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IN THIS ISSUE

A DEBTOR CANNOT CLAIM AN EXEMPTION IN PROPERTY IN WHICH SHE HAS NO INTEREST

In the case of *Stephens vs. Hedback, et. al*., 09-6083, (8th Cir. B.A.P. 2010), the debtor, G. Yvonne Stephens ("Stephens"), appealed an Order of the Bankruptcy Court which approved a settlement between the trustee of her Chapter 7 bankruptcy estate and the trustee of her husband's separate Chapter 7 bankruptcy estate, with regard to a property located at 875 Laurel Avenue in St. Paul. In her appeal to the 8th Circuit's Bankruptcy Appellate Panel, she claims that the Order was entered without consideration of and in direct contravention to her ownership interest in a property. The B.A.P. found none of her arguments to be persuasive and upheld the Bankruptcy Court's Order approving the trustees' settlement.

Stephens filed a Chapter 7 bankruptcy in 1998. Her case was assigned to Trustee John Hedback. Her then husband also filed a separate Chapter 7 case in the same year and his case was assigned to Trustee Mary Jo A. Jensen-Carter. The property located at 875 Laurel Avenue became the subject of extensive litigation in both bankruptcy cases.

Most relevant to this appeal was a 2006 Order in which the Bankruptcy Court held that neither Stephens nor her husband were entitled to claim an ownership interest in the Laurel property and that neither had properly claimed a homestead exemption with respect to the property. Additionally, the Court held that because Stephens' trustee had not abandoned the estate's interest in the property, the only issues left to decide with respect to the property were between the bankruptcy trustees of the two estates.

This Order was affirmed by the District Court. Not only did the District Court agree that neither Stephens nor her husband had an ownership or exemption interest in the property, but the Court added that Stephens and her husband were vexatious litigants who were congesting the court's dockets and who were barred from making any further filings of any kind with regard to the Laurel property unless signed by an attorney or they obtained prior permission from the court to file such pleadings. This Order was also affirmed by the Eighth Circuit

In the midst of the appeals on the 2006 Order, Stephens filed amended schedules in which she attempted to exempt the Laurel property as her homestead. Both trustees objected to her claimed exemption and both objections were stayed pending the outcome of the appeal of the 2006 Order.

In November of 2009, the trustees reached an agreement with respect to the Laurel property and filed motions asking the Court to approve their settlement. Stephens filed an objection to the settlement *pro se* and without prior court approval in direct violation of the District Court's Order barring her from doing so. Despite her violation of the Order, the Bankruptcy Court allowed Stephens to argue her position at the hearing. The Bankruptcy Court held that Stephens clearly had no interest in the Laurel property based on prior orders of the courts, and that her attempt to claim an exemption in the property had no effect. The Bankruptcy Court approved the settlement. Stephens appealed to the

B.A.P. from the Bankruptcy Court's Order approving the settlement.

The B.A.P. considered her appeal on the merits despite the District Court's bar on Stephens' filings because her appeal was signed by an attorney.

Despite a debtor's right under Rule 1009 to amend her schedules at any time before the case is closed, and despite the general rule that exemptions are presumptively valid, the B.A.P. determined that Stephens could not claim an exemption in property in which she has no interest. The Court noted that simply filing amended schedules in an attempt to exempt the property will not undo all of the prior Orders stating that she had no interest in said property. They upheld the Bankruptcy Court's Order which held that her claim of exemption in the property had no effect.

The B.A.P. did not consider the remainder of Stephens' arguments because they all assumed she had an ownership interest in the Laurel Avenue property. Since the prior orders stating she had no interest in the property had been upheld and since the B.A.P. held that she could not exempt property in which she had no interest, the other issues she raised were moot. The B.A.P. affirmed the Bankruptcy Court's order approving the trustees' settlement with respect to the Laurel Avenue property.

THE ELECTION OF A NEW CHAPTER 13 TRUSTEE WAS NOT PROPERLY CALLED BY A QUORUM OF ELIGIBLE UNSECURED CREDITORS

In *In re Petters Company, Inc., et al*, 425 B.R. 534 (Bankr. D. Minn. 2010), the Bankruptcy Court examined whether a Chapter 11 trustee was properly elected at a meeting of creditors in the bankruptcy case of Petters Group Worldwide, LLC ("PGW"). Several creditors of PGW ("Creditors") filed a request to the U.S. Trustee to convene a meeting of creditors for the purpose of electing a trustee in that case. After proper notice, the U.S. Trustee convened a meeting of creditors. Following the meeting of creditors, the U.S. Trustee filed a report of the election noting that although two creditors cast ballots at the meeting of creditors in favor of a new trustee, the election was disputed because there was an insufficient number of creditors that were qualified to vote under Section 702(a). Therefore, the U.S. Trustee concluded that the voting quorum of Section 702(b) was not met, a valid election did not occur, and as a result, the trustee appointed by the Court earlier in the case remained the trustee of PGW. Shortly thereafter, the Creditors filed a motion pursuant to Bankruptcy Rule 2003(d)(2) seeking resolution of the disputed election.

In its decision, the Court focused on the two challenges a creditor must overcome in order to prove entitlement to participate in the election of a trustee. First, the creditor must qualify to vote at an election as required by Section 702(a), which provides that "(a) a creditor may vote for a candidate for trustee only if such creditor— (1) holds an allowable, undisputed, fixed, liquidated, unsecured claim…; (2) does not have an interest materially adverse…to the interest of creditors entitled to such distribution; and (3) is not an insider." Second, the creditor must be entitled to vote under Bankruptcy Rule 2003(b)(3), which provides that "…a creditor is entitled to vote at a meeting if, at or before the meeting, the creditor has filed a proof of claim or a writing setting forth facts evidencing a right to vote pursuant to Section 702(a)…unless objection is made to the claim or the proof of claim is insufficient on its face…."

The Court's decision described the specific characteristics of each of the six types of creditors that participated in the election process and then applied the requirements of Section 702(a) to each of the creditor's claims. Several of the participating creditors were listed in PGW's schedules as holders of unliquidated and disputed claims or filed claims that were objected to prior to the meeting of creditors, while some of the creditors were not listed in PGW's schedules and did not file proofs of claim. In its analysis of each of the creditors, the Court focused on the following three distinctions to determine whether a creditor was entitled to vote for the election of a trustee: (i) whether the creditor holds an unsecured versus a secured claim; (ii) whether the claim is undisputed versus disputed; and (iii) whether or not the creditor holds an interest that is materially adverse to the interest of creditors entitled to a distribution from PGW's estate.

The U.S. Trustee ("Trustee") challenged the Creditors' qualification to vote on all three of these grounds, while the Unsecured Creditors' Committee ("Committee") challenged the Creditors' qualification on two of these grounds. First, the Trustee asserted that because the Creditors held secured claims, they were not qualified to vote under Section 702(a). The Court found this argument flawed because the classification of the Creditors as secured creditors was based upon the debtor's scheduling of the debt and claims filed by the Creditors not in the PGW case, but in the bankruptcy cases of related subsidiaries. Next, both the Trustee and the Committee alleged that the Creditors were not qualified to vote because they held disputed claims. The Court rejected this argument because it determined that a claim is disputed under Section 702(a) only when an objection to the claim is filed that disputes the legal or factual merits of the claim and because the Committee filed an objection to the Creditors' claims on the eve of the meeting of creditors for the purpose of determining the Creditors' eligibility to vote in the trustee election and failed to assert substantive challenges to the claims, the claims were not disputed. The Court agreed with the third argument raised by the Trustee and the Committee that the Creditors' claims were materially adverse to the interest of other creditors entitled to distribution. As a result, the Court determined that the Creditors were not qualified to vote for a trustee.

The Court also examined the other creditor groups that participated in the election of a trustee by analyzing whether or not the claims were disputed and materially adverse. The Court reiterated the distinction that a claim is deemed disputed as long as there is an objection to the claim on file at the time of the election that disputes the legal or factual merits of the claim. As for whether a creditor's claim is materially adverse, the Court concluded that "the comparison is between the nature, magnitude, and degree of the subject creditor's interest, and the interests of the general body of unsecured creditors." When applying these factors to determine whether these creditor groups were qualified to vote under Section 702(a), the Court found that four of the other creditor groups were qualified to vote and only one other creditor group was not qualified to vote. Irrespective of the Court's conclusion that four of the creditors were qualified to vote, the Court was still required to apply Section 702(b) to determine whether the election was properly called by the "…requisite fraction of the statutorily-specified creditor constituency…" pursuant to Section 702(b). After applying the statutory calculations to the claims of the two qualified creditors that requested the election, the Court concluded that the Creditors were not entitled to vote and the remaining creditor that voted did not hold a claim that met the minimum value-amount for requesting a forum under Section 702(b). For these reasons, the Court held that the election of a new Chapter 11 trustee was not properly called by a quorum of eligible unsecured creditors; therefore, the existing Chapter 11 trustee remains the trustee of PGW.

LENDER'S PRE-PETITION SECURITY INTEREST DID NOT EXTEND TO POST-PETITION SALE PROCEEDS

In *In re Genmar Holdings, Inc.*, *et al.*, (Bankr. D. Minn. Feb. 26, 2010), the Bankruptcy Court denied lender's request for allowance of an administrative expense on the grounds that the lender's claim arose pre-petition and the lender's security interest did not extend to the proceeds of the post-petition sale of the collateral.

The Debtors built and sold boats to dealers. Textron Financial Corporation (the "Claimant") provided dealers with floor plan financing enabling them to purchase boats from the Debtors. The Debtors and the Claimant were parties to a repurchase agreement that required the Debtors to purchase from the Claimant any boats repossessed by the Debtors and financed by the Claimant.

When a dealer defaulted, the Debtors took direct physical possession of the boats, resold them to other dealers and paid the Claimant the repurchase price out of the proceeds. On the petition date, the Debtors were in possession of a number of boats subject to the repurchase agreement, which the Debtors subsequently sold post-petition. The Claimant received no payment on account of these post-petition sales and therefore sought allowance of an administrative expense claim in its favor on account of the sales.

In denying the Claimant's request, the Court first considered whether the claim was in fact an administrative expense. In so doing, the Court noted that the Debtors' obligation to pay the Claimant pursuant to the repurchase agreement arose at the time a dealer defaulted not upon the Debtors' resale of the boats. As such, the Court found that the Claimant's claim arose pre-petition and was therefore not an administrative expense.

The Court then turned its attention to the crux of the Claimant's motion--the status of the Claimant's pre-petition claim. The Claimant argued that it had a senior perfected purchase-money security interest in the boats at the time the Debtors took possession of them. The implication from this argument and basis for the Claimants motion, the Court noted, was that the Claimant's security interest extended to the proceeds generated from the sale of the boats.

The Court found that the terms of the repurchase agreement indicated that the taking of possession of the boats by the Debtors was a foreclosure sale under Article 9 of the Uniform Commercial Code. As such, the Claimant's interest in the boats after the sale to the Debtors was limited to a reservation of its purchase-money interest. As the Court pointed out, however, the Claimant did not file a UCC-1 financing statement against the Debtors. The Claimant's interest in the boats was therefore unperfected, junior to the senior lien of the Debtors' lender and simply an unsecured pre-petition claim under 11 U.S.C. § 506(a).

DEBTOR'S INTEREST IN INTER VIVOS TRUST WITH SPENDTHRIFT CLAUSE NOT PROPERTY OF THE ESTATE

In the case of *In re Brown*, 08-35504 (Bankr. D. Minn. Feb. 11, 2010) (J. O'Brien), Chapter 7 debtor, Randall Brown, was the beneficiary of an inter vivos trust with a spendthrift provision. Relying on 11 U.S.C. §§ 541(a)(5) and 541(c)(2), the court held that Brown's interest and subsequent distribution from the trust did not constitute property of the estate.

Prior to Brown's Chapter 7 petition, Brown's cousin executed a will and established a revocable trust, which, of importance, contained a spendthrift clause. Under the will and trust, Brown inherited a portion of the cash residue of his cousin's estate. Also, prior to Brown's Chapter 7 petition, Brown's cousin died, whereupon probate proceedings commenced and continued through the beginning of Brown's bankruptcy proceeding.

On his schedules, Brown claimed an exemption of $500 for his interest in the trust. Later, Brown's share of the trust was determined to be approximately $35,300. This amount, less the $500 exemption, was distributed to the Chapter 7 trustee. Brown moved to compel the trustee to abandon that distribution on the basis that it was not part of the estate as a result of the inter vivos trust's spendthrift provision.

Notwithstanding the inter vivos nature of the trust, the Chapter 7 trustee contended that the "testamentary effect" of the distribution from the trust subjected the distribution to § 541(a)(5). In pertinent part, § 541(a)(5) provides that an estate is comprised of "any interest in property that would have been property of the estate if such interest had been an interest of the debtor on the date of the filing of the petition, and that the debtor acquires or becomes entitled to acquire within 180 days after such date – (A) by bequest, devise, or inheritance." However, case law holds that post-petition transfers from inter vivos trusts do not fall within the scope of § 541(a)(5)(A). The Court thereby rejected the Chapter 7 trustee's argument and held that because Brown, by way of the Chapter 7 trustee, received his distribution from the inter vivos trust post-petition, § 541(a)(5) was inapplicable.

The Chapter 7 trustee further argued that the testamentary or inter vivos nature of the trust should not control the outcome of the case, rather, the crucial inquiries were when the interest from the trust vested and was distributed. Because

Brown's interest was distributed upon the death of his cousin, before Brown filed for bankruptcy, the Chapter 7 trustee asserted that at the time of his cousin's death, Brown had a vested interest, which was property of the estate. In rejecting this argument, the court cited §§ 541(a)(1) and 541(c)(2), which state that an estate is comprised of "all legal or equitable interests of the debtor in property as of the commencement of the case" provided, however, that any "restriction on the transfer of a beneficial interest of the debtor in a trust that is enforceable under applicable non-bankruptcy law." Looking to the spendthrift clause, which was enforceable under controlling non-bankruptcy law, the court held that regardless of whether the transfer had occurred pre-petition or post-petition, the transfer necessarily was excluded from the estate. Accordingly, the court ordered the Chapter 7 trustee to abandon the distribution.