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UNITED STATES BANKRUPTCY COURT
DISTRICT OF VERMONT

In re:	Chapter 7
GARY A. FREDETTE	Case # 99-10321 cab
Debtor.	

Appearances of Counsel:

John R. Canney III, Esq.	*Carl O. Anderson, Esq.*	*Michael Palmer, Esq.*
Rutland, VT	*Rutland, VT*	*Middlebury, VT*
Chapter 7 Trustee	*Trustee Smith's Counsel*	*Debtor's Counsel*

MEMORANDUM OF DECISION
EXCLUDING TRUST INTEREST FROM BANKRUPTCY ESTATE
AND APPROVING DISTRIBUTION OF TRUST PROCEEDS

Sharon Smith, as Trustee of the Shirley M. Fredette Revocable Living Trust (hereafter "the Trust") has filed a Motion for Order Confirming Distribution of Trust Proceeds that raises a trust issue under state law as well as a property of the estate issue under bankruptcy law. A hearing was held on February 6, 2001 and the Court took the matter under advisement. For the reasons set forth below, the Court finds that the debtor's one-fourth share of the residue of the Trust is not property of the debtor's chapter 7 estate and grants Trustee Sharon Smith's motion for an order allowing distribution of trust proceeds.

This Court has jurisdiction over the issues raised pursuant to 28 U.S.C. §§ 157 and 1334.

BACKGROUND

On March 12, 1999, the debtor filed a voluntary petition for relief under chapter 7 of title 11 U.S.C. ("the Bankruptcy Code"). Thereafter, on February 23, 2001, the debtor filed various amendments to Schedules B, C and F. In pertinent part, Schedule C was amended to include as exempt a one-fourth

interest in the residue of the Shirley A. Fredette Living Trust, with a current market value of $17,000, specifying that the residual trust interest was not property of the estate pursuant to 11 U.S.C. §541(c)(2). Schedule C, as amended, also provides that the subject trust interest is exempt pursuant to 12 V.S.A. §2740(7) in the amount of $7,400 and 12 V.S.A. §2740(15) in the amount of $700. Schedule B, as amended, lists the debtor's one-fourth interest in the Trust as personal property under the section "contingent and non-contingent interests in estate or a decedent, death benefit plan, life insurance policy, or trust," with the debtor indicating a current market value of $17,606.82. Schedule F, as amended, includes the Trust as the holder of an unsecured non-priority claim, in connection with a loan due to Sharon Smith, as Trustee, in the amount of $7,519.21. The debtor amended the mailing matrix on February 23, 2001, to include Sharon Smith, Trustee. To date, the Trust has not filed a proof of claim herein.

The Shirley M. Fredette Revocable Living Trust was created November 10, 1997 [Trustee's Memorandum of Law, Exh. A - Shirley M. Fredette Revocable Living Trust - Revocable Living Trust Agreement]. There is no dispute that Shirley M. Fredette was both the settlor and the initial Trustee. The Trust provides that during Ms. Fredette's lifetime the Trustee shall distribute to Ms. Fredette all income and principal as she directs (the Trust, para. 12) and in the event a successor Trustee is appointed, the successor Trustee is to provide for Ms. Fredette's "proper health, maintenance and welfare" as the successor Trustee deems "necessary or advisable" in the event of Ms. Fredette's disability (the Trust, para. 13). The Trust also provides that Ms. Fredette, as Trustee, reserves the right to amend any provision or to revoke the Trust in its entirety at any time (the Trust, para. 14). The Trust corpus consists of two parcels of Vermont real estate and "all personal property, including jewelry, furniture, appliances, personal effects, silverware, furnishings and specifically including items mentioned in my trust." (*See,* the Trust, Schedule of Trust Property). The Trustee is granted broad powers over the management, acquisition and disposition

of all Trust property and further provides that upon the death of Ms. Fredette, the successor Trustee shall pay *inter alia* all final medical expenses, the expenses of the Trust's administration, any probate expenses, and all legally enforceable claims. After payment of the authorized expenses, the successor Trustee is directed to make specific distributions of Trust funds and personal property to various individuals identified in the Trust and to provide "to each then living child of [Ms. Fredette], a one-fourth share of the rest and residue of the Trust estate." (The Trust, at para. 17). The Trust also specifies that the "Trustee's obligations hereunder shall terminate upon the disbursement of all sums held or due hereunder and the completion of any reports or account with respect thereto." The Trust is governed by Vermont law (the Trust, para. 26).

Of particular significance in this proceeding, the Trust includes a classic anti-alienation clause which states:

> Neither the income nor the principal of the trusts created hereunder shall be alienable by any beneficiary either by assignment or by any other method and the same shall not be subject to be taken by his or her creditors by any process whatever.

The Trust, at para. 19. The debtor contends that as a result of this anti-alienation clause, the Trust established a "spendthrift trust" in his favor under Vermont law, thereby excluding his interest in the Trust from being property of his bankruptcy estate. The chapter 7 trustee disagrees and asserts that a review of the entire Trust reflects that Ms. Fredette is the sole trust beneficiary. The chapter 7 trustee takes the position that since the debtor is receiving his distribution as a remainderman of the Trust, he is not receiving it as a beneficiary, and because the Trustee is mandated to distribute the remaining Trust assets to the debtor and others without any discretion to retain assets for the benefit of these distributees, the anti-alienation provision does not apply to any distribution from the Trust to the debtor.

It is undisputed that the settlor and initial Trustee of the Trust, Shirley M. Fredette, died before the commencement of this case, and likewise undisputed that the successor Trustee of the Trust has not made

any disbursements of the proceeds from the Trust to the debtor as of the date of the hearing in this matter. The record also reflects that on February 17, 1999, the Trustee executed a Promissory Note evidencing a pre-petition loan to the debtor in the amount of $7,519.21 with the purpose of the loan identified to be "to pay current and delinquent taxes on mobile home ... so it may be moved" (hereinafter the "Note"). The Note required that the debtor repay the loan to the Trust, without interest, from the proceeds of the sale of the mobile home and that the loan balance, if any, would be paid upon the disbursement of the Trust, less any amount previously paid from the sale of the mobile home [see Motion for Order Confirming Distribution of Trust Proceeds, Exh. A - Promissory Note].

ISSUE

The issue presented is whether the debtor's remainder interest in the Trust renders him a beneficiary whose interest is subject to a valid anti-alienation provision of the Trust, and if so, if this compels exclusion of his interest from the bankruptcy estate pursuant to 11 U.S.C. §541(c)(2).

DISCUSSION

Under the Bankruptcy Code, a bankruptcy estate is created upon the commencement of a case under 11 U.S.C. §101, *et seq.* and generally consists of "all legal or equitable interests of the debtor in property as of the commencement of the case" wherever located and by whomever held. 11 U.S.C. §541(a)(1). However, §541(c)(2) limits to some extent the very broad definition of property of the estate by explicitly providing that "[a] restriction on a transfer of a beneficial interest of the debtor in a trust that is enforceable under applicable non-bankruptcy law is enforceable in a case under this title." The debtor contends that in light of the anti-alienation clause contained in the Shirley M. Fredette Revocable Living Trust, his beneficial interest in the Trust is subject to a valid transfer restriction under state law and is

therefore not property of the estate. If he is correct, his interest in the Trust is beyond the reach of both his creditors and the chapter 7 trustee. In seeking to have the debtor's interest under this Trust deemed to be property of the bankruptcy estate, the chapter 7 trustee argues, first, the debtor is not a beneficiary within the context of the spendthrift provision of the Trust; and second, the restriction on transferability does not apply to debtor's remainder interest. The Court is not persuaded by either argument.

It is well-settled that §541(c)(2) exempts from a bankruptcy estate traditional spendthrift trusts that are valid under applicable non-bankruptcy law. *See* In re Goldberg, 98 B.R. 353, 356 (Bankr. N.D.Ill. 1989). "A trust in which by the terms of the trust or by statute a valid restraint on the voluntary and involuntary transfer of the interest of the beneficiary is imposed is a spendthrift trust." In re Estate of Brown, 528 A.2d 752, 754-55, 148 Vt. 94 (1987)(quoting Restatement (Second) of Trusts §152(2)); *see also* Huestis v. Manley, 8 A.2d 644, 110 Vt. 413 (1939). However, §541(c)(2) does not include the words "spendthrift trust" and rather makes clear that the essential issue is the presence of an anti-alienation clause. Furthermore, while no specific language is needed to create a spendthrift trust, *see* In re Brown, *supra*, the Bankruptcy Code provision does require that the restraint on the voluntary and involuntary transfer of the interest must pertain to the debtor's beneficial interest under a trust. In construing §541(c)(2), the United States Supreme Court has observed:

> The natural reading of the [§541(c)(2)] provision entitles a debtor to exclude from property of the estate ***any interest*** in a plan or trust that contains a transfer restriction enforceable under any relevant nonbankruptcy law.

Patterson v. Shumate, 504 U.S. 753, 758, 112 S.Ct. 2242, 119 L.Ed.2d 519 (1992)(emphasis added). Based upon the plain meaning of the statute and the terms of the Trust, this Court finds that the debtor's remainder interest constitutes a "beneficial interest" under §541(c)(2). The critical issue hence becomes whether the subject anti-alienation clause applies to the debtor and constitutes a "restriction on the transfer

of a beneficial interest **of the debtor**" under the Bankruptcy Code.

In this instance, the settlor, Ms. Fredette, established an arrangement whereby certain real and personal property was held in trust for her support and maintenance during her life, while also reserving to her the right to amend or terminate the Trust at any time. The Trust additionally provided for the disposition of certain items of personal property and the remaining assets in the Trust to designated individuals upon the settlor's death. Thus, it appears the settlor actually intended to and did effectively create two trusts: an overall trust disposing of her testamentary estate and a narrower trust designed to provide for her health, support and maintenance. In determining the purpose of a trust under Vermont law, the dominant factor is the intent of the settlor. *See* Proctor v. Woodhouse, 241 A.2d 785, 789, 127 Vt. 148 (1968). The intent of a settlor is determined by the language of the instrument. *See* In re Carter's Will, 134 A. 581, 99 Vt. 480 (1926). A settlor's intention to create a spendthrift trust will be given effect. Town of Shrewsbury v. Bucklin, 163 A. 626, 105 Vt. 188 (1933).

Ms. Fredette has clearly evidenced her intent to create a gift for the benefit of the debtor by virtue of the residual provision and clearly evidenced her intent to protect this interest from alienation and his creditors by the unambiguous language of the Trust. In the subject anti-alienation clause, the settlor speaks of the applicable "trusts", in the plural, which this Court finds sufficient to reflect the creation of two distinct trusts, one for her own benefit and one for the benefit of her children and grandchildren. Moreover, the Trust speaks of "his or her creditors" when referring to beneficiaries and would not need the term "his" if she considered herself to be the sole beneficiary. Neither of these designations is consistent with an intent to create a single trust of which Ms. Fredette was the sole beneficiary.

In determining whether the debtor's remainder interest in the Trust is property of his bankruptcy estate, this Court finds the case of In re Mackta, 261 B.R. 189 (Bankr. E.D. Va. 2000) to be analogous

and persuasive. In Mackta, a credit shelter trust was created with a spendthrift clause that provided for the support and maintenance of the testatrix's husband for life with the trust principal being paid to the debtor thereafter. In language similar to the anti-alienation provision here, the trust provided that no beneficiary thereunder would be entitled to alienate his or her interest in the trust income or principal, and that this interest would not be subject to the claims of creditors of such beneficiary. Upon filing for bankruptcy relief, the debtor sought to exclude his remainder interest in the trust from his bankruptcy estate. A judgment creditor opposed the exclusion and argued that the debtor was not a "beneficiary" under the terms of the trust established by the debtor's mother. In rejecting this assertion, the Mackta court noted that the term beneficiary was not defined in the instrument and therefore relied upon common usage to find:

> Beneficiary, 'as it relates to trust beneficiaries, includes a person who has any present or future interest, vested or contingent...' BLACK'S LAW DICTIONARY142 (5th ed. 1979). Moreover, 'remainder' is defined as '[t]he property that passes to a beneficiary after the expiration of an intervening income interest.' *See id.* at 1162.

Thus, this Court finds that a debtor who holds a remainder interest may be a trust beneficiary. *See also* In re Blanchard, 201 B.R. 108 (Bankr. E.D. Pa. 1996)(debtor's remainder interest in spendthrift trust corpus rendered the debtor a trust beneficiary thereunder and his interest was not property of bankruptcy estate); In re Baydush, 171 B.R. 953 (E.D.Va. 1994)(reversing bankruptcy court and holding that a debtor's contingent remainder interest in spendthrift trusts was nontransferable and thus not included in bankruptcy estate); In re Hannegan, 155 B.R. 209 (E.D.Mo. 1993)(debtor's contingent remainder interest continued to enjoy protection of spendthrift clause and was not bankruptcy estate property accordingly); In re Wax, 147 B.R. 205 (Bankr. D.S.D. 1992)(debtor's contingent remainder interest in spendthrift trust excluded from bankruptcy estate); In re Davis, 110 B.R. 573 (Bankr. M.D.Fla. 1989)(debtor's contingent remainder interest in father's will was not bankruptcy estate property because it was subject to a spendthrift

clause).

Moreover, the fact that the debtor's interest was contingent does not diminish the potency of the anti-alienation clause, as to him. See In re Baydush, 171 B.R. at 956-57; In re Hannegan, 155 B.R. at 213.

The Court's determination that the debtor is a beneficiary under the subject anti-alienation clause by virtue of his remainder interest in this Trust is consistent with Vermont law. *See* Noyes v. Noyes, 9 A.2d 123, 110 Vt. 511 (1939) (testator's three children who received remainder interest in trust estate are described as trust beneficiaries). Not only does this result align with the testatrix's intent as manifested by the language of the Trust, it is also consistent with the doctrine in Vermont that property may be made inalienable by provision of a spendthrift trust based on the theory that the donor has a right to give his or her property to another upon any conditions which the donor sees fit. *See* Huestis v. Manley, 8 A.2d 644, 646, 110 Vt. 413 (1939).

Since the Court has found (i) the debtor to be a beneficiary under the trust who is protected by the anti-alienation clause; (ii) that the successor trustee had not distributed any funds to the debtor as of the date of the bankruptcy filing, and (iii) that the restrictions upon the transferability or alienation of the debtor's remainder interest were valid as of that date, the Court concludes that pursuant to 11 U.S.C. §541(c)(2) this interest is excluded from the debtor's bankruptcy estate. *See* In re Stephens, 47 B.R. 85 (Bankr. D. Vt. 1985); Huestis v. Manley, *supra*.

In reaching the determination that the debtor is a beneficiary under the Trust for purposes of the valid anti-alienation clause, this Court makes no finding as to whether the subject clause otherwise satisfies the requirements for a spendthrift trust under applicable non-bankruptcy law as to the settlor. The issue

of the enforceability of the anti-alienation clause against Ms. Fredette's creditors is inapposite and has no impact upon the validity of the transfer restriction on the residual interest of the debtor.

The Court also declines to determine whether the Trust has a valid or enforceable claim against the bankruptcy estate or a lien against the proceeds of any sale of the debtor's mobile home pursuant to the terms of the subject Promissory Note as that issue is not before the Court at this time. Although the debtor amended his schedules on February 23, 2001 to include the claim of the Trust as an unsecured nonpriority claim against debtor's bankruptcy estate, any dispute regarding an allegedly offsetting claim by the Trust related to its pre-petition loan of $7,519.21 to the debtor pursuant to the terms of the Note is not ripe for determination because no proof has been presented on that issue.

CONCLUSION

The motion filed by the Trustee of the Shirley M. Fredette Revocable Living Trust is approved and the Trust is authorized to disburse to the debtor the amount of $17,606.82 accordingly.

July 19, 2001
Rutland, VT

/s/ Colleen A. Brown
Colleen A. Brown
United States Bankruptcy Judge