Is It or Is It Not Property of the Estate? § 541 Conundrums

Hon. James W. Boyd, Moderator
U.S. Bankruptcy Court (W.D. Mich.); Grand Rapids

Joseph A. Baldi
Baldi Berg & Wallace, Ltd.; Chicago

Andrew W. Muller
Stinson Leonard Street LLP; Kansas City, Mo.

Claire Ann Resop
Steinhilber, Swanson & Resop; Madison, Wis.

IS IT OR IS IT NOT PROPERTY OF THE ESTATE – SECTION 521 CONUNDRUMS

Joseph A. Baldi
Baldi Berg, Ltd.; Chicago, IL

Hon. James W. Boyd
U.S. Bankruptcy Court (W.D. Mi.); Grand Rapids, MI

Andrew Muller
Stinson Leonard Street LLP; Kansas City, MO

Claire Ann Resop
Steinhilber Swanson Resop & Sipsma; Madison, WI

IS IT OR IS IT NOT PROPERTY OF THE ESTATE – SECTION 521 CONUNDRUMS

I. EARNINGS:

- Claire Ann Resop

A. Unfinished Business Doctrine: *Geron v. Seyfarth Shaw (In re Thelen LLP*), 736 F.3d 213 (2d. Cir. Nov. 15, 2013) and *In re Coudert Brothers LLP v Development Specialist, Inc., et al. (In re Coudert Brothers, LLP*), 2014 WL 293152 (N.Y. Ct. App., July 1, 2014); *In re Scotchel*, 2013 Bankr. LEXIS 1736 (Bankr. N.D. W.Va. 2013; *Segal v. Rochelle,* 382 U.S. 375 (1966): Hourly fees from the unfinished cases are only property of the bankruptcy estate if the hours were incurred while in the employ of a debtor. Contingency fees are property of the estate for the portion incurred while in the employ of debtor, and pre-petition, for an amount that is *quantum meruit* for the effort involved.

B. Earnings from filing of Chapter 11 until conversion to Chapter 7:

1. Debtor's post-petition pre-conversion earnings are not property of the estate:

    1. *In re Markosian*, 506 B.R. 273 (9th Cir. BAP 2014): 11 U.S.C. § 1115 including Debtor's post-petition earnings as property of the estate in a Chapter 11 case, in inapplicable upon conversion to Chapter 7. 11 U.S.C. § 348(f)(1)(8) expressly excludes a debtor's post-petition earnings from property of a Chapter 7 estate upon conversion, but no parallel statute exists for Chapter 11.

    2. *In re Evans* 464 B.R. 429 (Bankr. D. Col. 2011)

2. Debtor's post-petition pre-conversion earnings are property of the estate:

    1. *In re Tolkin*, 2011 WL 1302191 (Bankr. E.D. N.Y. 2011)

    2. *In re Hoyle*, 2013 WL 3294273 (Bankr. D. Idaho 2013)

II. TRUST LAW AND SECTION 541 – WHAT RIGHTS DO TRUSTEES HAVE? - Andrew Muller

A. Trust Issues Related to Property of the Estate

When a debtor either is the beneficiary of a trust, the trustee of a trust or completely lacks assets because the debtor transferred all of her assets to a trust, significant issues arise for a bankruptcy trustee ("Trustee") in determining what rights the Trustee has with respect to the debtor's trust. These materials will focus on three general aspects concerning a Trustee's rights in Chapter 7 cases involving trusts: (1) the Trustee's right to receive benefits of the trust; (2) the Trustee's right to exercise powers granted under the trust documents; and (3) the Trustee's ability to invade trust assets under her strong-arm powers.

B. General Law

- § 541(a) property of the estate includes legal and equitable interests of the debtor in property
    - Bankruptcy estate's interest in a trust is derivative of a debtor's rights under state law.
    - Rights include debtor's interest in the trust as well as powers under the trust including power to revoke or withdraw assets. *Askanase v. LivingWell, Inc.* 45 F.3d 103, 106 (5th Cir. 1995); *In re Gifford*, 93 B.R. 636, 640 (Bankr. N.D. Ind. 1988)
- § 541(c)(2) enforces provisions in trusts which restricts access to certain beneficial interests in a trust, provided such restrictions are enforceable under applicable nonbankruptcy law.
- Uniform Trust Code ("UTC")
    - Designed to be a multi-state body of trust law, like the UCC

- Not all states have adopted
  - Illinois and Indiana have not
  - Michigan has (Section 7103)
  - Wisconsin in 2014 (Chapter 701)
  - Introduced in Minnesota legislature 2015

C. Trusts Involved

- Mandatory Trusts
  - Trust instrument requires set amounts to be paid to beneficiaries under established formula
  - No discretion on the part of trustee
  - No right of beneficiary to demand certain payments or distribution of assets of trust
- Discretionary Trust
  - Distributions to beneficiaries left to discretion of the trustee
  - Timing, amount, even recipient, not defined
  - Beneficiary has no right to demand payment or distribution
- Domestic Asset Protection Trusts / Qualified Spousal Trust
  - Limited use – only a few states permit (Alaska, Delaware, and Missouri)
  - Designed to protect tenancy by the entirety when marital property transferred into a trust.
  - Exception to rule that transfer to trust voids tenancy by the entirety
  - Also provides an exception to certain rules that apply to self-settled trusts
  - Residency restrictions
- Medicaid Support Trusts

- Trust used to support an individual so as to allow them to qualify for Medicaid.
- Sometimes limited to providing funds for medical services that Medicaid does not cover.

D. Right as a Beneficiary

- UTC provides that a beneficial interest in a discretionary trust is not an enforceable property right. UTC § 504.
  - If the beneficiary cannot compel payment, neither can the Trustee.
- If the trust provides for discretionary distributions, right to receive distributions not property of the estate. Conversely, if the distributions under the trust instrument are mandatory, those distributions are property of the estate that the Trustee can receive.
  - Does not apply if the beneficiary is also the sole trustee for his own benefit and his own discretion to make distributions is not limited by any standard or the consent of a party holding an adverse interest to the beneficiary.
- Beneficiary rights under a "spendthrift trust" are also excluded from property of the estate.
  - "spendthrift" provisions are ones that restrain either the voluntary or involuntary alienation of the beneficiary's interest. UTC § 502
    - Beneficiary must be a different person from the settlor; or
    - The trust benefits an individual with a disability.
  - Where the debtor is both the beneficiary and the settlor under an alleged spendthrift trust, the trust does not meet the criteria of a spendthrift trust

and the debtor's beneficial interest becomes property of the bankruptcy estate. *In re Simmonds*, 240 B.R. 897 (B.A.P. 8th Cir. 1999)

- Reciprocal trusts (husband creates trust for wife and vice versus) will not solve the problem – spendthrift provision will be void and beneficiary rights may be transferred to the bankruptcy estate
- *In re McCoy*, 274 B.R. 751 (Bankr. N.D. Ill. 2002), spend-thrift provision was not valid to keep trust property out of bankruptcy estate where trustee/settlor was able to withdraw trust assets for "health, maintenance and support" and as "required or desirable".
- *In re Mitchell*, 423 B.R. 758 (Bankr. E.D. Wis. 2009) spend-thrift provision invalid where beneficiary was entitled to immediate payment of principal from the trust without any restrictions.

E. Power to Revoke or Invade the Trust

- If a trust is revocable, the Trustee of a settlor/debtor has the power to revoke the trust for the benefit of settlor's creditors. UTC § 602.
  - If the debtor/settlor is a co-settlor, the power to revoke may be limited to only those assets or trust property the debtor/settlor contributed. UTC § 103
  - Trust instrument may further provide that if there are multiple settlors only one will have the power to revoke.
- If the trust instrument grants the debtor the power to withdraw from the trust as of the petition date, that power is property of the estate and may be exercised by the Trustee.

- Must be "presently exercisable power . . . to withdraw assets from the trust without the consent of the trustee or any other person." UTC § 103
- If power to withdraw is contingent, it is not exercisable by the Trustee.

F. Strong-Arm Powers Related to Trusts

- Generally, irrevocable, self-settled, spendthrift trusts are not available to satisfy claims of creditors. UTC § 505. Except:
  - Conveyance of assets to trust was a fraudulent transfer;
  - If at the time the trust becomes irrevocable the settlor was the sole beneficiary or retained the power to amend the trust; or
  - If at the time the trust became irrevocable the settlor was one of a class of beneficiaries and retained a right to receive a specific portion of the income or principal of the trust that was determined solely from the provisions of the trust instrument
- If the self-settled trust is invalidated, Trustee may use her powers under § 544 to recover assets from the trust.
- Under § 548(e) a Trustee may avoid a transfer of an interest of the debtor that was made within 10 years of the filing date if:
  - Transfer to a self-settled trust;
  - Transfer by the debtor;
  - The debtor is the beneficiary under the trust; and
  - The debtor made the transfer with the actual intent to hinder, delay, defraud any entity to which the debtor was indebted or became indebted
- Alter-ego Arguments

- *In re Dawes*, 2008 WL 4822526 (Bankr. D. Kan. 2008)
  - Parents created two trusts. Trust #1 benefited the spouses and upon their deaths separated into four separate trusts one for each of their children.
  - Trust #2 was created by the parents to distribute real estate upon the parents' death to Son. (the Sisters each received direct gifts of real estate). The trust was created for the Son because of IRS problems.
  - Mom and Dad die. The three Sisters each terminated their individual trusts under Trust #1, but Son did not because of the aforesaid IRS issues
  - Parents' accountant was the trustee of both Trust #1 and Trust #2. Trust #1 contained a spendthrift provision. Trust #2 required annual distributions of income but distribution of the corpus of the trust was left to the trustee's discretion. Trust #2 also had a spendthrift provision.
  - Son files bankruptcy.
  - IRS complained that the trusts were a sham and that the trust assets should be part of the estate
  - Absent a claim of sham or alter ego, there was no basis to contend the trust principal was property of the estate:
    - Independent trustee
    - Spendthrift provision

- Discretionary distributions

- Kansas had no case law on whether a trust could be considered a sham or an "alter ego" of the Debtor. Court considered several factors:
  - Debtor's control over the assets and the trustee;
  - Use of trust funds to pay Debtor's personal expenses;
  - Relationship between Debtor and the trustee;
  - Lack of internal controls and the lack of oversight by the trustee of debtor's actions; and
  - Lack of consideration for any transfers.
- Debtor continued to farm the real property held in Trust 1 and 2 through a separate entity. All of the proceeds from farming, livestock or other farm income, was deposited into the farming company's account. Debtor used equipment owned by Trust 1 in farming. The farming entity paid the Debtor's personal expenses. Debtor's personal residence was located on property belong to Trust 2. Expenses for repair and upkeep were paid from Trust 2.
- Bankruptcy court concluded that fact issues required trial on whether Trust #1 or Trust #2 were property of the estate.

G. State Law Issues under *Stern*

- The debtor's (and by extension the Trustee's) rights in the trust will be determined based on the language of the trust instrument as interpreted by applicable state law.

- Under *Stern* bankruptcy judges do not have the constitutional authority to enter final judgment on purely state-law issues
- Cert has been granted in *Wellness Int'l Network, Ltd. V. Sharif* on two issues:
    - Whether a state property law issue necessary to determine whether property is part of the bankruptcy estate "stems from the bankruptcy itself" and thus is one over which bankruptcy judges have constitutional authority;
    - Whether Article II permits bankruptcy judges to exercise judicial power on the basis of litigant consent and, if so, whether implied consent suffices
- *Sharif* involved a state-law alter ego claim which, if successful, would have brought additional assets into the bankruptcy estate. The 7th Circuit concluded such a claim was indistinguishable from the state-law tortious interference claim at issue in *Stern* and that the bankruptcy court lacked judicial authority to issue final orders on whether the alter-ego's property was property of the bankruptcy estate.
    - If the Supreme Court affirms, this might impact the bankruptcy court's ability to adjudicate whether trust assets are estate property based on pure state law issues.

III. TENANCY BY THE ENTIRETIES - MARITAL PROPERTY

A. **Marital Property in Wisconsin** – Claire Ann Resop

1. The nature and extent of the debtor's legal or equitable interest in property is a question of applicable nonbankruptcy law, usually state law. *Burnhill v. Johnson*, 503 U.S. 393 (1992); *Butner v U.S.,* 440 U.S. 48, 54 (1979).
2. Wisconsin is a marital property state. Marital property = community property. Wis. Stat. § 766.001(2)
3. "All property of spouses is marital property except that which is classified otherwise by this chapter…" Wis. Stat. § 766.001(2)
4. Property of the estate includes: "All interests of the debtor spouse and the debtor's spouse in community property as of the commencement of the case that is:
    i. Under the sole, equal, or joint management and control of the debtor; or
    ii. Liable for an allowable claim against the debtor, or for both and allowable claim against the debtor and an allowable claim against the debtor's spouse, to the extent that such interest is so liable. 11 U.S.C. § 541(a)(2).
5. *In re Schmiedel*, 236 B.R. 393 (Bankr. E.D. Wis. 1999): All property of spouses becomes estate property. Accordingly, a judicial lien state statute is also applicable to that marital property. This case addresses collection issues against marital property and the hypothetical discharge.
6. *In re Landsinger,* 490 B.R. 827 (Bankr. W.D. Wis. 2012): A husband has exemption rights in his wife's inherited, thus individual property, to the extent the marital mixing portion can be traced, as was accomplished in this case by

mortgage payments with marital property income. Caution: investigate Wisconsin case law for whether mortgage payments are enough to reclassify property from individual to martial.

7. *In re Thongta*, 401 B.R. 363 (Bankr. E.D. Wis. 2009): Property that debtor had joint management and control over was property of the estate, and could not be attached by creditor of non-filing spouse. Although the co-debtor stay did not protect the non-filing spouse because creditor did not possess a consumer debt, creditor violated the stay by docketing a judgment and creating a lien on the non-filing spouse's property that was property of the estate because it was martial property.
8. *In re Peel*, 725 F.3d 696 (7th Cir. 2013): Where debtor's ex-wife agreed to accept monthly payments in lieu of her interest in an annuity, the annuity remained property of the estate. This is an Illinois case, in which the annuity may not have been otherwise exempt.
9. *In re Morgan*, 286 B.R. 678 (Bankr. E.D. Wis. 2002); Both spouses' interest, not just debtor's one-half interest, are in the debtor's bankruptcy estate filed in Florida, including the entire home in Wisconsin, which is marital property. The wife's subsequent bankruptcy filing did not include her Wisconsin home because her marital property was already included in her spouse's Florida bankruptcy estate.
10. *In re Page*, 171 B.R. 349 (Bankr. W.D. Wis. 1994): A non-debtor spouse who has received a discharge and is not currently eligible for a discharge, cannot benefit

from a hypothetical discharge; therefore, only half the garnishment at issue in this case may be avoided.

11. *In re Sweitzer,* 11 B.R. 792 (Bankr. W.D. Wis. 1990): This case discusses change of domicile and choice of law issues with regard to community property and community claims.

B. <u>Tenancy by the Entireties and Marital Property in Illinois</u> – Joseph A. Baldi

1. In Illinois, after passage of the Married Women's Act of 1861, the Illinois Supreme Court in the case of Cooper v Cooper, 76 Ill. 57 (1875) held that the premise of unity of husband and wife, which the theory of estates by the entireties was predicated upon, no longer existed because the Married Women's Act afforded Women the same rights as their husbands to dispose of the estates without consent of the other. After the Illinois Supreme Court decision in Cooper, Illinois courts no longer recognized estates by the entireties.
2. Tenancy by the Entirety is created pursuant to the Joint Tenancy Act, 765 ILCS 1005/0.01 et seq. The requirements for the deed to create the tenancy by the entirety and the circumstances when the tenancy is terminated are set forth in 765 ILCS 1005/1c.
3. In 1990, 735 ILCS 5/12-112 was enacted to establish a tenancy by the entirety provision in the Code of Civil Procedure. The statute afforded spouses protection in their principal residence which could not be sold to satisfy the debt of only one spouse. The statute was later amended to read as follows:
4. Any real property, any beneficial interest in a land trust, or any interest in real property held in a revocable inter vivos trust or revocable inter vivos trusts

created for estate planning purposes, held in tenancy by the entirety shall not be liable to be sold upon judgment entered on or after October 1, 1990 against only one of the tenants, except if the property was transferred into tenancy by the entirety with the sole intent to avoid the payment of debts existing at the time of the transfer beyond the transferor's ability to pay those debts as they become due. However, any income from such property shall be subject to garnishment as provided in Part 7 of this Article XII, whether judgment has been entered against one or both of the tenants.

5. Transfers into tenancy by the entirety can only be avoided if the transfer was with the "sole intent" to avoid payment of debts. Premier Property Management, Inc. v Jose Chavez, 191 Ill 2d. 101 (2000), this provision supersedes "fraudulent intent" standard of Illinois Fraudulent Transfer Act. Provides greater protection to innocent spouses from creditor claims.
6. Entireties property is not exempt from sale to the extent there are joint debts. Some courts have also held that judgments may attach to contingent future interests of each tenant, such as the present interest in rents excluded by section 212, the future interest as a tenant in common in the event of divorce, a future interest as a joint tenant if the event another homestead is established and the future interest in the entire property in the event of the death of the co-tenant. See, In re Yotis, 2014 Bankr. LEXIS 3781 (Bankr. N.D. Ill. 2014); In re Chinosom, 243 B.R. 688 (Bankr. N.D. Ill. 2000) rev'd on other grounds, 248 B.R. 324 (N.D. Ill. 2000).

7. Tenancy by entirety converted to tenants in common on divorce or converted to joint tenancy if property no longer homestead. On death, survivor succeeds to entire interest in property.

C. **Tenancy By the Entireties in Michigan** – Hon. James W. Boyd

1. Michigan is one of the few states retaining common law tenancy by the entirety. *In re Grosslight*, 757 F2d 773 (6th Cir 1985).
2. Real property owned as tenants by the entireties is treated as being wholly exempt if owned by both spouses.
3. Neither spouse acting alone can alienate an interest in the property until the marriage is terminated, either by divorce or death.
4. Creditors of one spouse cannot reach interests in the entireties property.
5. Joint creditors can reach entireties property, subject to the $3,500 homestead exemption floor in the Michigan constitution and a statutory homestead exemption of $37,775 (adjusted for inflation). See MCL 600.5451 et seq.
6. Proceeds of entireties property may be distributed to the joint creditors. *In re Trickett*, 14 B.R. 85 (Bankr. W.D. Mich. Sept. 10, 1981). But see *In re Raynard*, 327 B.R. 623 (Bankr. W.D. Mich. July 15, 2005), holding that all unsecured creditors are to be paid from the sale of entireties property, not just joint creditors.
7. If the trustee administers entireties property, the non-filing spouse must be compensated for his or her interest without diminution by debtor's exemption, attorney fees, or trustee fees. 11 USC 363(j).

8. MCL 557.151 also permits the creation of tenancies by the entirety in certain personal property including bonds, certificates of stock, mortgages, notes, debentures and other evidences of indebtedness
9. Does this apply to brokerage accounts? See *Zavradinos v JTRB, Inc*., 482 Mich 858, 753 NW2d 60 (2008), in which the Michigan Supreme Court denied leave to appeal, holding that checking a box on an application indicating the account was to be a joint tenancy with rights of survivorship was insufficient to rebut the presumption of it being entireties property.
10. The bankruptcy-specific Michigan exemption statute, MCL 600.5451(n) codifies the treatment of entireties property.

IV. Application of Nonbankruptcy Law
- **Claire Ann Resop**

1. Supreme Court:

    a. *Patterson v Shumate*, 504 U.S. 753 (1992): An interest in an ERISA qualified pension plan may be excluded from the estate because applicable nonbankrutpcy law includes ERISA which contains an antialienation provision. Applicable nonbankrutpcy law is not limited to state laws.

    b. *Rousey v. Jacoway, 544 U.S. 320 (2005): Affirms Patterson v Shumate* and extends the holding to IRAs because the 11 U.S.C. § 522(d)(10)(E) requirement of the right to receive payment because of age is met.

2. Court of Appeals:

    a. 1st Circuit – *City of Springfield v. Ostrander*, 329 F.3d 204 (1st Cir. 2003): Payments to the debtor that were for reimbursement to the City were not property of the estate because debtor was only a delivery vehicle pursuant to the Telecommunications Act of 1996.

    b. 2nd Circuit - *In re Handel,* 301 B.R. 421 (2nd Cir. 2003): Debtor's interest in a profit sharing plan was not property of the estate because it is an ERISA plan subject to an antialienation prohibition. There is not an additional requirement that the plan must also be tax qualified under the Internal revenue Code.

    c. 3rd Circuit – *In re Laher*, 469 F.3d 279 (3rd Cir. 2007): Debtor's annuity is not property of the estate. The Court found that the requirements of New York law had been met and the operation of the retirement account as an annuity did not take the account out of the definition of a trust.

d. 4th Circuit – *In re Sewell*, 180 F.3d 707 (4th Cir. 1999): Debtor's ERISA qualified retirement plan is excluded from the bankruptcy estate despite the fact that the employer's acts caused the retirement plan to not be tax qualified pursuant to the Internal Revenue Code.

e. 6th Circuit – *In re Quinn*, 327 B.R. 8181 (6th Cir. 2005): Debtor's guaranteed annuity which was part of his retirement plan through employment with Michigan State University was not included in the bankruptcy estate because it contained restrictions on transfer enforceable under applicable nonbankrutpcy law and thus was indistinguishable from a spendthrift trust, which is excluded under 11 U.S.C. § 542(c)(2).

f. 9th Circuit - *In re Snyder*, 285 B.R. 712 (9th Cir. 2002): Debtor's interest in his ERISA plan was property of his Chapter 13 estate for the purposes of securing the IRS's tax claim. The IRS had levied the plan pre-bankruptcy, and Debtor's interest in the plan was not exempt from levy under 26 U.S.C. § 6334(a), thus the exclusion under 11 U.S.C. § 541(c)(2) does not apply and the IRS has the right to enforce its lien and its secured claim.

V. Property of the Estate: Judicial Estoppel, Standing and the Real Party in Interest - Joseph A. Baldi and Hon. James W. Boyd

1. **Introduction.** In the case of *Matthews v Potter*, the Seventh Circuit described judicial estoppel as applied in bankruptcy as follows:

Judicial estoppel is an equitable doctrine designed to "protect the integrity of the judicial process" by preventing litigants from "deliberately changing positions according to the exigencies of the moment." *New Hampshire v Maine*, 532 U.S. 742, 749-50, 121 S.Ct. 1808, 1049 L.Ed. 2d 968 (2001). The doctrine is generally invoked to prevent a party from asserting positions in successive judicial proceedings that are so "clearly inconsistent" that accepting the latter position would create the perception that at least one of the courts was misled. *Id* at 750-751; *Eastman v Union Pacific R.R. Co.*, 493 F. 2d 1151, 1156 (10th Cir. 2007). Accordingly, courts consistently hold that a debtor who conceals a legal claim and denies owning the asset in bankruptcy is judicially stopped from later pursuing that claim to the debtor's personal benefit. See, e.g. *Cannon-Stokes*, 453 F. 3d 448; *Jethroe v Omnova Solutions, Inc.*, 412 F. 3d 598 (5th Cir. 2005); *Barger v City of Cartersville* 348 F. 3d 1289, 1296 (11th Cir. 2003).

Matthews v Potter, 316 Fed. Appx 518 (7th Cir. 2009). The Seventh Circuit has also recognized a proviso to the rule on judicial estoppel: the concealment designed to hide an asset from creditors does not prevent creditors, through the office of the trustee, from themselves realizing on the claim after its discovery. *Cannon Stokes v Potter*, 453 F. 3d 446, 448 (7th Cir. 2006); *Biesek v Soo Line R.R.*, 440 F. 3d 410 (7th Cir. 2006); *See also Stephenson v Malloy*, 700 F 3d 265 (6th Cir. 2012)(debtor failure to disclose does not bar trustee from pursuing claim). "Judicial estoppel is an equitable doctrine, and using it to land another blow on the victims of bankruptcy fraud is not an equitable application."

Judicial estoppel is most often invoked by a defendant being sued by a former debtor in an attempt to end that litigation. The first issue in an analysis of whether judicial estoppel should be applied is whether the underlying claim or cause of action was property of the estate in the bankruptcy case and whether the it remained so when the case was closed.

a. Property of the Estate. Section 541 determines what is property of the estate and its broad definition includes legal claims and causes of action which existed on the date of the filing of the case. 11 U.S.C. 541(a)(1); *In re Yonikus*, 996 F.2d 866 (7th Cir. ; *Cannon-Stokes*, 453 F. 3d at 448; *Biesek*, 440 F. 3d at 413; *Matthews v Potter*, 316 Fed Appx at 521. If the debtor lists the claim in his schedules as required under §521 of the Code judicial estoppel would not apply because the debtor has disclosed the asset to the trustee and creditors. To the extent there is a recovery, the debtor can assert exemptions which are available to him and the debtor will also receive any surplus remaining after payment of the exemptions, administrative expenses and creditor claims in the case, in accordance with §726(a)(6).

Property of the estate will not include those claims or causes of action which did not arise until after the filing of the bankruptcy petition. *In re Underhill*, 579 Fed Appx 480, 482 (6th Cir. 2014). (tortious interference claim against competitor not property of the estate where debtors sustained no loss until after bankruptcy case closed). In a chapter 13 case, however, property acquired by the debtor during the case, including causes of action, becomes property of the estate pursuant to §1306(a)(a) of the Code. See, e.g. *Thomas v Indiana Oxygen Company, Inc*. 2014 U.S. Dist. LEXIS 95905 (S.D. IN, 2014). The same would be true in a chapter 11 case for an individual pursuant to §1115(a)(1).

b. **Abandonment of Scheduled Claims**. If the trustee declines to administer scheduled causes of action, once the case is closed those claims are abandoned to the debtor, who

is free to pursue the claims. Section 554(c) provides that "any property scheduled under section 521(a)(1) of this title not otherwise administered at the time of the closing of a case is abandoned to the debtor…". Once abandoned, ownership of the claims reverts to the debtor as if he owned the property continuously and the bankruptcy never happened. *Matthews v Potter*, at 522.

c. **Unscheduled Claims.** If the debtor fails to schedule pre-petition claims or causes of action, they nevertheless become property of the estate. If the case is closed without disclosing the asset to the trustee, the asset remains "forever property of the estate, and the trustee remains the real party in interest." *Matthews v Porter*, 316 Fed Appx at 521. An unscheduled claim is not abandoned under §554(a), (b) or (c) and remains property of the estate pursuant to §554(d), which provides that "property that is not abandoned under this section and that is not administered in the case remains property of the estate". Where the causes of action were not disclosed and are subsequently abandoned, the courts generally hold that only the trustee has standing to pursue the claim as the real party in interest. *Matthews v Potter*, 316 Fed Appx. at 521; *Biesek v Soo Line R.R.*, 440 F 3d at 412. The claim or cause of action no longer belongs to the debtor. Where the claim was initially concealed and then later abandoned after the case was reopened, the Court will determine if judicial estoppel applies to prevent the debtor from pursuing the claim based on whether the debtor intended to conceal the asset from the reach of his creditors. See, e.g., *Cannon-Stokes v Potter,* 453 F.3d 446, 448 (7th Cir. 2006) (debtor intentionally omitted claim, did not seek to amend schedules, estoppel applied); *Eubanks v CBSK Fin. Group, Inc.* 385 F. 3d 894, 898 (6th Cir. 2004) (judicial estoppel inapplicable where debtor omitted potential claim from schedules but orally disclosed it to the trustee); *Spaine v Community Contacts, Inc.* 756 F. 3d 542 (7th Cir. 2014) (incomplete schedules orally corrected

by disclosure to trustee, no evidence of intent to deceive creditors, judicial estoppel not applicable).

2. Standing to Sue and the Real Party in Interest Doctrine

a. Distinction between Standing and Real Party in Interest. In considering whether judicial estoppel applies in a case, courts sometimes address the issue in terms of standing and sometimes in terms of the real party in interest. *See, Spaine v Community Contacts, Inc*., 756 F. 3d 542, 546 (7th Cir. 2014). Courts tend to blur the distinction between standing to sue and the real party in interest doctrine and use the terms interchangeably when discussing a debtor's right to assert pre-bankruptcy claims. *Hernandez v Forest Preserve District of Cook County*, 2010 U.S. Dist. LEXIS 29650 (N.D. Ill. Mar 29, 2010). The debtor in the judicial estoppel cases typically has Article III standing to purse the undisclosed claim, since he is the person with an injury, traceable to conduct of the defendant and who is likely to be compensated by the relief sought. *Id* at 29650, 9, fn 4. The real question is whether the debtor is the real party in interest who possesses the right to bring the claim. *See, Tate v Snap-on Tools Corp*, 1997 U.S Dist. LEXIS 1485 (N.D. Ill. Feb 11, 1997). The real party in interest doctrine is a prudential limitation on a plaintiff's ability to invoke federal jurisdiction imposed by Rule 17 of the Federal Rules of Civil Procedure.

The debtor who fails to disclose his cause of action in a subsequent bankruptcy filing undoubtedly has standing to file a claim in the Constitutional sense that he is the party who suffered an actual injury traceable to the defendant and which can be redressed in the action. His standing to sue, therefore, is sufficient to invoke the jurisdiction of the court. The debtor is not, however, the real party in interest as that term is defined in Rule 17(a)(1) of the Federal Rules of Civil Procedure once his bankruptcy is filed. The real party in interest and the party entitled to

bring the claim is the bankruptcy trustee. *Tate v Snap-on Tools Corp., supra*; *Matthews v Potter, supra; In re Biesek, supra.*

The distinction between standing to sue and the real party in interest doctrine can have a significant effect on the prosecution of the undisclosed claim in the event that the statute of limitations has expired. Under Rule 17(a)(3), the real party in interest is given a reasonable time to ratify, join or substitute in the action and if he is substituted, the action continues as if it had been originally commenced by the real party in interest, such as a trustee seeking to pursue the undisclosed claims on behalf of creditors. The trustee will, therefore, be able to overcome defendants claims that the trustee's action is time barred due to the lapse of the statute of limitations.

b. **Debtor's Continued Involvement in Suit.** In some cases, the Debtor may retain an interest in a lawsuit despite his failure to disclose the case in his bankruptcy. In a case asserting employment discrimination, for instance, the right to reinstatement is a personal right which would not be property of the bankruptcy estate under any circumstances. As such, that right remains with the debtor and courts will often allow the debtor to remain as a plaintiff in the case to pursue his personal claim as a co-plaintiff with the trustee, who pursues the monetary claims for relief. See, e.g. *Prasad v. Acxiom Corp*., 2012 U.S. Dist. LEXIS 20587(N.D. ILL. 2012); *Morlan v Universal Guaranty Life Insurance Company*, 298 F. 3d 609 (7th Cir. 2002)(future benefits under ERISA plan not assignable, remain debtor's property).

3. Exemption Claims and Surplus Funds.

a. Exemptions in Concealed Assets. Despite the debtor's failure to disclose a claim or cause of action, he may still be able to assert an exemption in any recovery which the trustee collects on behalf of the estate. Prior to *Law v Siegel*, 134 S. Ct. 1188 (2014), it was

generally accepted that where a debtor concealed an asset or otherwise acted in bad faith, the debtor's exemption claim could be disallowed. *Lucius v McLemore*, 741 F. 2d 125, 127 (6th Cir. 1984); *In re Yonikus,* 996 F. 2d 866 (7th Cir. 1993). The United States Supreme Court in *Law v Siegel*, however, in commenting on the assertion that the Bankruptcy Court had the power to deny an exemption claim based on the debtor's fraudulent conduct, observed that the Bankruptcy Code "admits no such power". *Id* at 1196. Although this observation was in dicta and the facts of the case before the Court were quite different than those in the fraudulent concealment cases, this statement by the Supreme Court has led a number of lower courts and at least one Circuit Court to hold that the Bankruptcy Court indeed does not have the power to disallow an exemption on grounds not set forth in the Bankruptcy Code. See, e.g. *Mateer v Ostrander*, 525 B.R. 559, 565 (Bankr. D Mass. 2015); *In re Franklin*, 506 B.R. 765, 771 (Bankr. C.D. Ill. 2014)(Law v Siegel determined that courts do not have a general equitable power to deny exemptions based on a debtor's bad faith conduct); *In re Baker*, 514 B.R. 860 (ED. Mich. 2014); *U.S. v Ledee*, 772 F.3d 21, 29 n. 10 (1st Cir. 2014). Perhaps the trustee should consider whether judicial estoppel would provide the authority for the Bankruptcy Court to deny a debtor's attempt to assert an exemption in property debtor fraudulently concealed.

b. Debtor Receipt of Surplus Funds. Where the trustee elects to reopen a case to administer a previously concealed cause of action, that asset will usually have substantial value. In a fair number of reopened cases, the claims which are actually filed may be no more than a few thousand dollars, but the recovery, even after payment of administrative expenses, may produce a sizeable surplus. In this situation, can the debtor who concealed the asset receive the surplus? It depends on whether judicial estoppel applies as a result of the debtor's conduct in the case**.**

In the case of *Wiggins v Citizens Gas & Coke Utility*, 2008 U.S. Dist. LEXIS 79415 (S.D. Ind. 2008), a debtor brought a discrimination case against his former employer, which he failed to list in his chapter 7 bankruptcy case. The court found that the debtor's failure to disclose the claim was not inadvertent and that the application of judicial estoppel was warranted. The Court did not want to penalize creditors of the bankruptcy estate, however. The court instead entered an order capping the recovery in the case and estopping the trustee from receiving a monetary recovery that exceeded the creditor claims, interest on the claims and the trustee's fees.

A recent Seventh Circuit case considered and rejected a damages cap similar to that used in the *Wiggins* case. In *Metrou v M.A. Mortenson Co*., 781 F. 3d 357 (7th Cir. 2015), the Court found that the debtor's error was innocent and he did not intend to conceal an asset from creditors. Debtor had listed a workmen's compensation claim in his schedules but he failed to list tort claims against 3rd parties which arose from the same accident. The Court held that judicial estoppel was not applicable where the errors were innocent or inadvertent and where the debtor had taken steps to correct the error by surrendering the asset. The Court also found that the damages cap would injure the creditors by reducing the value of the overall claims and thus make it more difficult for the trustee to retain counsel on a contingent fee basis. The Court held that judicial estoppel was not to be applied in a manner that would injure the innocent creditors. The Court also left open the possibility that the Bankruptcy Judge may later decide if the Debtor should receive the surplus or if it should be given to creditors as a bonus or returned to the defendants in the tort suit if there is evidence that the debtor was trying to intentionally deceive creditors.