

UNITED STATES BANKRUPTCY COURT
DISTRICT OF SOUTH DAKOTA
NORTHERN DIVISION

In the Matter of)	Case No. 385-00071
)	Chapter 7
LEROY MILTON HORSLEY and)	
DARLENE JOY HORSLEY,)	
)	
Debtors.)	
)	MEMORANDUM DECISION
)	
DARLENE JOY HORSLEY,)	
)	
Movant,)	
)	
-vs)	
THOMAS M. MAHER,)	
CHAPTER 7 TRUSTEE,)	
)	
Respondent.)	

Debtor Darlene Horsley filed a motion on July 23, 1987 to determine if her interest in a testamentary trust is property of the bankruptcy estate. The motion was in response to the Chapter 7 Trustee informing Mrs. Horsley's counsel that he considered the Debtor's interest part of the estate. Mrs. Horsley's Chapter 7 petition was filed June 17, 1985. The hearing on the present motion was held November 4, 1987. The matter was taken under advisement to afford counsel an opportunity to submit briefs in support of their respective positions.

The trusts under consideration were established by the Will of Clarence T. Schuldt, the Debtor's father. Mr. Schuldt died August 24, 1980. The testator's wife's survival activated the two trusts established in the will. Mrs. Schuldt is alive today.

The relevant terms of Trust A are as follows: Mrs. Schuldt is to receive the net income from the trust during her lifetime. She and the testamentary trustee are also given the power to invade the trust principal. Mrs. Schuldt also holds the power of appointing her successor to the entirety of the trust assets.

In addition, Mrs. Schuldt was given a life estate in the net income of Trust B. The will further allows the testamentary trustee to invade the principal of Trust B on the life tenant's behalf under certain circumstances, and on behalf of the testator's children under certain circumstances.

As for the remainder of Trust B, the will provides:

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. . .

2. After the death of my spouse, or in the event my spouse predeceases me, then upon my decease my Trustee shall divide Trust B into equal shares so as to provide one share for then each living child of mine, and one share for the living issue, collectively of each deceased child of mine. My Trustee in making the division shall take into account advances of principal made to any of my children. After making such division, such shares shall be distributed outright to such children and to the issue of deceased children by right of representation.

The trust in paragraph XII contains a spendthrift clause which states:

No title in the Trust created in and by this Will, or in the income therefrom, except the income and general testamentary power of appointment reserved to my spouse in Trust A, shall vest in any beneficiary and neither the principal nor the income of any such Trust shall be liable for the debts of any beneficiary, and no beneficiary shall have any power to sell, assign, transfer, encumber, or in any manner to anticipate or dispose of his or her interest in any such Trust, or the income produced thereby, prior to the actual distribution in fact, by the Trustee to said beneficiary.

Prior to examining the arguments of counsel, it is necessary to clarify which trust is at issue. Both the Debtor's attorney and the trustee fail to specify whether they are speaking of Trust A, Trust B or both trusts. Since Mrs. Schuldt holds the power of appointing the future owner(s) of the assets of Trust A, the debtor holds no interest in Trust A. See S.D.C.L. 43-3-6 and 43-4-3. The Court therefore concludes that Trust B is the only trust in issue.

Debtor's counsel argues the spendthrift provision of paragraph XII excludes the Debtor's interest in Trust B from the bankruptcy estate under Section 541(c) (2). However, Trustee Maher correctly contends that because the proceeds are to be paid "outright" to the testator's descendants upon the death of the life tenant, the spendthrift provision does not apply to Mrs. Horsley's share when her interest becomes present.

The testator's instructions to split Trust B among his descendants and distribute the assets "outright" indicates his intent to deliver both legal and equitable title to the devisee/legatees. Therefore, the trust terminates on the death of Mrs. Schuldt, and there is no spendthrift restriction beyond that point. In fact, paragraph XIII expressly provides that the spendthrift restriction applies only "prior to the actual distribution in fact" of the trust proceeds. Mrs. Horsley will have no present interest in the trust assets until after this distribution and the spendthrift provision therefore has no application to the debtor's interest.

This conclusion alone cannot be construed to mean the Chapter 7 trustee and creditors may reach the debtor's interest. Local law must now be consulted to determine if such a future interest is a "legal or equitable interest of the debtor in property as of the commencement of the case" as required under Section 541. Matter of Garten, 52 BR 497 (W.D. Mo. 1985).

To make this determination the debtor's interest must be classified. Since her estate follows a life estate she holds a remainder. See SDCL 43-9-4. Further classification of the remainder as vested or contingent is necessary as this distinction can create opposite results depending on local law. Compare In Re Kreiss, 72 BR 933 (E.D. N.Y. 1987) (contingent remainder part Hicks , 22 BR 243 (Ga. 1982) contingent remainder not part of bankruptcy estate).

The South Dakota Supreme Court has stated that determining whether a remainder is vested or contingent is "consistently troubling." *Rowett v. McFarland*, 394 NW2 298 (1986). Fortunately in this case the terms of the will are determinative. The will provides that after the death of the life tenant the testamentary trustee is to "divide Trust S into equal shares so as to provide one share for then each living child of mine, and one share for the living issue, collectively of each deceased child of mine." (Emphasis added.) Use of the phrase ``then each living child'' demonstrates his intent to require that his children be alive at the death of the life tenant for their interests to vest. This wording is sufficiently clear to overcome the presumption that the remainder vested on the death of the testator and not the life tenant. See Rowett at 302. The debtor's remainder is therefore contingent on surviving the life tenant.

The issue now becomes whether a contingent remainder may be reached by creditors. There apparently is no South Dakota case authority on point. There is however legislative guidance. Under SDCL 43-4-1 "[t]ransfer is an act of the parties, or of the law, by which the title to property is conveyed from one living person to another." SDCL 43-4-2 provided that [p]roperty of any kind may be transferred, except as otherwise provided by this chapter. Because transfer of a contingent remainder is nowhere prohibited in SDCL Chapter 43-4, the court concludes such an interest is therefore part of the bankruptcy estate. Kreiss.

The Court concludes the debtor's future interest in Trust B is a legal or equitable interest included in the bankruptcy estate under Section 541(a) (1). The court now finds itself in the same situation as the Garten Court when it stated "[t]he trustee does not now ask this Court to value the interest which has passed to the estate, but only to declare that it is in fact property of the estate." 52 BR at 501. No evidence has been presented regarding the possible value of Mrs. Horsley's interest, nor is the question properly before the Court.

Counsel for Debtors may prepare an appropriate order.

Dated this 4th day of January, 1988.

BY THE COURT:

Irvin N. Hoyt
Bankruptcy Judge

ATTEST:

PATRICIA MERRITT, CLERK

By: _____

(SEAL)