UNITED STATES BANKRUPTCY COURT
FOR THE WESTERN DISTRICT OF MICHIGAN

In re:

ANTHONY J. FRISCH,

Debtor.
_______________________________________/

Case No. DG 11-12290
Chapter 7
Hon. Scott W. Dales

MARCIA R. MEOLI, CHAPTER 7 TRUSTEE,

Plaintiff,

v.

KAREN S. THRUN, JANICE WATEREWAY, and ANTHONY J. FRISCH,

Defendants.
_______________________________________/

Adversary Pro. No. 13-80072

OPINION REGARDING DEFENDANTS' MOTION TO DISMISS ADVERSARY PROCEEDING

PRESENT: HONORABLE SCOTT W. DALES
United States Bankruptcy Judge

I. INTRODUCTION

On the day Anthony J. Frisch (the "Debtor") filed his Chapter 7 bankruptcy petition, he owned a beneficial interest in a testamentary trust (the "Trust") that his mother established for him and his siblings. Marcia Meoli (the "Bankruptcy Trustee") has named the Trust's trustees, Karen Thrun and Janice Waterway, as defendants.[1] By filing this adversary proceeding, the Bankruptcy Trustee seeks an order declaring that the Debtor's beneficial interest in his mother's Trust is included within his bankruptcy estate. Because the Trust includes a spendthrift

[1] The court will refer to Ms. Thrun and Ms. Waterway as the "Scheid Trustees" or the "Defendants."

provision and other limitations or restrictions on the Debtor's interest, the Defendants have filed a motion to dismiss the adversary proceeding (the "Motion," DN 8), arguing that § 541(c)(2) prevents the Debtor's interest from being included within the bankruptcy estate.[2]

Resolving the Motion requires the court to decide whether the Trust's restrictions prevented the Debtor's beneficial interest from being included in the bankruptcy estate when he filed his voluntary chapter 7 petition with this court on December 14, 2011; whether the Scheid Trustees breached their fiduciary duties; and whether the bankruptcy court should resolve the dispute given the probate overtones of the matter. The court heard oral argument regarding the Motion on June 5, 2013, in Grand Rapids, Michigan. This Opinion sets forth the court's reasons for denying the Motion in part, granting it in part, and granting summary judgment for the Bankruptcy Trustee on Count I.

II. JURISDICTION

The court has jurisdiction over the Debtor's chapter 7 bankruptcy case pursuant to 28 U.S.C. § 1334(a). The United States District Court has referred the Debtor's case and this adversary proceeding to the United States Bankruptcy Court pursuant to 28 U.S.C. § 157(a) and LCivR 83.2(a) (W.D. Mich.). Through this adversary proceeding, the Bankruptcy Trustee seeks turnover and related relief, which brings the lawsuit within the statutory definition of "core proceeding" under 28 U.S.C. § 157(b)(2)(A), (E) and (O). Venue is appropriate under 28 U.S.C. § 1409.

To the extent this adversary proceeding involves a demand for turnover, this court has authority to enter final judgment, notwithstanding doubts concerning such authority engendered by the United States Supreme Court's decision in *Stern v. Marshall*, 131 S. Ct. 2594 (2011).

[2] At oral argument the parties clarified that the Motion is one under Fed. R. Civ. P. 56, not Fed. R. Civ. P. 12.

To some extent, however, the adversary proceeding is "non-core" because the Bankruptcy Trustee's complaint seeks relief premised on state law claims merely related to the Debtor's case, but not arising in the case or under title 11, United States Code. The court is mindful of the limits on its authority to resolve these controversies, as discussed more fully in Part III(D) of this Opinion under the heading "Probate Exception and Abstention."

III. ANALYSIS

A. Summary Judgment Standards.

The court should grant summary judgment only "if the pleadings, the discovery and disclosure materials on file, and any affidavits show that there is no genuine issue as to any material fact and that the movant is entitled to judgment as a matter of law." Fed. R. Civ. P. 56(c). Additionally, "the substantive law governing the case will determine what issues of fact are material . . . ." *Street v. J.C. Bradford & Co.*, 886 F.2d 1472, 1479 (6th Cir. 1989). Here, Michigan law, specifically trust law, will determine what facts are material. *See* Trust at § 9.1.

The Sixth Circuit has consistently explained that "at the summary-judgment stage, the moving party bears the initial burden of identifying those parts of the record that demonstrate the absence of any genuine issue of material fact." *See Steele v. City of Cleveland*, 375 Fed. App'x. 536, 540 (6th Cir. 2010) (citing *Celotex Corp. v. Catrett*, 477 U.S. 317, 323 (1986)). The court must view the record in the light most favorable to the non-moving party, and this includes the facts and any inferences that can be drawn from those facts. *Hawkins v. Anheuser-Busch Inc.,* 517 F.3d 321 (6th Cir. 2008).

B. Material Undisputed Facts.

The following facts are not genuinely disputed. The Debtor's mother, Barbara J. Scheid, created the "Barbara J. Scheid Trust," dated January 10, 2001, and funded it with real property,

cash, oil and gas interests, and other personal property. Ms. Scheid's stated intention in settling the Trust[3] was two-fold: first "to provide management of assets during Settlor's lifetime and [second] to act as the means of distributing Settlor's assets after Settlor has died." *See* Trust at § 1.3. As twice amended during the Settlor's lifetime, the Trust named Ms. Thrun (the Debtor's sister), and Ms. Waterway (an unrelated trust professional), as co-trustees.

The Settlor died on August 26, 2011, at which point her Trust became irrevocable, and her four children, including the Debtor, became the Trust's current beneficiaries. Given the testamentary nature of the Trust, the Settlor directed the Scheid Trustees to satisfy any claims against the Settlor's estate, including final expenses such as funeral and medical expenses, and other claims that would typically be handled through probate proceedings. *See* Trust at § 4.3 (directing the Scheid Trustees to "pay all charges against the Settlor's estate . . ."). The Scheid Trustees took steps to comply with this directive by giving the Settlor's creditors a four-month claims notice in accordance with M.C.L. § 700.7606. The notice period had not fully run when the Debtor filed his bankruptcy petition.

The Trust further authorized the Scheid Trustees to "use principal for the beneficiary if, in Trustee's discretion," a situation arose in which a beneficiary could not support himself, needed educational assistance, or encountered some extraordinary expense requiring special assistance. *See* Trust at § 5.4. The Trust also contained an age-based restriction on the beneficiaries' withdrawal rights, including the Debtor's withdrawal rights:

> **Age Withdrawal.** After the date on which the beneficiary attains age 25, the beneficiary has a continuing right to withdraw an amount up to one-half of the value of the Trust assets; and after the beneficiary attains age 30, the beneficiary has a continuing right to withdraw all Trust assets. The amount subject to withdrawal shall be computed on the date the beneficiary attains the specified

[3] The court will refer to Ms. Scheid throughout this Opinion as the "Settlor."

> age or, if later, the date of the creation of the Separate Trust.

See Trust at § 5.5. When the Settlor died, the Debtor was 42 years old.

In an amendment to the Trust dated July 2, 2008, the Settlor made changes to reflect certain loans she made to the Debtor, evidenced by a promissory note dated February 25, 2003 in the original amount of $204,160.00. The Trust dictates that the Defendants distribute to the Debtor "as part of his otherwise then *pro rata* share of the Trust assets" any indebtedness remaining under the note. The amendment further provides as follows:

> Any forgiveness of debt treated as taxable income as a result of this allocation shall either be paid by ANTHONY J. FRISCH or deducted from his share of Trust assets. If the balance of principal and interest on such promissory note on the date of Settlor's death exceeds ANTHONY J. FRISCH'S otherwise pro rata share of the Trust assets, such excess shall be treated as any other asset of the estate and divided among the beneficiaries as provided in the first flush paragraph 5.2, above. ANTHONY J. FRISCH shall have the option of paying such excess to the Trust without any penalty for pre-payment.

See Amendment to Barbara J. Scheid Trust dated July 2, 2008 at § 1(c).

For purposes of this Opinion, another key provision within the Trust is the spendthrift clause:

> **Spendthrift Provision**. A beneficiary may not assign any portion of his or her beneficial interest in income or principal. No creditor of any beneficiary may attach, interfere, take or reach by any legal or equitable process any part of a beneficiary's interest in satisfaction of any debt or liability of the beneficiary prior to actual receipt by the beneficiary after payment from trustee. Trustee may withhold distributions to any beneficiary whose interest would or likely could become payable to anyone other than the beneficiary.

See Trust at § 6.6 (the "Spendthrift Provision"). In a passing reference within the moving papers, presumably to amplify the Settlor's intention in including the Spendthrift Provision, the Scheid Trustees contend that the Debtor has a learning disability. The Bankruptcy Trustee regards the assertion as unsupported.

C. Legal Analysis.

The general rule in bankruptcy is that all legal or equitable interests of the debtor are included within the property of the bankruptcy estate upon the filing of a petition. The filing of a bankruptcy petition commences the case, and the commencement of the case creates the estate. 11 U.S.C. § 541(a). Conceptually, creating the estate under § 541 is akin to transferring all of the debtor's property to the estate. To complement the estate-creating effect of § 541(a), and to foreclose any argument that pre-bankruptcy contractual, statutory, or other property transfer restrictions might limit the property that could enter the bankruptcy estate, Congress exercised its authority to preempt or invalidate most restrictions on transfer. *See* 11 U.S.C. § 541(c). As a result, the bankruptcy estate in most cases effectively includes all of a debtor's prepetition property, as well as, on occasion, some post-petition additions.

Congress, however, acknowledged an important exception in cases involving a debtor's beneficial interest in a trust, expressly excluding such interests from the estate if the debtor's ability to transfer the interest is limited by a generally enforceable transfer restriction. More specifically, the statute provides that "[a] restriction on the transfer of a beneficial interest of the debtor in a trust that is enforceable under applicable nonbankruptcy law is enforceable in a case under this title." 11 U.S.C. § 541(c)(2). To determine whether § 541(c)(2) excludes specified interests from the bankruptcy estate, the Sixth Circuit set forth a straightforward, three-fold inquiry:

> An inquiry under § 541(c)(2) normally has three parts: First, does the debtor have a beneficial interest in a trust? Second, is there a restriction on the transfer of that interest? Third, is the restriction enforceable under nonbankruptcy law?

Taunt v. General Retirement System of the City of Detroit (In re Wilcox), 233 F.3d 899, 904 (6th Cir. 2000).

Under Michigan law, the analysis of trust documents is also easily summarized. Interpretation is principally guided by the rules of construction applicable to wills. *See Matter of Maloney Trust*, 377 N.W.2d 791, 793 (Mich. 1985). In resolving trust controversies, Michigan courts follow the fundamental rule that the "intent of the [settlor] is to be carried out as nearly as possible," and must be "gleaned from the [trust document] unless an ambiguity is present." *Id.* (citations omitted). Michigan applies the parol evidence rule with particular force to testamentary documents "because the maker is not available to provide additional facts or insight." *Id.*

First, on the Petition Date, the Debtor, along with his siblings, held a beneficial interest in the Trust. Therefore, the Trust satisfies the first *Wilcox* condition for excluding the Debtor's interest from the bankruptcy estate.

Second, it appears that the Trust includes a spendthrift clause and other limitations and to some extent imposes a restriction on the transfer of the Debtor's interest. In their answer, and in support of their Motion, the Defendants originally posited three restrictions which, they contend, prevent the Debtor's beneficial interest from becoming part of his bankruptcy estate: the Debtor "(1) was not entitled to mandatory distribution as of the date his bankruptcy petition was filed because his interest was subject to the Trustee's discretion, (2) the scope of expenses and creditor claims were not yet known and . . . had to be paid before Trust shares were to be calculated, and (3) the Trust had a valid and enforceable spendthrift provision." *See* Answer at ¶ 2 (DN 11).

With respect to the first two limitations asserted by the Scheid Trustees —their discretion in making distributions and their duty to pay final expenses— the court regards these not as restrictions on transfer by the Debtor, but merely limitations on the Debtor's distribution rights. They are terms that define the nature, extent, or value of the Debtor's rights as holder of a beneficial interest, but do not restrict him from transferring his beneficial interest, whatever it may be worth. The court notes that § 541(c)(2) does not concern itself with every form of limitation on a debtor's interest, but only "restriction(s) on the transfer of a beneficial interest." 11 U.S.C. § 541(c)(2). Other restrictions that may affect the value of the Debtor's interest, or postpone its enjoyment, are not restrictions on the *transfer* of that interest. Strictly speaking, the only transfer restriction included within the Trust is the Spendthrift Provision of § 6.6, set forth above in full. This provision, unlike Trust §§ 4.3 or 5.4, expressly purports to limit a beneficiary's assignment or transfer rights.[4] For this reason, the outcome of the Motion depends upon whether the Spendthrift Provision is enforceable under Michigan law, which all parties agree is the applicable law. *See* Trust at § 9.1. Neither party, however, has cited any Michigan Supreme Court opinion directly on point.

When considering unsettled state law questions, a federal court's task is not to make law but to predict how a state's highest court would rule, based on well-established markers or "relevant data." *Strong v. Page*, 239 B.R. 755, 763 (Bankr. W.D. Mich. 1999). In confronting a similar controversy involving § 541(c)(2) and Michigan trust law, the court has looked to the Restatement (Second) of Trusts, as the Michigan Supreme Court itself has, to determine whether transfer restrictions within a trust document were enforceable. The court predicted that Michigan

[4] The provisions giving the Defendants discretion to make distributions or not, in contrast, are more indicative of the Settlor's intent to provide for her children rather than a formal restriction on their transfer rights. Similarly, payment of the final expenses does not restrict the Debtor's transfer of his beneficial interest, but merely subordinates it or postpones the enjoyment of it.

would not honor a restriction on a beneficiary's right to transfer his interest in a trust if, in effect, the beneficiary could withdraw the entire principal for his own benefit, as if he owned it: "[i]f the beneficiary is entitled to have the principal conveyed to him immediately, a restraint on the voluntary or involuntary transfer of his interest in the principal is invalid," and "[i]f the beneficiary may call for the principal, *e.g.,* take it as needed, the restraint on alienation is invalid." *Strong*, 239 B.R. at 765 (citing Restatement (Second) Trusts § 153(2) and Comment c).

The Michigan Supreme Court has similarly looked to the Restatement (Second) Trusts for guidance in resolving difficult spendthrift trust issues, including the Restatement (Second) Trusts § 153 upon which Judge Gregg relied in *Strong*. *See Roy v. Comerica Bank-Detroit (In re Edgar)*, 389 N.W.2d 696, 702-03 (Mich. 1986). Although the Supreme Court did not specifically address Comment c in its *Edgar* opinion, its citation to the Restatement (Second) Trusts § 153, its expressed aim to modernize trust law, and its intent to avoid conflict between Michigan law and the "general rule in the United States" (as catalogued in the Restatements) is informative. *Edgar*, 389 N.W.2d at 704.

The concept of "ownership equivalence" within the Restatement (Third) Trusts § 58 is to similar effect: "[a]n intended spendthrift restraint is also invalid with respect to a nonsettlor's interests in trust property over which the beneficiary has the equivalent of ownership, entitling the beneficiary to demand immediate distribution of the property." Restatement (Third) Trusts, § 58, Comment b. Under the Trust, after the Debtor attains age 30 (as he did years ago), he enjoys a "continuing right to withdraw all Trust assets." *See* Trust at § 5.5. These facts are remarkably similar to those included within Restatement (Third) Trusts § 58, Illustration 1, which describes a trust that includes a spendthrift clause, but also gives a beneficiary "the power at any time after reaching age 30 to withdraw all or any part of the principal and thereby

terminate the trust in whole or in part." Under such circumstances, the authors of the Restatement (Third) Trusts reach the following conclusion, equally applicable here: "[a]lthough the restraint on alienation of B's interest is initially valid, once B reaches age 30 the spendthrift provision is no longer effective because he has the equivalent of complete ownership of the entire trust estate . . . ." As applied here, the Debtor's right to withdraw after age 30 renders the Spendthrift Provision no longer enforceable.

From the Trust's four corners, the court concludes that the Settlor intended to impose spendthrift protections while her beneficiaries were younger than 30 years of age, but after they reached an age she evidently regarded as bringing suitable discretion and judgment, she lifted the transfer restrictions by giving the beneficiaries the equivalent of ownership, specifically the "continuing right to withdraw all Trust assets." Trust at § 5.5.

For these reasons, the court finds that the Bankruptcy Trustee is entitled to an order declaring that the Debtor's interest in the Trust is included within the estate.[5]

D. Probate Exception and Abstention.

In addition to claiming ownership of the Debtor's beneficial interest in the Trust (Count I), the Bankruptcy Trustee also seeks relief from what she regards as the Scheid Trustees' breaches of fiduciary duty by allegedly misusing the Trust's assets (Count II) and refusing to make mandatory distributions (Count III). In view of these allegations, the Bankruptcy Trustee seeks essentially an accounting of Trust assets (Count IV).

---

[5] At oral argument, without objection, the Bankruptcy Trustee asked the court to consider granting summary judgment for her even though she did not formally move for this relief. *See* Fed. R. Civ. P. 56(f)(1). After considering the authorities discussing a court's authority to grant summary judgment for a non-movant, including *Dietrich v. Bell*, 1:11-CV-1145, 2013 WL 309026 (W.D. Mich. Jan. 25, 2013), the court is willing to do so here because (1) the Scheid Trustees were on notice of this possibility, certainly by the time the Bankruptcy Trustee made her oral request during the hearing, but did not oppose the request; (2) they have been fully heard on the issues under § 541(c); and (3) the court, in reaching its decision, confined itself to the four corners of the Trust document as the Scheid Trustees suggested.

The nature of Counts II-IV of the Bankruptcy Trustee's complaint, particularly given the testamentary overtones of the Trust, prompted the Scheid Trustees to invoke the "probate exception" to federal jurisdiction. The court rejects the Scheid Trustees' argument that the probate exception applies in this case, but nevertheless concludes under principles of abstention, that it should abstain from exercising the jurisdiction it has under 28 U.S.C. § 1334.

First, regarding the probate exception, the Sixth Circuit has recognized that federal courts historically have resolved matters involving trusts and trustees, notwithstanding the probate exception. *See Evans v. Pearson Enter., Inc.*, 434 F.3d 839, 848-49 (6th Cir. 2006). The Scheid Trustees' reliance on *Lepard v. NBD Bank*, 384 F.3d 232 (6th Cir. 2004), which stated that a district court lacked jurisdiction over a breach of fiduciary duty claim against a trustee, is misplaced: the decision has been limited by the Sixth Circuit, *Evans*, 434 F.3d at 848 n.3, and criticized by the Supreme Court as extending the probate exception too far beyond its *in rem* underpinnings. *Marshall v. Marshall*, 547 U.S. 293, 311 (2006) (including *Lepard* among the decisions that "block federal jurisdiction over a range of matters well beyond probate of a will or administration of a decedent's estate."). Because there is no probate proceeding pending in which a probate court has custody or jurisdiction over the Trust *res*, the probate exception to federal jurisdiction does not apply, as our Supreme Court recently clarified in *Marshall*.

Acknowledging that the court has jurisdiction over the Bankruptcy Trustee's remaining claims does not resolve the separate question of whether it should abstain from exercising that jurisdiction. Certainly, with no probate proceeding now pending, abstention is not mandatory under 28 U.S.C. § 1334(c)(2). The question is whether the court should abstain from hearing this proceeding "in the interest of justice, or in the interest of comity with State courts or respect for State law. . . ." 28 U.S.C. § 1334(c)(1).

The court has no reason to doubt that the "interest of justice" will be equally served in this court or in Michigan's probate courts, so the question is one of comity. The court concludes that comity favors ceding authority over the fiduciary duty counts to the state courts.

Unlike the question in Count I of whether the Debtor's beneficial interest in the Trust is included within the property of the estate —a question involving the interpretation of § 541(c)(2) and property arguably within the federal court's initially exclusive *in rem* jurisdiction under 28 U.S.C. § 1334(e) at least initially— the fiduciary duty allegations of Count II inherently raise questions of *in personam* liability under state law. Ironically, although the Supreme Court's earlier decision in the *Marshall* case fortified the court's jurisdiction by confining the probate court exception to matters involving property in the probate courts' custody, our high court's later decision in the same matter undermined this court's authority to resolve non-core related proceedings. *Compare Marshall*, 547 U.S. at 311, with *Marshall*, 131 S. Ct. at 2605. After the more recent *Marshall* opinion, the bankruptcy court's authority to enter a final judgment on Counts II-IV, at least without consent, is doubtful. *See* Answer to Complaint and Affirmative Defenses at ¶ 6 (DN 11)(denying court's jurisdiction over Counts II-IV given nexus with probate court concerns).

As the District Court noted in *Cenker v. Cenker*, 660 F. Supp. 793, 795–96 (E.D. Mich. 1987), a federal court may abstain from exercising jurisdiction over claims even if the probate exception does not apply. This is especially true in bankruptcy courts where the jurisdictional statute expressly contemplates collisions with state law and authorizes the federal court to cede authority, including its otherwise exclusive *in rem* jurisdiction. *Compare* 28 U.S.C. § 1334(e) (bestowing "exclusive" jurisdiction over property of the estate) with *Id.* § 1334(c) ("nothing in this section," including the grant of exclusive *in rem* jurisdiction, precludes abstention).

Here, the Bankruptcy Trustee's remaining Counts involve questions under Michigan's trust law and relatively new trust statute which, though not within the probate exception, come very close as the Sixth Circuit recognized in its now-limited *Lepard* decision. Indeed, it is not unfair to describe the Trust as a "will substitute" at least to some extent. Moreover, abstaining will eliminate jurisdictional wrangling over the bankruptcy court's authority to enter final judgment, because the state courts' authority over trust matters is unassailable. Finally, dismissing the remaining counts under principles of abstention has the added benefit of making the court's decision resolving Count I —the primary area of dispute— immediately appealable under Fed. R. Civ. P. 54(b).

IV. CONCLUSION

Because the Spendthrift Provisions are not enforceable under Michigan law, the Debtor's interest in the Trust is included within the property of the estate. For this reason, the Bankruptcy Trustee is entitled to summary judgment under Fed. R. Civ. P. 56(c) and (f)(1), awarding declaratory relief to this effect. Because the Bankruptcy Trustee's remaining Counts, however, are non-core related matters calling for the special expertise of, and lying within the historical province of, Michigan's probate courts, the court will enter judgment dismissing Counts II-IV without prejudice, as a matter of comity.

NOW, THEREFORE, IT IS HEREBY ORDERED that the Scheid Trustees' Motion is DENIED as to Count I and GRANTED, without prejudice, as to Counts II-IV.

IT IS FURTHER ORDERED that the Clerk shall enter judgment in favor of the Bankruptcy Trustee on Count I, declaring the Debtor's interest in the Trust to be included within the property of the estate, and dismissing the remaining Counts without prejudice.

IT IS FURTHER ORDERED the Clerk shall serve a copy of this Opinion (and the separate judgment) pursuant to Fed. R. Bankr. P. 9022 and LBR 5005-4 upon James W. Alexander, Esq., Laura E. Morris, Esq., Elisabeth M. Von Eitzen, Esq., William R. Farley, Esq., and the United States Trustee.

END OF ORDER

IT IS SO ORDERED.

Dated June 26, 2013

Scott W. Dales
United States Bankruptcy Judge