CONTINGENT PROPERTY INTERESTS IN BANKRUPTCY

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1. **INTRODUCTION**

The law of contingent interests in bankruptcy is full of colorful facts and questionable rulings based on old Supreme Court cases that are no longer good law and interpretations of statutes that don’t say what the courts say they say. Thus, contingent interest cases in bankruptcy are a perfect example of Aaron Burr’s quote that: “Law is whatever is boldly asserted and plausibly maintained.”

11 U.S.C. § 541(a)(1) provides that even contingent interests of the debtor that exist as of the filing of a bankruptcy are property of the estate. Further, under 11 U.S.C. § 541(a)(6) the definition of “property of the estate” includes: “Proceeds, product, offspring, rents, or profits of or from property of the estate.” What does all that mean? There is also some fairly strange language in the same section that talks about “earnings from services” being an exception to contingent interests - is that exception as straightforward as it seems? This webcast will walk through some of the common and more esoteric examples of contingent property interests in bankruptcy and examine why some scholars think that the interpretation of what is a contingent interest is consistently misapplied by nearly all bankruptcy judges.

2. **DEFINITION OF CONTINGENT INTEREST**

businessdictionary.com defines “Contingent Interest” as: [An] advantage, profit, right, or share that (unlike an absolute interest or vested interest) depends on the occurrence of a specified event.”

This outline attempts to review the following issues with regard to a debtor who owns a contingent interest in property.

- What does the bankruptcy code say about contingent interests?
- Who owns the contingent interest, the debtor or the bankruptcy estate?
- How does a bankruptcy court decide that issue?
- What are the issues that are unresolved or developing in the law?
A bankruptcy case filed under any section of the bankruptcy code creates a vast estate, defined in 11 U.S.C. § 541(a):

“The commencement of a case under . . . this title creates an estate. Such estate is comprised of all of the following property, wherever located and by whomever held:”

There are seven subsections to § 541(a), the broadest “sweep” of the section is found in subsection (a)(1), which provides:

“Except as provided in subsections (b) and (c)(2) of this Section, all legal or equitable interests of the debtor in property as of the commencement of the case [are property of the estate].”

So unless the bankruptcy code itself excepts out a piece of property, that property belongs to the estate.

The Bankruptcy Code specifically includes several property types that fully vest post-petition as an exception to the general rule that only assets that exist as of the time of the filing of the bankruptcy come into the estate:

“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: 
(B) as a result of a property settlement agreement with the debtor’s spouse, or of an interlocutory or final divorce decree; or
(C) as a beneficiary of a life insurance policy or of a death benefit plan.”

11 U.S.C. § 541(a)(5)(A)(B) and (C).

One additional sub-section of § 541(a) that brings after-acquired property into the bankruptcy estate that is of special concern for contingent interests is § 541(a)(6). That sub-section says property of the estate includes:

(6) Proceeds, product, offspring, rents, or profits of or from property of the estate, except such as are earnings from services performed by an individual debtor after the commencement of the case.
3. SPECIAL RULES FOR INDIVIDUAL CHAPTER 11 CASES AND CHAPTER 13 CASES

Most of this outline and most of the court cases on the topic of contingent interests concern Chapter 7 cases. There are special provisions that add to the basic definition of estate property in §541(a) for personal Chapter 11 and Chapter 13 cases.

In an individual Chapter 11, after the passage of the 2005 law known as “BAPCPA” property of the estate includes all income of the debtor after the filing of the bankruptcy.

(a) In a case in which the debtor is an individual, property of the estate includes, in addition to the property specified in § 541:

(1) all property of the kind specified in § 541 that the debtor acquires after the commencement of the case but before the case is closed, dismissed, or converted to a case under chapter 7, 12, or 13, whichever occurs first; and

(2) earnings from services performed by the debtor after the commencement of the case but before the case is closed, dismissed, or converted to a case under chapter 7, 12, or 13, whichever occurs first.

11 U.S.C. § 1115(a)(2)

Similarly, in a Chapter 13, all income of the debtor earned after the bankruptcy is filed is property of the estate.

(a) Property of the estate includes, in addition to the property specified in § 541 of this title:

(1) all property of the kind specified in such § that the debtor acquires after the commencement of the case but before the case is closed, dismissed, or converted to a case under chapter 7, 11, or 12 of this title, whichever occurs first; and

(2) earnings from services performed by the debtor after the commencement of the case but before the case is closed, dismissed, or converted to a case under chapter 7, 11, or 12 of this title, whichever occurs first.
11 U.S.C. § 1306(a)(2)

There is a twist in Chapter 13s however, since once a plan is confirmed, property of the estate not used to pay the plan re-vests in the debtor. 11 U.S.C. § 1327.

(b) Except as otherwise provided in the plan or the order confirming the plan, the confirmation of a plan vests all of the property of the estate in the debtor.

(c) Except as otherwise provided in the plan or in the order confirming the plan, the property vesting in the debtor under subsection (b) of this section is free and clear of any claim or interest of any creditor provided for by the plan.

Just how this works for contingent property interests that become fully vested after a Chapter 13 plan is confirmed is the subject of much discussion. For example, the 11th Circuit has several decisions that twist in different directions. See generally, Jennifer Leigh Shea, “When Does a Post-confirmation Asset Become Property of the Estate in the Eleventh Circuit?” ABI Journal September 2009 at 34. See also a description of five separate tests that various courts have used to determine how 11 U.S.C. §§1306(a) and 1327 may work together. In re Hymond, 2012 WL 6692196 (Bankr. N.D. Tex. 2012).

The Eighth Circuit’s decision in Security Bank of Marshalltown, Iowa v. Neiman, 1 F.3d 687 (8th Cir. 1993) clarified, at least in the Eighth Circuit, that unlike in Chapter 11 case, the bankruptcy estate continues to exist post-confirmation. As pointed out by the district court in In re Lee:

Neiman merely decided that the estate continues to exist after confirmation of the plan; it did not hold that property of the estate may not vest with a debtor until completion of the plan. In fact, the court specifically stated that even if all property of the estate vests in the debtor before completion of the plan, that does not mean that the estate no longer exists. Id. at 690. “The estate can continue to exist as a legal entity after confirmation even if it holds no property.” Id. In short, Neiman supports a conclusion that the collateral may vest with debtors prior to completion of the plan even though the estate will continue to exist until completion of the plan.
In re Lee, 162 B.R. 217, 225 (D. Minn. 1993). Neiman is cited by the court in Hymond as standing for the proposition that all property of the estate remains property of the estate until discharge, dismissal or conversion. See Hymond, 2012 WL 6692196 at *3. Lee suggests otherwise and the “reconciliation approach” adopted by Hymond, citing Waldron, is not necessarily inconsistent with Neiman. “Under that approach, property that exists at the time of confirmation vests in the debtor, but the estate continues to exist after confirmation and includes the debtor’s earnings and property acquired post-confirmation.” Id. (citing Waldron v. Brown (In re Waldron), 536 F.3d 1239, 1243 (11th Cir. 2008)).

Why is this an important concept in a discussion of contingent interests? If a court adopts the “reconciliation approach” to property of the estate in chapter 13, and the property subject to the contingent interest is property of the estate at the time of confirmation, then that interest will vest in the debtor and will not be subject to the claims of creditors when the contingency occurs. In other words, the contingent interest should be valued as of the date of confirmation for purposes of the liquidation test, see 11 U.S.C. § 1325(a)(4), and the disposable income test. 11 U.S.C. § 1325(b)(1). If the contingency increases the debtor’s disposable income for purposes of confirmation and the contingency fails to occur, the debtor may amend the plan to reduce the payments due to the change in anticipated circumstances. See 11 U.S.C § 1329(a). If the contingency would not affect the debtor’s disposable income, but rather the value of the debtor’s estate, and the value of the asset is more than anticipated, a creditor or the trustee cannot seek to modify the plan to due to a change in liquidation value. See 11 U.S.C. § 1328(b)(excludes the liquidation test of § 1325(b) from the requirements of modification of a plan). On the other hand, if the asset was overvalued it is unlikely that the debtor could modify the plan since the valuation of the asset does not increase or decrease the debtor’s disposable income. This would
change, of course, if the sale of the asset itself was being used to fund the plan. Under those circumstances modification may be appropriate.

Note also, that in individual Chapter 11 cases, unlike Chapter 13 cases, Congress did not helpfully provide for re-vesting of assets to the debtor of any assets not needed for confirmation of the plan. Suppose an individual chapter 11 debtor’s home equity increases beyond that protected by the applicable state exemption in year 3 of a five year payment plan. Does that value, under Schwab v. Reilly, 130 S. Ct. 2652 (2010) now have to be put in the plan through amendment? Shortly after Reilly was decided, the Ninth Circuit Court of Appeals ruled that where a Chapter 7 trustee kept the Chapter 7 estate open and the homestead of the debtor increased in value above the exempt amount, the trustee had a right to sell the house and collect the increase in equity. Gebhart v. Gauchan (In re Gebhart), 621 F.3d 1206 (9th Cir. 2010), so a like-minded court might very well force a Chapter 11 debtor to increase the plan payments to account for the now non-exempt equity during the course of a payment plan.

4. PARING THE VERBIAGE

How does a Bankruptcy Court decide whether a contingent interest is property of the bankruptcy estate? Actually, that question is already answered under §541(a), since that provision states that all property of whatever type is included in the bankruptcy estate. The contingent interest therefore comes into the bankruptcy estate. The issue occurs when the contingent interest that exists at the time of the filing of the case later vests. At that point, who owns the now vested interest?

On the face of the statute, it seems logical that a court would look at the asset that exists on the date of the filing and then try to determine the value as of that day and make the debtor put that amount into the bankruptcy estate. Such a rule is easy to state but difficult to achieve.
For instance, a debtor who possesses a $15,000 engagement ring lists her ring on her schedule B. Many states hold that when an engaged debtor, in possession of an engagement ring at the time of filing subsequently calls off the wedding, the ring is not property of the bankruptcy estate. The ring is a conditional gift, and the Code does not oblige the debtor to go through with the wedding. *In re Heck*, 355 B.R. 813 (Bankr. D. Kan. 2006); *see also Benassi v. Back & Neck Pain Clinic, Inc.*, 629 N.W.2d 475 (Minn. Ct. App. 2001). What if bankruptcy trustee get an appraisal of the debtor’s interest in the engagement ring at the time of the bankruptcy filing? If the court orders the debtor to pay the bankruptcy trustee the value of the ring at a turnover hearing, will the debtor be entitled to a complete refund from the trustee if the engagement is later called off? Or is does the value that the court held the ring was worth at the time of the filing take into account the chance that the engagement might be called off and therefore no refund is available? These are the types of conundrums that bankruptcy courts enter into when they deal with contingent interests. As with all hard issues in bankruptcy court the decisions vary broadly.

5. LACK OF FRAMEWORK

Sometimes, courts realize what they are up against:

“We are …hindered by the lack of analytical guidance offered by the[se] [contingent interest] cases. There does not appear to be even a framework to guide us as we contemplate the inherently inexact process of trying to determine what level of uncertainly must be present for a property interest to be outside the scope of section 541(a)(1), a scope that all agree is quite broad indeed.”

*In re Dittmar*, 618 F.3d 1199, 1211 (10th Cir. 2010) (dissent of Judge Holloway).

The lack of a framework has been noted in an excellent article on the concepts that are contained in the current bankruptcy code. Practitioner George Pitts argues that the bankruptcy code divides estate property temporally, but since contingent assets exist on both sides of the

“Section 541, because it limits the concept of property of the estate temporally but not conceptually, is often insufficient standing alone to strike the balance courts instinctively want to strike when considering whether a debtor’s right to future payment should become property of the estate...[W]hen a debtor’s interest in property has a temporal dimension, § 541 may provide only uncertain guidance as to whether, or to what extent, that interest should become property of the estate.”

Id. at 91-92.

6. WHY THE COURTS REACH SO FAR

In evaluating how a court should decide whether a vested contingent asset is property of the estate where there is no “framework” to guide the courts, it is perhaps helpful to look at the way these cases are presented. Professor Charles G. Hallinan published a historical review of the “Fresh Start” policy that is one of the cornerstones of the Bankruptcy Code. Hallinan, “The ‘Fresh Start’ Policy in Consumer Bankruptcy: A Historical Inventory and an Interpretive Theory,” 21 U Rich. L. Rev. 49 (1986) (hereafter “Fresh Start.”) In that article Professor Hallinan observed that while it is clear that the bankruptcy system serves the dual function of ratable payment of creditors and the fresh start of the debtor, “[t]hat description is accurate, however only when applied to the system as a whole. As a practical matter, the great majority of consumer bankruptcy proceedings produce little or nothing in the way of payments to creditors. In those bankruptcies, relief of the debtor by means of the bankruptcy discharge and its ancillary protection is not merely an objective of the system; it is, rather, the principal (if not the sole) point of the exercise.” Fresh Start at 50-51, citations omitted.

Statistics kept since Professor Hallinan wrote his article support the fact that this is still true. A comprehensive study of over 11,000 bankruptcy cases was undertaken by the non-
partisan American Bankruptcy Institute and the National Conference of Bankruptcy Judges to study the effects of BAPCPA on consumer bankruptcy filings. *The Consumer Bankruptcy Fee Study Final Report*, Lois R. Lupica, Reporter, December 2011 (hereafter “Lupica Report”). The Lupica Report studied a proportionate example of 3821 Chapter 13 cases (34% of all cases filed) and 7350 Chapter 7 cases filed (66% of all cases filed) in 90 bankruptcy districts across the United States over a number of years both before and after the passage of BAPCPA. *Lupica Report* at 33. The Lupica Report found that overall, both before and after the passage of BAPCPA, no-asset bankruptcy filings were approximately 90% of all Chapter 7 filings. *Id.* at 48-49, Table 2.

Since 90% of all Chapter 7 filings are no asset cases, it is not far-fetched to suppose in those 10% of cases where a bankruptcy filing presents assets (or even potential assets) to be distributed to creditors, that a bankruptcy court would be tempted to err on the side of the largely dormant purpose of providing the creditors with some return. There is no value judgment in this statement, only a recognition that the chance to balance the two principle purposes of the bankruptcy code in the same case comes rarely. Therefore it would be natural to expect bankruptcy courts to place more emphasis on putting assets into a bankruptcy estate on those infrequent cases when they can. It could be argued that to do so balances out the 90% of the time that there is absolutely no chance to effect any kind of balance between the two main purposes of the bankruptcy code. For the debtor seeking to protect a contingent asset that is arguably outside of the definition of “estate property,” it is of course no comfort whatsoever that the bankruptcy universe is arguably in better balance when that balance is being achieved on their backs.
7. THE TWO TOUCHSTONES, POST-PETITION SERVICES AND SEGAL V. ROCHELLE

To the extent there is a “framework” for analyzing contingent interest cases it consists mainly of two legal theories.

First, based on a broad reading of 11 U.S.C. § 541(a)(6), courts nearly universally find that contingent interests that vest due to “services” provided by the debtor after the filing of the Chapter 7 Bankruptcy are NOT part of the bankruptcy estate. Conversely, they hold that everything else that was partially created or earned or developed before the filing and partially created or earned or developed (etc.) after the bankruptcy was filed comes into the bankruptcy estate.

Secondly, many courts still use a nebulous and pre-1978 code Supreme Court ruling to determine whether an interest in property that only became fully realized after a bankruptcy is filed is part of the bankruptcy estate. That case is Segal v. Rochelle, 382 U.S. 375 (1966) which held that that a profit-sharing payment was “sufficiently rooted in the debtor’s pre-bankruptcy past” so as to be considered part of the bankruptcy estate under the 1898 Bankruptcy Act.

Based on these two touchstones, in many cases ruling on contingent interest issues, bankruptcy trustees have had a relatively easy time bringing contingent interests into the estate.

8. CASE SURVEY

a. Clearly Vested Interests

Some cases deal with clearly fully vested or fully non-vested rights as of the petition date and seem easily dealt with under 11 U.S.C. § 541(a)(1), even if the court gets bogged down in § 541(a)(6) or the Segal case:
(1) Real Estate Commissions

Self-employed real estate agent’s proceeds from pre-petition listings that were sold post-petition were not part of estate. *In re Zahneis*, 78 B.R. 504 (Bankr. S. D. Ohio 1987); *But see, In re Ruetz*, 317 B.R. 549 (Bankr. D. Colo. 2004), real estate commissions earned per state law pre-petition but paid post-petition were property of the estate despite post-petition contingencies; *Bogdonov v. Laflamme (In re Lalamme)*, 397 B.R.194 (Bankr. D. NH 2008); *In re Prochnow*, 467 B.R. 656 (C. D. Ill. 2012); *Tully v. Taxel (In re Tully)*, 202 B.R. 481 (B.A.P. 9th Cir. 1996); *In re Smith*, 402 B.R. 887 (B.A.P. 8th Cir. 2009). cf; *In re Parsons*, 262 B.R. 475 (8th Cir, BAP 2001-Kressel, C.J.), aff’d *In re Parsons*, 280 F.3d 1185 (8th Cir. 2002) (Real estate commissions earned (even those listed pre-petition but closed post-petition) by a team including debtor are property of the estate and not earnings of the debtor unless the debtor can prove which portion of the commissions were due to her individual efforts.)

(2) Causes of Action

Age Discrimination in Employment Act claim arising pre-petition but paid post-petition is § 541 property. *In re Williams*, 197 B.R. 398 (Bankr. M. D. Georgia, 1996); cf; *Chartschlaa v. Nationwide Mut. Ins. Co.*, 538 F.3d 113 (2d Cir. 2008) (Insurance agent formed new insurance agency (although did not file the paperwork until post-petition) then filed bankruptcy. The insurance company fired the debtor and the debtor sued for age discrimination, winning a $2,300,000 judgment. The Second Circuit ruled that the cause of action was a “proceed” of the new insurance agency under 11 U.S.C.§ 541(a)(6) and “rooted in the
bankruptcy past” per Segal. The court therefore found that only the bankruptcy trustee had the right to pursue the (seemingly personal) claim against the insurance company. The trustee indicated his intent to abandon the claim against the insurance company and the court vacated the judgment.)

(3) Vacation Pay


b. Examples of Contingent Interests Included in the Bankruptcy Estate

Other contingent Interests have been included in the estate where the issues quickly get twisted by the courts:

(1) Insurance Renewal Commissions

Commissions payable to insurance agents for pre-petition customers who re-new their annual insurance contracts post-petition are estate property; In re Braddy, 226 B.R. 479 (Bankr. N.D. Fla. 1998); In re Williams, 354 B.R. 604 (N.D. N.Y. 2006); In re Palmer, 167 B.R. 579 (Bankr. D. Ariz. 1994); In re Schimmel, 2012 WL 3061488 (Bankr. N. D. Cal.); contra; In re Selner, 18 B.R. 420 (Bankr. S. D. Florida 1982); Williams v. Tomer (In re Tomer), 128 B.R. 746 (Bankr. S. D. Ill. 1991); and, In re Hodgson, 54 BR. 688 (Bankr. W.D. Wis. 1985), insurance renewal commissions Chapter 7 debtor had received post-petition were excluded from property of the estate because vast majority of debtor’s time was spent servicing current clients and debtor had to meet performance goals to receive commissions; in addition, trustee did not assume executory insurance contracts and therefore was unable to keep benefits of contracts for estate. Cf. In re Wu,
173 B.R. 411 (9th Cir. 1994) (Post-petition services owed to clients of insurance agent could lead to finding that renewal commissions should be apportioned-case remanded for findings).

(2) Native American Tribal Distributions

Held to be property of the estate: In re Brown, 2006 WL 6810938 (B.A.P. 9th Cir. 2006); In re McDonald, 353 B.R. 287 (Bankr. D. Kansas 2006); In re Howley, 446 B.R. 506 (Bankr. D. Kansas 2011) (same). The finding that an asset is property of the estate is only the beginning of the inquiry: See, Whitaker v Dakota Finance Corp., 474 B.R. 687 (B.A.P. 8th Cir. 2012) (in adversary action to avoid lien and compel turnover of tribal revenue payments to debtor member, action dismissed on sovereign immunity grounds).

(3) Covenants Not to Compete

(4) Future Wages

Found to be property of the estate. *In re Goins*, 181 B.R. 45 (Bankr. S.D. Ohio 1994). The reinstatement of employment portion of discrimination settlement proceeds (settled by the trustee) were included in property of the estate where the payments were not conditioned upon actual performance of postpetition services by the debtor; *In re Lerocque*, 164 B.R. 4 (Bankr. D.N.H. 1994) (same); *In re Carson*, 82 B.R. 847 (Bankr. S.D. Ohio 1987) (same).

(5) Personal Injury Proceeds

Under Georgia law, class action settlement proceeds received by Chapter 7 debtor postpetition from products liability case were property of the estate even though debtor only became aware that the medicine caused the disease post-petition, the products liability cause of action accrued prepetition and was property of the estate under 11 U.S.C. §541(a)(1). *In re Webb*, 484 B.R. 501 (Bankr. M.D. Ga. 2012); cf. *In re Smith*, 293 B.R. 786 (Bankr. D. Kan. 2003); Fen Phen user filed bankruptcy; stopped using Fen Phen post-petition, case closed before she experienced symptoms allegedly tied to use of the drug; Under Kansas law, her settlement was not property of the estate since the cause of action had not accrued pre-petition.)

All proceeds from a suit concerning a pre-petition automobile accident, even post-petition lost wages and medical bills are property of the estate; *In re Ballard*, 238 B.R. 610 (Bankr. M.D. La. 1999); *But see, In re Coltellar*, 204 B. 640 (Bankr. S.D. Fla. 1997) lost future wages that a state court would award to the Chapter 7 debtor-seaman, in his pending suit against his employer for injuries suffered while
working aboard a cruise ship, would not be property of the estate, because if the
debtor had not been injured but had filed for relief under Chapter 7, such future
wages would have been earned post-petition and therefore would have been
excluded from property of the estate pursuant to § 541(a)(6)).

(6) Malpractice Claims

Post-petition malpractice claim against same lawyer who committed pre-petition
malpractice on an entirely different issue was property of the bankruptcy estate. In
re Schwartz, 2012 WL 4965284 (Bankr. W. D. Ky 2012); Wright v. D’Agostino,
Jr., 2013 WL 541097 (Sup. Ct. Conn. 2013); cf. In re Strada Design Associates,
7 debtors alleged that the law firm that served as their bankruptcy counsel
negligently advised them to file Chapter 7 rather than Chapter 11 and alleged
additional negligence in failure to convert case to Chapter 11, second tort was
derivative of the other claims and was also estate property); contra, In re Rivera,
379 B.R. 728 (Bankr. N.D. Ohio 2007) (Chapter 7 debtor’s legal malpractice
claim against his state-court personal injury attorney, which was based upon
advice rendered postpetition, did not exist as of commencement of debtor’s case
and thus was not property of his bankruptcy estate.)

(7) Chapter 13 Attorney Fees

Fees for services by bankrupt bankruptcy attorney to Chapter 13 clients are
property of the estate as approval of fees can only be for services rendered pre-
petition even though attorney also provides post-petition services; In re Banks,
(8) Pre-Petition Contingent Fees

Attorney’s pre-petition contingent fee agreement partially estate property – post petition work on case excluded; Jess v. Carey (In re Jess), 169 F.3d 1204 (9th Cir. 1999);

(9) Other Commissions


(10) Stock Options


(11) Profit Sharing Benefits

(12) Proceeds of Insurance Policy

Proceeds from fire insurance policy issued pre-petition but not identified on the schedules for (suspicious) fire that destroyed the debtor’s home over two years after the bankruptcy was filed are property of the estate; *In re Fox*, 80 B.R 753 (Bankr. W. D. Wisc. 1987); Debtor failed to disclose cash on bankruptcy schedules; *see also, In re McLain*, 516 F.3d 301 (5th Cir. 2008); Debtors may have used part of that cash a week after filing Chapter 7 to pay for the first monthly premium on a new $1,200,000 life insurance policy purchased by debtor’s father. Debtors obtained their discharge and made 12 more payments on the life insurance policy. Father was then shot to death by persons unknown.

Held: Case remanded to determine if hidden cash was used to pay for the first payment of the undisclosed life insurance policy. If so, the court would hold that all of the proceeds of the policy belonged to the estate under the “proceeds” portion of 541(a)(6) and the “after acquired property” portion of § 541(a)(7).

Limits on inclusion of life insurance interests to those received within first 180 days under § 541(a)(5) not mentioned. Court extended Texas law that uses a constructive trust to hold insurance proceeds purchased by “wrongfully acquired funds.” *Id.* at 313; *cf. Landry v. Exxon Pipeline Co.*, 260 B.R. 769 (Bankr. M.D. La. 2001) (in an extremely complicated factual and procedural case, Judge Phillips decides that a liability insurance policy held by the debtor is not property of the estate because the contractual benefits of that policy protect others, not the debtor. *Id.* at 785-90. Nor are the benefits “proceeds” under 11 U.S.C. § 541(a)(6), which is limited per legislative history to the “sale” or “conversion” of
assets of the bankruptcy estate (similar to 11 U.S.C. § 552(b)(1) definition of “proceed.”) Id. at 795.

(13) Disability Insurance Proceeds

Disability insurance payments (debtor was disabled both before and after start of bankruptcy) are part of bankruptcy estate. Being disabled is not a § 541(a)(6) “service.” The post-petition payments are “proceeds” of the asset that existed as of the time of the filing of the case. In re Skinnett, 321 B.R. 477 (Bankr. S.D. Ind. 2005).

(14) Increase in value of non-exempt closely-held corporation

The value of the shares of the debtor’s corporation are assets of the bankruptcy estate unless earnings increased as a result of debtor’s post-petition efforts. In re Reeves, 65 F.3d 670, 673 (8th Cir., 1995); cf. In re Moyer, 421 B.R. 587 (Bankr. S.D. Ga. 2007) (Increase in value of stock of wholly-owned corporation included in property of the estate, where debtor was unable to show what he did to personally increase the value of his corporation.)

(14) Distribution of Profits

Debtor lawyer’s pre-petition partnership interest in his firm and the post-petition year-end distributions that came with it belonged to the bankruptcy estate. In re Shearin, 224 F.3d 346 (4th Cir. 2000); cf. In re Sholdra, 270 B.R. 64 (Bankr. N.D. Tex. 2001) (Distributions that debtor-ophthalmologist received from his wholly-owned one employee professional corporation were earnings from services performed by debtor; no evidence that any portion of these payments represented return on goodwill).
(14) Consulting Fees for Future Services

Post-petition payments made to Chapter 7 debtor under a settlement agreement with his former employer arising out of an employment dispute were included in debtor’s estate as debtor's obligation to provide consulting services was not the "essence" of the settlement agreement and was not the sole reason the payments were being made. *Laughlin v. Nickless*, 190 B.R. 719 (D. Mass. 1996).

c. Examples of Contingent Interests Not Included in Bankruptcy Estate

Some legal interests have been deemed to not be included in the property of the estate where *Segal* was examined and rejected:

(1) Retroactive Government Program Payments (Crop insurance, etc.)

All crop insurance payments where the law providing for the payments was not in existence at the time of the filing, even though the crop loss was pre-petition; *In re Bracewell*, 454 F.3d 1234 (11th Cir. 2006); *In re Burgess*, 438 F.3d 493 (5th Cir. 2006 8-7 en banc decision); *In re Vote*, 276 F.3d 1024 (8th Cir. 2002); *In re Stallings*, 290 B.R. 777 (Bankr. D. Idaho 2003); *cf.* *In re Grandpre*, 2007 WL 1076945 (Bankr. E.D. La. 2007) (tax credits for Hurricane Katrina losses belonged to debtor when law making tax credits available was passed post-petition even though losses were pre-petition). *Contra*, *Battley v. Schmitz (In re Schmitz)*, 224 B.R. 117 (Bankr. D. Alaska 1998, supplemented by 232 B.R. 173 (Bankr. D. Alaska 1999) and *Lemos v. Rakoz* (In re Lemos), 243 BR 96 (Bankr. Idaho 1999) (both *Schmitz* and *Lemos* use Segal analysis rejected by later cases on same topic); *cf.* *In re Evans*, 337 B.R. 551 (Bankr. E.D. N.C. 2005) (tobacco transition payments under federal law enacted post-petition that repealed tobacco
marketing quota and related price supports, but that required transition payments to debtors to compensate them for lost value of tobacco quotas were proceeds of those quotas and therefore property of the estate) and *In re Alguire*, 391 B.R. 252 (Bankr. W.D. New York 2008) (Economic Stimulus Act passed post-petition amends pre-petition taxes and therefore stimulus funds are property of the estate as governmental retroactive reduction in taxes for previous year); *contra, In re Andrews*, 386 B.R. 871 (Bankr. D. Utah 2008) (where debtors-taxpayers had no legal or equitable interest in economic stimulus payment from government at time of filing, debtors’ payment under later enacted Economic Stimulus Act was not estate property).

(2) Income Tax Refunds

Income tax refunds where debtors proved that the trustee’s demanded split of the refunds based on the number of days the debtors were in bankruptcy was too simplistic; *In re Donnell*, 357 B.R. 386 (Bankr. W. D. Tex. 2006), (rejecting Segal). *Cf. In re Law*, 336 B.R. 780 (B.A.P. 8th Cir. 2006) (income tax refunds attributable to federal child tax credit were property of the estate even though the amount was only calculable when the tax year ended post-petition).

(3) Negotiations Before and After Petition

Proceeds of contract for share of profits signed after petition was filed was not property of estate despite fact negotiations for contract went on prior to filing. *Hoseman v. Weinschneider*, 277 B.R. 894 (Bankr. N. D. Ill. 2002); *cf. In re LaSpina*, 304 B.R. 814 (Bankr. S.D. Ohio 2004) (pre-petition negotiated
severance agreement that was not signed until after petition was filed was nevertheless property of the estate.)

(4) Marital Property where Divorce Commenced Pre-Petition

Real estate owned by non-debtor spouse did not become property of debtor’s estate merely because of commencement of divorce action pre-petition. Where there was no vesting of “marital property” until conclusion of divorce. In re McAvoy, 2009 WL 1120029 (Bankr. D. Conn.); but see, In re Bennett, 175 B.R. 181 (Bankr. E.D. Pa. 1994) – in some states, such as New Jersey, New York, and Pennsylvania a marital interest in property vests immediately upon the initiation of a divorce action coupled with the request for equitable distribution of marital assets. Id. at 185-86 nn. 5 & 6.

(5) Military Benefits

Under federal military pension law, assignees of pension (survivors, ex-spouses) are protected under Patterson v. Shumate from future pension benefits being included in the debtor’s bankruptcy estate property and therefore paid to the debtor’s creditors. In re Satterwhite, 271 B.R. 378 (Bankr. W. D. Mo. 2002) (Federman); Alternatively, Judge Federman opined that payments that are not yet due when the bankruptcy case is filed are not yet owning to the debtor (debtor could not sue at the time of the filing to get future benefits) and therefore are not estate property - §541(a)(1) not cited; See also, In re Harter, 10 Bankr. 272 (Bankr. N. D. Ind. 1981), “the right to payment [of future veteran’s survivor benefits] must be distinguished from the payment itself. Although the statute grants an entitlement, the entitlement is the only interest which the debtor has at
the commencement of his bankruptcy case, not the payments themselves. The debtor does not have the ability to proceed to a court of law to enforce his interest in receiving future payments by demanding the future payments at the present time. Rather, the debtor may proceed to court to protect his right to the future payments. The right to future payment is of no value to the debtor’s estate due to the fact that the Army will not make a lump sum distribution or any distribution in advance… Even if this court would view the future retirement benefits as present property, it could not find that the trustee’s proposed procedure is consistent with the bankruptcy laws enacted by Congress.” *Id.* at 275 (“Proceeds” argument of §541(a)(6) not discussed). *cf.* In re Zrubek, 149 B.R. 631 (Bankr. D. Mont. 1993) where ex-spouse sought (pre-enactment of 11 U.S.C. § 523(a)(15)) to keep debtor from discharging pre-petition obligation for past-due military pension benefits (denied) and from future military pension benefits awarded pre-petition by state divorce award. Court ruled that Military pension benefits were not “wages” under the Federal military pension plan and therefore were included in the property of the estate. *Id.* at 634 (*Patterson v. Shumate* not discussed, 11 U.S.C. § 541(a)(5)(B) not discussed). Despite the fact that the Court ruled that the wife’s portion of the pension benefits were part of the bankruptcy estate (through a technicality the Air Force was paying the ex-spouse’s share to the debtor), the court also ruled that the benefits were “future obligations” that could not be discharged. “The husband is under no obligation to pay his former wife until the Air Force pays him; therefore, a debt does not arise under the Code until each payment is due. See 11 U.S.C. § 101(4), (11). Since the post-petition and
prospective payments are not debts under the Code, they are not subject to discharge in this bankruptcy. 11 U.S.C. § 727(b).” Id. at 635 (quotation omitted). At least three questions arise from this strange case: 1: If the obligation to pay was a future property right, wouldn’t the right to receive the benefit be a future property right and therefore that property not come into the bankruptcy estate either (see Satterwhite?) 2: If in fact the military pension benefits were not part of the estate property per Patterson, would the bankruptcy court have jurisdiction to rule whether the debt owed from that monthly benefit could be discharged? 3: If the pension benefits came into the estate, wouldn’t the court be obligated to pay those benefits out to the debtor’s unsecured creditors?

(6) Insurance renewal commissions
Fire insurance renewal commissions which were contingent on agent generating new business and providing service to customers are not property of the estate. In re Kervin, 19 B.R. 190 (Bankr. S. D. Ala. 1982).

(7) Post-petition employment bonuses

(8) Spousal Maintenance/Alimony
Post-petition spousal support payments are not "earnings," within the meaning of §541(a)(6), and therefore included in the property of the estate. In re Anders, 151
B.R. 543 (Bankr. D. Nev. 1993); contra, In re Mitchem, 309 B.R. 574 (Bankr. W.D. Mo. 2004), post-petition spousal maintenance payments were not assets of the bankruptcy estate since maintenance was personal right that did not vest until each maintenance payment was due and payable; In re Wise, 346 B.R. 1239 (10 Cir. 2003), spousal maintenance payments received during the first 180 days of the case were not property of the estate because under Colorado law they were a personal statutory right of debtor.

d. Cases Decided Under § 541(a)(5)

There are many cases discussing the potential of estate property under the “180 Day Rule” of § 541(a)(5):

(1) Payable on Death Accounts, IRA Benefits and Transfer on Death Deeds

In re Hall, 394 B.R. 582 (D. Kansas 2008); A payable-on-death account, an IRA benefit and property via a transfer-on-death deed all received within 180 days after the petition date are not property of the estate under 11 U.S.C. §541(a)(5) and under Kansas law.

(2) Elective Share of Decedent’s Estate

Pre-petition death of spouse, debtor elects to wait more than 180 days after filing to elect to take share of estate, not property of the estate since trustee was not entitled to acquire the elective share until debtor exercised the right of election. In re Miller, 441 B.R. 154 (Bankr. S.D. Fla. 2010); cf. In re Farrior, 344 B.R. 483 (Banrk. W.D. Va. 2006) (Attempt to disclaim interest in inherited property received within 180 days post-petition ineffective as legal interest belonged to trustee).
Bohm v. Radinick, (In re Radinick), 419 B.R. 291 (W.D. Penn. 2009). A Pennsylvanian filed divorce and then filed bankruptcy prior to the family law court ruling on the split of property, which left that task to the bankruptcy court. The debtor argued that her inchoate interest in her non-debtor spouse's pension plan was not estate property because under § 541(a)(5)(B) interests that don't come into the bankruptcy estate through "a property settlement agreement with the debtor's spouse, or of an interlocutory or final divorce decree" within 180 of the filing of the bankruptcy case are not property of the estate. The bankruptcy court ruled that § 541(a)(6)'s "proceeds" section trumped § 541(a)(5)(B) and that "anything that the Debtor might derive from her right to equitable distribution vis-a-vis the Estranged Spouse's Retirement Plan will (a) constitute proceeds or product of or from property of the Debtor's bankruptcy estate (such bankruptcy estate property being the Debtor's marital interest in the Estranged Spouse's Retirement Plan), and (b) thus also constitute bankruptcy estate property, pursuant to 11 U.S.C. § 541(a)(6), regardless of whether it is distributed to the Debtor within 180 days after the date of the commencement of her bankruptcy case." Id. at 395-96 (no discussion of Patterson v. Shumate or §541(c)(2)); cf. In re Mullican, 417 B.R. 389 (Bankr. E.D. Tex. 2008) (11 U.S.C.A. §541(a)(5) is the only method under the bankruptcy code a post-petition inherited interest can come into the estate, the contingent interest in inherited property existing as of the date of the petition does not allow the later-vested interest into the estate under §541(a)(1) (§ 541(a)(6) “proceeds” argument not discussed).
In re Street, 395 B.R. 637 (S.D. Ohio 2008). Wife and husband were involved in a dissolution of marriage proceeding pre-petition. In May of 2007 the parties agreed to a property settlement whereby wife would be paid $14,500 over time from her husband as payment for wife’s agreeing to waive any interest in husband’s teacher retirement pension and waive any interest in the marital homestead. Debtors then filed a joint bankruptcy in June of 2012. Schedule C noted a joint(?) interest in the teacher’s pension in the amount of $1.00 and exempted the homestead in the amount of $5,000 per debtor. No objection was made by the trustee. The divorce decree noting the payment due to the wife was filed in state court on October 7, 2007. The trustee thereafter filed a turnover motion for the $14,500. In April of 2008, shortly before the turnover hearing was held, Schedule C was amended to increase the value of the pension exemption to $22,000. The court ruled that the divorce order was entered less than 180 days after the filing of the bankruptcy and that therefore the payment was part of the wife’s bankruptcy estate (Id. at 641). The court also ruled that although the payment order in the divorce decree divested wife’s interest in the homestead and the pension plan, as of the date of the petition, she had a marital interest in both the assets and could exempt them from the estate Id. at 643-647). The court also ruled that the substitute payment for her interest in her husband’s pension was considered to be a pension benefit (Id.) (which begs the question why it would be an asset of the estate).

(4) Inter-Vivos Trusts
Distributions from an inter vivos trust were not acquired through “bequest, devise, or inheritance” and were excluded from estate per spendthrift clause in trust (thus invoking §541(c)(2)). *In re Blount*, 438 B.R. 98 (Bankr. E.D. Tex. 2010); *In re Rogove* 443 B.R. 182 (Bankr. S.D. Fla. 2010) (same – first 180 days of testamentary trust benefits, are, however, payable to the estate); *In re Ciano*, 433 B.R. 431 (N.D. Fla. 2010) (same); *In re Spencer*, 306 B.R. 328 (Bankr. C.D. Ca. 2004) (same); *In re Roth*, 289 B.R. 161 (Bankr. D. Kan. 2003) (same).

e. Contingent Exemptions

There has been at least one case discussing what happens if a debtor exempts a property interest but that property interest is contingent and the contingency later fails. The 9th Circuit ruled that, where there was the sale of an exempt home, and where there was no re-investment of the proceeds to a new home within six months, the equity of the home became the property of the bankruptcy estate. *Wolfe v. Jacobson (In re Jacobson)*, 676 F.3d 1193 (9th Cir. 2012).


a. Plain Language

It is absolutely clear from a plain reading of 11 U.S.C. § 541(a)(6) that (most) earnings from services performed after the filing of the bankruptcy are not excepted from the bankruptcy estate under the terms of that Section. Let me clarify. It is common for a bankruptcy court to use § 541(a)(6) to say that any sums earned from services after the filing of a bankruptcy estate do not belong to the bankruptcy estate. But that reading of that section of the code is superfluous because the definition of property in § 541(a)(1) already excludes property that comes into existence after the filing of the petition. In addition, § 541(a)(6) in no way says such a thing:

“(6) [Property of the estate includes]: Proceeds, product, offspring, rents, or profits of or from property of the estate, except such as are
earnings from services performed by an individual debtor after the commencement of the case.”


Broken down, it is difficult to really parse the language of the statute, but what it clearly does NOT say is:

“Except for sums earned by the debtor after the commencement of the case, all proceeds, etc. of or from property of the estate are property of the estate.”

The section in fact states that all proceeds, etc. of or from property of the estate are property of the estate as well, EXCEPT THAT any proceeds, etc. of the estate that are earnings paid to the debtor from services after the commencement of the case are not property of the debtor.

Well, that’s awkward. And just what are services performed by the debtor after the commencement of the case? Wouldn’t the debtor have to be hired by the estate to be able to obtain payment for services? And why this special rule about excluding only proceeds of the estate that are paid to the debtor from definition of property? Why not just leave well enough alone, since a debtor can be paid from any property of the estate (and not just proceeds of property that become vested after the commencement of the case) through 11 U.S.C. § 330?

b. Legislative History of 11 U.S.C. § 541(a)(6)

Legislative History is of some help here. Bankruptcy Judge Louis Phillips wrote an article 15 years ago that has largely been ignored concerning the fact that § 541(a)(6) is being misused nearly universally to provide a rationale for allowing a wide range of contingent assets to flow fully into the bankruptcy estate without further analysis. Honorable Louis M. Phillips, U.S. Bankruptcy Court, M. D. Louisiana (and his former law clerk, Tanya Martinez Shively), “Ruminations on Property of the Estate--Does Anyone Know Why a Debtor’s Postpetition
Earnings, Generated by Her Own Earning Capacity, Are Not Property of the Bankruptcy Estate?” 58 La. L. Rev. 623 (1997-1998) (hereafter “Phillips”). What is at issue is the converse of the alleged meaning of § 541(a)(6). That is, if the debtor’s “services after the commencement of the case” are NOT property of the estate, any other interest in property that vests after the commencement of the case must therefore BE property of the estate. Judge Phillips points out that the legislative history of § 541(a)(6) shows that the intent of § 541(a)(6) is to exclude a narrow category of assets from the bankruptcy estate, not include all contingent assets that are not “sums earned by the debtor after the commencement of the case.”

“The Report of the Committee on the Judiciary, House of Representatives, accompanying proposed § 541(a)(6), provided as follows:

‘The estate also includes ... proceeds, product, offspring, rents, and profits of or from property of the estate, except such as are earnings from services performed by an individual debtor after the commencement of the case. See proposed U.S.C. [§] 503(b)(1). Postpetition payments to an individual debtor for services rendered to the estate are administrative expenses, and are not property of the estate when received by the debtor. This situation would most likely arise when the individual was a sole proprietor and was employed by the estate to run the business after the commencement of the case. An individual debtor in possession would be so employed, for example. See Local Loan v. Hunt, 292 U.S. 234, 243 (1943).’

The Report of the Committee on the Judiciary, United States Senate, regarding § 541(a)(6), is virtually identical, as follows:

‘Postpetition payments to an individual debtor for services rendered to the estate are administrative expenses, and are not property of the estate when received by the debtor. This situation would most likely arise when the individual was a sole proprietor and was employed by the estate to run the business after the commencement of the case. An individual debtor in possession would be so employed, for example. See Local Loan v. Hunt, 292 U.S. 234, 243 (1943).’

Both the House and the Senate Reports, and Local Loan Co. v. Hunt, set up the meaning of § 541(a)(6) in the context of an individual debtor employed by the estate to run her business postpetition, and contemplate
shielding the debtor’s postpetition salary, paid by the estate as an administrative expense under § 503(b)(1), from the reach of property of the estate. In other words, the legislative history of § 541(a)(6) contemplates an “earnings exception” that is narrowly tailored to fit the situation where the debtor’s earnings, generated from the proceeds, product, offspring, rent or profits of estate property and paid, perhaps, under § 503(b)(1), are excluded from property of the estate. § 503(b)(1) is the perfect vehicle for implementing § 541(a)(6), as it allows the court to determine the extent to which wages, salaries, and earnings have been accruing to preserve or benefit the estate. The plain meaning of § 541(a)(6) accords with this interpretation.”

Id. at 634-35 1997-1998 (citations omitted).

Nearly all of the cases listed above use § 541(a)(6) to separate the sheep (property owned by the estate) from the goats (property owned by the debtor). If you believe Judge Phillips, or, if you read both §541(a)(1) and § 541(a)(6) and the relevant legislative history, you might come to believe that the courts are using §541(a)(6) incorrectly, although getting a bankruptcy judge (except Judge Phillips) to throw away perhaps hundreds of cases, including cases from the circuit courts, that use §541(a)(6) to determine which contingent interests are in the bankruptcy estate is a daunting task.

There are some courts that have at least found that §541(a)(6) is not necessary for the determination of which assets are part of the bankruptcy estate. In In re Carlton, 309 B.R. 67 (Bankr. S. D. Fl. 2004) the court found that §541(a)(6) is unnecessary to shelter post-petition income for services in a Chapter 7 as that income is generated post-petition and therefore is not part of § 541(a)(1) property. Id. at 74. The court went on to determine that the only act necessary for the exercise of the stock options was continued employment which the court deemed a condition subsequent (a maintenance of the status quo) and that absent a condition precedent (a change of the status quo that is mandated before the stock could be issued) that the
stock options and their increase in value after the filing of the petition was all estate property.\(^1\)

_Cf: In re: Satterwhite, 271 B.R. 378 (Bankr. W. D. Mo. 2002);_ (Judge Federman first held that under federal military pension law, assignees of the pension (survivors, ex-spouses) are protected under _Patterson v. Shumate_ from having the post-petition pension payments included in the debtor’s bankruptcy estate property. As an alternative finding, Judge Federman opined that payments that are not yet due when the bankruptcy case is filed are not yet owning to the debtor (debtor could not sue at the time of the filing to get future benefits) and therefore are not estate property – _Id._ at 382; Section 541(a) is not cited, however it’s a short leap to say that there is no inclusion of assets in the bankruptcy estate under §541(a)(1) if the debtor could not sue to enforce a right to future payments as of the petition date and therefore no need to delve into whether post-petition vested assets are “services” under §541(a)(6)). _See also, In re Harter, 10 Bankr. 272, 276 (Bankr. N. D. Ind. 1981) (same)._ 

Other Eighth Circuit cases have, however, opined that the broad view of § 541(a)(6) is alive and well; _In re Wick, 276 F.3d 412, 415, 416 (8th Cir. 2002); In re Reeves, 65 BR 670, 674 (8th Cir. 1995) (Lokken); In re Irish, 311 B.R. 63, 66 (B.A.P. 8th Cir. 2004)._ However, the _Wick_ case at least broadened the definition of post-petition services to mere continued employment (id. at 416), which therefore narrows those activities that are not post-petition services and which therefore narrow the number of contingent assets that come into the bankruptcy case despite the increase in value of the assets due to some sort of effort on the part of the debtor. Many other

\(^{\text{1}}\) The _Carlton_ Court ignored the fact that a rather large condition precedent, the necessity of payment for the stock options, existed as of the time of the filing of the bankruptcy case. In this instance, the debtor hid the existence of the stock options from the court and exercised the options post-petition, so it is understandable that the court wasn’t giving any breaks to the debtor on these fine points of law.
cases refuse to include mere continuation of employment as “post-petition services” that exempt assets from coming into the bankruptcy estate (see cases, supra).

10. THE DOUBTFUL UTILITY OF SEGAL V. ROCHELLE

Judge Phillips described Segal v. Rochelle, 382 U.S. 375, 379, 86 S. Ct. 511, 515 (1966) which is a seminal Bankruptcy Act case decided in 1966 that attempted to define “property of the estate” under section 70(a) of that act. In Segal v. Rochelle, the issue before the Court was whether the loss-carryback tax refunds arising out of business losses immediately prior to bankruptcy but not collected until after the bankruptcy petition had been filed were “property” under Section 70a(5) of the Bankruptcy Act.

[T]he Court [held] that the “future wages” (i.e., postpetition earnings) of the bankrupt were not property, within the meaning of Section 70a(5) of the Bankruptcy Act, which provided that the trustee was vested by operation of law, as of the commencement of the case, with the bankrupt’s title in “property... which prior to the filing of the petition [the debtor] could by any means have transferred or which might have been levied upon and sold under judicial process against him, or otherwise seized, impounded, or sequestered.” The Court acknowledged that “[t]he main thrust of [section] 70a(5) is to secure for creditors everything of value the bankrupt may possess in alienable or leviable form when he files his petition,” 7 but excepted from the reach of Section 70a(5) are the “future wages” of the bankrupt, because “one purpose [of the Act] which is highly prominent ... is to leave the bankrupt free after the date of his petition to accumulate new wealth in the future.” 8 The Court added, however, that any sums received postpetition by the bankrupt that were “sufficiently rooted in the pre-bankruptcy past and so little entangled with the bankrupts’ ability to make an unencumbered fresh start ... should be regarded as ‘property’ under section 70a(5).”

Phillips at 629, citations omitted.

A key difference between the Bankruptcy Act and the Bankruptcy Code of 1978 is that under the Code, “property of the estate” is statutorily defined, whereas under the act it was not. Despite the fact that the 1978 Code has a perfectly good definition of “property of the estate”

There is a growing trend however, to declare *Segal v. Rochelle* as inapplicable to help define “property of the estate” under the Bankruptcy Code. *See, e.g., In re Bracewell, 454 F.3d 1234 (11th Cir. 2006) (Crop Insurance Proceeds); In re Burgess, 438 F.3d 493 (5th Cir., 2006); In re Donnell, 357 B.R. 386 (Bankr. W. D. Texas 2006); In re Vote, 276 F.3d 1024, 1026 (8th Cir 2002)” cf: *In re Klein-Swanson, --- B.R. ----, 2013 WL 1164430 (B.A.P. 8th Cir. 2013) (Discretionary post-petition bonus not part of bankruptcy estate [distinguishing cases to the contrary] – refuses to say *Segal* is dead but distinguishes facts from facts in *Segal*); *In re Grandpre, 2007 WL 1076945 (Bankr. E.D. La. 2007) (Hurricane Katrina benefits from law enacted post-petition, recognizing *Segal* was no longer good law in the 5th Circuit).

The *Donnell* Court explained the 5th Circuit’s rejection of *Segal*:

The Fifth Circuit’s recent en banc decision in *Burgess* significantly informs our analysis of this issue. The court there held that, with the enactment of an explicit statutory definition for “property of the estate” in the Bankruptcy Reform Act of 1978, “*Segal*’s ‘sufficiently rooted’ test did not survive the enactment of the Bankruptcy Code. This conclusion is consistent with the actual holding in *Barowsky*, though it more explicitly (and correctly) rejects the notion that “sufficiently rooted in the pre-bankruptcy past” describes the scope of the estate’s interest in property. As we have seen, it does not. The language was employed by the Supreme Court in *Segal* to determine whether the debtor’s “fresh start” would be impaired were the property in question incorporated into the estate. This was a live issue under the Act. Because any alienable or leviable property could become property of the estate, a debtor’s future wages in perpetuity could conceivably be swept up (many states in 1966 permitted full wage
garnishment, a species of alienation or levy). By limiting the reach of property to that “sufficiently rooted in the pre-bankruptcy past,” the debtor’s future wages (which are, by definition, not “rooted in the pre-bankruptcy past” of the debtor) would thereby be insulated from estate administration. The Bankruptcy Code has no need for this limitation. Instead, the statute itself de facto excludes certain assets from inclusion in the estate, first by changing the reach of estate property from “any alienable or leviable property” (the scope under the Act, according to Segal) to “all legal or equitable interests in property as of the commencement of the case” (the scope under the Code). Secondly, Section 541 itself contains specific statutory exclusions from the reach of Section 541(a)(1), including the “except” clause in section 541(a)(6) for post-petition earnings, and the various exclusions in Section 541(b). This is what the Fifth Circuit meant when it ruled that Segal’s “sufficiently rooted” test did not survive the enactment of the Code.

*In re Donnell*, 357 B.R. at 391.

11. **ALTERNATIVES TO SEGAL V. ROCHELLE**

If “rooted in the past” is not the measuring stick for determining which contingent property is part of the bankruptcy estate, is there another one, or is one needed at all? One commentator stated:

“To conclude that a right to property in the future is property of the estate under § 541 leads inevitably to questions of policy under the Code, just as under the Act the conclusion that property either was or was not property of the estate could not be made without considering the purposes the Act was enacted to further.”

*Pitts at 62.*

You could argue that the determination of whether an interest in property is in the estate should still be determined by the dual purposes of the bankruptcy code – distribution to creditors of available assets and the debtor’s fresh start. However, unless you’re willing to weigh one against the other based on the facts of the case (which is the “rooted in the past” analysis) you’re perhaps stuck where no other determination can be made other than dividing the asset in some fashion. Just how to do that is the issue; Many cases attempt this based on the (flawed) analysis

A (fairly rare) approach more in keeping with the literal language of the Bankruptcy Code is attempted by some courts to determine the present value of the asset at the time of the filing, and, if there is no value to the present asset, keeping the entire asset out of the bankruptcy estate; See, *In re Satterwhite*, 271 B.R. 378 (Bankr. W. D. Mo. 2002) (no future veteran’s survivor benefits come into the bankruptcy estate as the debtor could not sue on the date of the petition to get a lump sum of those future benefits); *In re Selner*, 18 B.R. 420 (Bankr. S. D. Fla. 1982) (Insurance renewal commissions due to post-petition efforts of debtor, none of those commissions are part of the bankruptcy estate); *In re Harter*, 10 B.R. 272 (Bankr. N. D. Ind. 1981) (The right to future Army pension payments is of no value to the debtor’s estate due to the fact that the Army will not make a lump sum distribution or any distribution in advance, id. at 277).
12. **ONE EXAMPLE – LIFE INSURANCE PROCEEDS AS PROPERTY OF THE ESTATE**

a. Life Insurance Interests Under the 1898 Bankruptcy Act

Another pre-Bankruptcy Code case, *Burlingham v. Crouse*, attempted to decide how to classify assets based on the two competing policies of the Bankruptcy Act. *Burlingham v. Crouse*, 228, U.S. 459 (1913). The Supreme Court ruled that it was possible to effectuate both policies of the 1898 Bankruptcy Act in determining the meaning of the language of § 70(a)(5). “We think it was the purpose of Congress to pass to the trustee that sum which was available to the bankrupt at the time of the bankruptcy as a cash asset [the cash value of the life insurance policy]; otherwise to leave to the insured the benefit of his life insurance.” *Id.* 228 U.S. 473. By “his life insurance” the Court was talking about the proceeds of a policy owned by the debtor. Assuming that the Court meant that the debtor’s right to the proceeds of an insurance policy on the life of another is what is being protected in the name of a fresh start, the Supreme Court was determining a doubtful provision of the Bankruptcy Act based on its determination that Congress did not intend to impede the debtor’s fresh start by determining that the property of the estate included a “speculative right to the net proceeds of the policies, contingent upon the death of the [co-debtor]… and possibly dependent upon the payment of large annual premiums for thirteen years.” *Id.*

The 1898 Act did not allow exempt property to come into the estate (*id.* at 470), and the 1978 Code first puts all estate property into the estate and then allows the exemption of property under 11 U.S.C. § 522. Therefore, the inquiry that is being made for contingent assets under the current bankruptcy law is whether a contingent interest is property of the estate rather than exempt property. At least one court has ruled that *Burlingham* has been overturned through the passage of the Bankruptcy Code; *In re Meyers*, 483 B.R. 89 (Bankr. W.D. N.C. 2012); however
the case was quoted generally recently by the Supreme Court, *Schwab v. Reilly*, 130 S. Ct. 2652, 2674 (2010).

b. Life Insurance Proceeds Under the Bankruptcy Code

However, it is doubtful that the questions about the status of potential life insurance proceeds as property of the estate are any clearer under the Code than under the Act of 1898. For instance, other than the admonition that all assets of the debtor that exist as of the time of the filing of the petition are property of the estate in 11 U.S.C. § 541(a), there is further information on how the Bankruptcy Code treats certain after-acquired property in § 541(a)(5): “Property of the estate also includes property acquired for 180 days after the petition date by bequest, devise, inheritance, settlement, or life insurance proceeds.” 11 U.S.C. § 541(a)(5)(c). Does this mean that any life insurance proceeds received by the debtor 181 days after the filing don’t belong to the estate? Or are life insurance benefits a “proceed” of the pre-petition property interest held by the debtor as a beneficiary of that policy under § 541(a)(6)? See, *In re Holland*, 2008 WL 5455410 (Bankr. W.D. Tex. 2008) (Judge Monroe). In *Holland*, the Debtor filed her Chapter 7 in September of 2005, did not schedule any interest as a beneficiary of her mother’s life insurance policy as she believed she had been disinherited. The facts do not state when the bankruptcy case was closed. Thereafter, in February of 2007 the debtor’s mother died and debtor was paid a $108,0000 life insurance benefit in August of 2007. Debtor did not inform the trustee of the benefit. Trustee moved to re-open the case and obtain the life insurance benefit for the benefit of the creditors. The court ruled that under 11 U.S.C. § 541(a)(5)(C), since more than 180 days passed post-petition before the debtor became entitled to the life insurance proceeds, that the proceeds were not property of the bankruptcy estate. No discussion of whether the payments could be considered to be a “proceed” of the contingent interest of the death benefit. *Cf. In re
disability insurance settlement negotiated post-petition by debtor was property of the estate as a “proceed” of the disability insurance policy (id. at 5, collecting cases); cf. Wornick v. Gaffney, 544 F.3d 486 (2d Cir. 2008) (the cash value of a life insurance policy is contingent interest at time of filing of bankruptcy because debtor could have changed the beneficiary at any time up to the filing of the bankruptcy. As a benefit of a life insurance policy, the only way the cash value can come into the bankruptcy estate is if the life being insured dies within the first 180 days of the bankruptcy case. Id. at 490); In re Fetter, 354 B.R. 242 (C.D. Ill. 2006) (spendthrift trust exception of 11 U.S.C. § 541(c)(2), which specifically excludes interests protected under state laws from being part of the bankruptcy estate protected that income against a claim that they should be included in the bankruptcy estate under the “after acquired” property provision in 11 U.S.C. § 541(a)(5)).

Section 522(d)(7) exempts all life insurance contracts owned by the debtor other than a credit life insurance contract” – “owned by the debtor”. “Ownership” means, under § 522(d)(7) the right to maintain the policy and name a beneficiary. See H.R. Rep. No. 595, at 361, reprinted in 1978 U.S. Code Cong. & Admin. News at 6317 (§ 522(d)(7) “refers to the life insurance contract itself. It does not encompass any other rights under the contract, such as the right to borrow out the loan value”); 3 Collier ¶ 522.16, at 522-63 (same).

If a non-matured life insurance policy is not property of the estate, a bankruptcy trustee has no ability to change the beneficiary. However, sometimes that is not the case. A debtor filed bankruptcy and then attempted to change the beneficiary of a life insurance policy on his own life from his grandmother to a third party. The debtor then committed suicide and his grandmother filed for bankruptcy. The grandmother’s bankruptcy court ruled that the grandson did not have ownership of the policy when he changed the beneficiary, since (among other
things) he had not listed the policy on his bankruptcy schedules and that therefore the unmatured policy, which came into the bankruptcy estate under 11 U.S.C. § 541(a) and was never exempted out, belonged to the grandson’s bankruptcy trustee. Therefore, the attempt of the grandson to change the beneficiary of the policy when he was in bankruptcy was a legal nullity and the grandmother’s bankruptcy estate got the $2,000,000 proceeds of the policy. *In re Meyers*, 483 B.R. 89, 97-98 (Bankr. W.D. N.C. 2012). It pays to list and exempt non-matured life insurance contracts.

Another reason why the debtor in *Meyers* was not able to control the change in a beneficiary was that North Carolina opts out of federal exemptions and there is no similar exemption under North Carolina state law for the ownership of a non-matured insurance policy. *Id.* at 100. Minnesota shares this deficiency. Although Minn. Stat. § 550.37 protects some insurance proceeds and interests in cash value\(^2\), there is no provision under Minnesota exemption law similar to 11 U.S.C. § 522(d)(7) which provides for the exemption of an “ownership interest” in a life insurance policy. A Minnesota bankruptcy trustee could, theoretically, therefore, change the beneficiary designation on a life insurance policy owned by the debtor to the bankruptcy estate for debtors choosing Minnesota exemptions.

\(^2\) Minn. Stat § 550.37, Subd. 10. **Insurance proceeds.** All money received by, or payable to, a surviving spouse or child from insurance payable at the death of a spouse, or parent, not exceeding [$46,000]. The [current $46,000] exemption provided by this subdivision shall be increased by [$11,500] for each dependent of the surviving spouse or child.

Subd. 23. **Life insurance aggregate interest.** The debtor’s aggregate interest not to exceed in value [$9,200] in any accrued dividend or interest under or loan value of any unmatured life insurance contract owned by the debtor under which the insured is the debtor or an individual of whom the debtor is a dependent.
c. The Trustee’s Ability to Assume a Life Insurance Contract

(1) The Vexing Problem of “Executory Contracts”

The ability of a bankruptcy Trustee to control a debtor’s life insurance policy faces a couple of other significant roadblocks that are similar to other contingent interests. These issues have either been ignored by debtors or raised and disposed of by the courts in other contexts by referral to Segal or § 541(a)(6). First is the issue of whether a life insurance policy is an executory contract. Whether insurance contracts are executory contracts is an issue that is subject to debate; see, e.g., Counties Contr. and Constr. Co. v. Const. Life Ins. Co., 855 F.2d 1054, 1060 (3rd Cir. 1988), listing cases but making no conclusion. However, this may not have any practical utility. Again we are assuming that 11 U.S.C. § 541(a)(5) does not apply (that is, we’re assuming that the life insurance proceed comes into the estate after 180 days). Under 11 U.S.C. § 541(a)(1) if a life insurance policy is an executory contract it cannot be assumed after 61 past the petition date, 11 U.S.C. § 365(d)(1)). Alternatively, a life insurance contract may be deemed to be a non-executory contract which therefore may not be able to be assumed per Vern Countryman’s essay on executory contracts (see below for further discussion on the always confusing issue of “executory contracts”).

(2) The Need for an “Insurable Interest”

A final obstacle concerning the transfer of a life insurance benefit to a bankruptcy estate is whether the estate has an “insurable interest” in the life of the life of the insured.

In Minnesota, as in any other state, in order to obtain an insurance policy, a prospective insured has to have an “insurable interest” in the subject to be paid on an insurance policy that purports to provide an insurance contact in that subject. Casablanca Concerts v American Nat. General Agencies, Inc., 407 N.W.2d 440, 447 (Minn. App. 1987). While in some states,
“insurable interest” is a statutory concept, in Minnesota it is largely be rooted in the common law. “A person has an insurable interest if it may be fairly be said that that person has a reasonable expectation of deriving pecuniary advantage from the preservation of the subject-matter of insurance...” Custer v. Homeside Lending Inc., 858 So. 2d 233, 247 (Ala. 2003) (Citations omitted). See also, Lumbermens Mut. Ins. Co. v. Edmister, 412 F.2d 351, 353 (8th Cir. 1969). If a court finds that a policy holder has no insurable interest, the most that policy holder can collect is a refund of the premiums paid. See generally, “Automobile Fire, Theft, And Collision Insurance: Insurable Interest In,” 38 A.L.R. 4th 538 at § 2[b].

In Minnesota, as elsewhere, if the amount of the insurance policy greatly exceeds a person’s insurable interest, it is void as an illegal gambling contract. Casablanca Concerts, 407 N.W.2d at 447. “[T]he reason for the rule most commonly assigned is that if the insured has no insurable interest in the property insured, the insured is wagering that a loss or damage will occur and the insurer is wagering that it will not, thereby supplying the insured with an incentive to injure or destroy the insured property, which is against public policy.” Custer, 848 So. 2d at 247. In the Lumberman’s case, a tenant who formerly owned real property including a building, and who had purchased an fire insurance policy prior to the time he sold the real estate, sought to be paid on that policy when the building burned down. The 8th Circuit held that such an insurance policy was void because the policy holder lacked an “insurable interest” in an amount necessary to obtain the policy. The Court found that “to permit a holder of less than a one-tenth interest at best to insure that interest for ten times its value removes the transaction from the category of insurance contracts to those of gambling agreements, concededly illegal in Missouri.”

Lumbermens Mutual Ins. Co., supra at 357.
13. **OPTIONS FOR DEBTORS**

As a debtor, you want the court to compare your property interest to a farmer’s right to a crop payment under a federal agriculture program that wasn’t in existence at the time of the filing. The farmers in that situation always win and get to keep their crop payment. You want to avoid at all costs the court comparing your contingent interest to the right of insurance agents to obtain a commission on insurance renewals that are made by their customers after the filing of the bankruptcy. Insurance agents (nearly) always lose the right to keep those renewals out of the hands of their trustee.

The general rule is “[T]he broad scope of the estate under the 11 U.S.C. 541(a)(1) definition does not enlarge a trustee’s substantive property rights beyond those existing at the commencement of the case.” *Calvert v. Bongards Creameries (In re Schauer)*, 62 B.R. 526, 529-30 (Bankr. D. Minn. 1986). What can Debtor’s counsel attempt to get court out of their penchant for simply seeking the easy way out by citing to 11 U.S.C. § 541(a)(6) or even Segal and finding that a contingent asset belongs to the estate?

a. **Condition Precedent:**

At least one court has specifically said that if there is a condition precedent to the vesting of the asset, then the asset will not vest in the bankruptcy estate; *In re Carlton*, 309 B.R. 67 (Bankr. S. D. Fl. 2004) (Stock options property of the estate, post-petition increase in value also property of the estate. Section 541(a)(6) is unnecessary to shelter post-petition income in a Chapter 7 as they are generated post-petition and therefore are not part of § 541(a)(1) property (*Id.* at 74)). The Carlton court suggests that you can divide contingent interests that come into the estate by excluding those that have a condition precedent to obtaining that interest (*Id.* at 74) but ignores the fact that there was
a condition precedent in this case (payment for the stock option); a different court specifically rejected the argument that the mere existence of a condition precedent took the asset out of the bankruptcy estate; *Parks. v. Ditmmar, et. al., (In re Ditmar),* 618 F.3d 1199 (10th Cir. 2010) (Stock Appreciation Rights (bargained for interest in new company-similar to stock options, but entirely optional) are part of the bankruptcy estate. Fact that the SARs were subject to the condition precedent of payment for the options does not take the assets out of the bankruptcy estate (*Id. at 1205*)).

b. **Non-existence of a right to sue as of the petition date:**

*See, In re: Satterwhite, 271 B.R. 378 (Bankr. W. D. Mo. 2002) (no future veteran’s survivor benefits come into the bankruptcy estate as the debtor could not sue on the date of the petition to get a lump sum of those future benefits); In re Selner, 18 B.R. 420 (Bankr. S. D. Florida 1982) (Insurance renewal commissions due to post-petition efforts of debtor, none of those commissions are part of Bky estate); In re Harter, 10 Bankr. 272 (Bankr. N. D. Ind. 1981) (The right to future Army pension payments is of no value to the debtor’s estate due to the fact that the Army will not make a lump sum distribution or any distribution in advance, *id. at 277*); In re Tomer, 128 B.R. 746 (Bankr. S. D. Ill. 1991) (insurance renewal case where court ruled that no renewals due at time of petition came into the estate partially because the debtor could not sue to get paid for those renewal rights as of the date of the filing).*

c. **Personal Service Contract:**

An argument sometimes made but not often accepted is 11 U.S.C. 365(c):

If a contingent interest is an executory contract, the Trustee cannot assume the contract (where it is a personal service contract under 11 U.S.C. § 365(c)); *In re Tomer,*
128 B.R. 746 (Bankr. S. D. Ill. 1991) (insurance contracts a personal service contract that the Trustee could not assume).

d. Executory Contract Issues:

(1) In General

“Bankruptcy is that volume of the law that might have been written by Lewis Carroll, every conventional legal principle refracted through the prism of insolvency….In no chapter of that volume has the law become more psychedelic than in the one titled “executory contracts.”


Many debtors’ counsel in contingent asset cases bring up the fact that a contingent interest in property is an executory contract that the trustee failed to assume and that therefore the contract was rejected on the 61st day by the estate under 11 U.S.C. § 365(d). These arguments sometime get a hearing; In re Tomer, 128 B.R. 746 (Bankr. S. D. Ill. 1991); more often the argument is ignored or rejected by courts finding that a contingent contract was not executory and that, therefore, the contract was not rejected and that the benefits of the contract flow into the bankruptcy estate as either “proceeds” of the pre-petition property interest or under other theories; In re A.P. Johnson, 178 B.R. 216 (B.A.P. 9th Cir. 1995) (covenant not to compete); In re A’Hearn, 2011 WL 4704235 (Bankr. N. D. Iowa 2011) (same); In re Alstad, 265 B.R. 588 (Bankr. M.D. Fla. 2001) (same); In re Fox, 80 B.R 753 (Bankr. W. D. Wis. 1987) (fire insurance); In re Schneeweiss d/b/a Niagra Geriatric Cntr., 233 B.R. 28 (Bankr. N.D. N.Y. 1998) (covenant not to compete).
(2) **Challenge to the Assumption that If a Contract Is Not “Executory”, It Automatically Flows Into the Bankruptcy Estate:**

A contingent asset is an asset that is in some ways incomplete, unripe or unvested as of the date of the bankruptcy petition. Consider an asset coming into the estate post-petition as a result of a pre-petition completed contract, such as a pre-petition bonus earned on December 31 where the Chapter 7 filing is made on January 2 and the payment of the bonus is made on January 10. In that instance, the contract right had ripened and was complete as of the petition date. But for most other cases, for insurance renewal commissions cases for example, the debtor has no right to obtain proceeds at the start of the case. They cannot sue their employer to obtain their potential future insurance renewal commissions at the start of the case. If the court labels such a contract as “executory” and the trustee doesn’t assume the contract, under 11 U.S.C. § 365(d)(1) the contract is deemed rejected after 60 days and the trustee cannot claim the on-going benefit from the contract. However, to say that these contract rights are not “executory” doesn’t solve the issue. If they are not “executory” then they are at least in some way incomplete and either contingent on a condition precedent or some activity beyond the mere passage of time in order for the payment to occur. Otherwise there wouldn’t be any controversy.

The court’s determination that a contract brought into the bankruptcy estate is not executory (one suspects that much of these decisions over the murky nature of “executory contracts” are done on a results-oriented basis) therefore does not resolve the issue of what asset existed at the time of the filing of the
bankruptcy, what it was worth and therefore what belongs to the bankruptcy estate. Since a trustee only gets what the debtor has at the beginning of the case and no more, a bankruptcy court should not be able to pretend that merely by labeling a contingent interest as a “non-executory contract” that that magically converts the debtor’s interest at the beginning of the case to a fully vested property right that automatically goes to the debtor and therefore to the estate. The trustee’s option to assume or reject does not apply to non-executory contracts which the non-bankrupt has fully performed. “The estate has whatever benefit it can obtain from the other party’s performance and the trustee’s rejection would neither add to nor detract from the creditor’s claim or the estate’s liability.” Vern Countryman, Executory Contracts in Bankruptcy: Part 1, 57 MINN. L. REV. 439, 451 (1973). Therefore, the bankruptcy estate cannot assume a non-executory covenant not to compete (for example), which would obligate the estate to perform the obligations of the debtor (whether those obligations were “executory” or not). So the fact a contingent interest such as a non-competition contract is not executory doesn’t mean that a bankruptcy trustee can reap the benefits of that contract without assuming the contract, quite the opposite, there is nothing to assume and the trustee can’t obtain the benefit of the contract between the debtor and the non-debtor party. Put another way, the time limit on assuming executory contracts under 11 U.S.C. § 365(d)(1) doesn’t mean that non-executory contracts are automatically assumed by a bankruptcy trustee (which would surprise bankruptcy trustees) but rather that a bankruptcy trustee cannot assume such a contract and reap its benefits.
If the Trustee does not assume a debtor’s pre-petition contract, the contract is not terminated, but rather is abandoned back to the debtor at the closing of the case. Resnick & Sommer, 3 Collier on Bankruptcy, ¶ 363.103[3][b] at 365-50 (16th Ed. 2012). Just what is going on when courts assume that a contingent asset that vests post-petition is not executory is difficult to say and never articulated. Perhaps there is yet a third type of contract, a non-executory yet uncompleted contract that a bankruptcy trustee can reap the benefit of even if they don’t assume the contract. Without the crutch of 11 U.S.C. §541(a)(6), it is difficult to see where a bankruptcy court can come up with that result.