Id.

FN6. The testator, Gertrude Lyons, failed to designate what State law applies to the administration of her trust.

FN7. N.Y.Est.Powers and Trust Law § 7-1.5(a)(1) states:

(a) The interest of the beneficiary of any trust may be assigned or otherwise transferred, except that:

(1) The right of a beneficiary of an express trust to receive the income from property and apply it to the use of or pay it to any person may not be transferred by assignment or otherwise unless a power to transfer such right, or any part thereof, is conferred upon such beneficiary the instrument creating or declaring the trust.

N.Y.Est.Powers and Trust Law § 7-1.5(a)(1) (McKinney Supp.1987) (re- enacting N.Y. Real Property Law § 103 and Personal Property Law § 15).

FN8. N.Y.Est.Power and Trust Law § 1-1.5 states:

Unless otherwise stated therein, the provisions of this chapter apply to the estates, and to instruments making dispositions or appointments thereof, of persons living on its effective date or born subsequent thereto, without regard to the date of execution of any such instrument; except that the provisions of this chapter shall not impair or defeat any rights which have accrued under dispositions of appointments in effect prior to its effective date. N.Y.Est.Power and Trust Law § 1-1.5 (McKinney 1967).

FN9. On September 1, 1967, N.Y.Est.Power and Trust Law repealed N.Y.Personal Property Law and Real Property Law, re-enacting many of the latter's provisions.

FN10. N.Y.Pers.Prop.Law § 15 states:

1. (a) The right of the beneficiary to enforce the performance of a trust to receive the income of personal property, and to apply it to the use of any person, cannot be transferred by assignment or otherwise. But the right and interest of the beneficiary of any other trust in personal property may be transferred....

N.Y.Pers.Prop.Law § 15 (current version at N.Y.Est.Powers and Trust Law § 7-1.5 (McKinney 1967, see also, McKinney Supp.1987).

FN11. N.Y.Real Prop.Law § 103 states:

1. (a) The right of a beneficiary of an express trust to receive rents and profits of real property and apply them to the use of any person, can not be transferred by assignment or otherwise, but the right and interest of the beneficiary of any other trust in real property may be transferred.

N.Y.Real Prop.Law § 103 (current version at N.Y.Est.Powers and Trust § 7-1.5 (McKinney 1967, see also, McKinney Supp.1987).

FN12. N.Y.Est.Powers and Trust Law § 7-3.4 states:

Where a trust is created to receive the income from property and no valid direction for accumulation is given, the income in excess of the sum necessary for the education and support of the beneficiary is subject to the claims of his creditors in the same manner as other property which cannot be reached by execution.

N.Y.Est.Powers and Trust Law § 7-3.4 (McKinney 1967) (reenacting N.Y.Real Prop.Law § 98).

FN13. N.Y.Civ.Prac.Law § 5205(d) states:

(d) Income exemptions. The following personal property is exempt from application to the satisfaction of a money judgment, except such part as a court determines to be unnecessary for the reasonable requirements of the judgment debtor and his dependents:

1. ninety per cent of the income or other payments from a trust the principal of which is exempt under subdivision (d) [sic].

N.Y.Civ.Prac.Law § 5205(d) (McKinney 1967).

FN14. See, In re Estate of Vought, supra, fn. 4.

FN15. Our conclusion is based upon the pragmatic realization that if the remainder interest was to be sold by the Trustee no one would purchase it while Jean Lyons Graham is alive. Accordingly, the Trustee's interest is worthless.

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