

**IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF KANSAS**

IN RE:)	
)	
LEWIS EUGENE SEMMEL)	Case No. 01-14433
JUDY ANN SEMMEL,)	Chapter 7
)	
Debtors.)	
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)	

MEMORANDUM OPINION AND ORDER

This case presents a dispute between the debtor, Judy Ann Semmel (“debtor”), and the chapter 7 trustee, J. Michael Morris (“Trustee”), over income distributions under a testamentary trust. The matter comes before the Court on the Trustee’s Motion to Determine Rights in Trust¹ filed June 20, 2002 and the Motion to Distribute Funds² filed June 18, 2002 by Security State Bank (“Bank”) as trustee of the testamentary trust.³

There are no factual disputes. Two questions of law are presented: (1) whether the testamentary trust is a spendthrift trust and excluded from the property of the estate; and (2) whether the trust income distributions are exempt under Kansas law. The Court took the matter under advisement after receiving the written submissions of the debtor and the Trustee. The Court has studied the parties’ briefs, examined the Last Will and Testament (“Will”) creating the testamentary trust at issue here, and is prepared to rule.

¹ Dkt. 24.

² Dkt. 22.

³ Security State Bank takes no position on the legal issues before the Court. It holds the trust funds and merely seeks direction from the Court as to whom trust distributions should be made.

Factual Background

In 1974, Bertha Ware and C.C. Ware executed their joint and mutual Will, a nine page instrument.⁴ Highly summarized, the surviving testator received all the residue of the estate of the non-survivor (subject to specific bequests) and a life estate in the non-survivor's real property, with further bequests and devises to various beneficiaries and heirs, including their niece, debtor Judy Ann Semmel.⁵ Most of the devises and bequests to beneficiaries and heirs were outright devises of real estate (subject to the surviving testator's life estate) or special bequests of personal property, but the devise to debtor was in the form of a trust.⁶

The testamentary trust provision⁷ in question provides, in relevant part:

TWENTY: It is our joint and mutual will, that subject to the life estate of Bertha A. Ware, there is devised and bequeathed to the First National Bank of Dighton, Kansas, as trustee for the use of our niece, Judy Ann [Semmel], the following described real estate of the estate of C.C. Ware: . . . all in Lane County, Kansas, for the period of her natural life; that in the event of the death of Judy Ann [Semmel], such income shall be paid to the living children of Judy Ann [Semmel] in equal shares until the youngest of such children shall attain the age of 21 years, upon which date this trust shall terminate and such real estate shall be the property of the children of Judy Ann [Semmel], in equal parts, share and share alike.

* * *

The real estate herein devised shall be kept intact that there be continuous income. We authorize the trustee to retain so much of the income that the trust estate be protected against emergencies that may arise, that it may retain in its hands monies that it may effect payment of taxes for a period of two years, that immediately subsequent to the creation of this trust such trustee may retain 25% of the income

⁴ See Ex. A attached to Security State Bank's Motion to Distribute Funds.

⁵ C.C. Ware died in 1975, with Bertha surviving. Bertha died some ten years later in 1985.

⁶ Some of the outright devises and bequests, however, were subject to conditions. For example, devises to two nephews contained restrictions on attachment of liens, encumbering the property, and conveying the real estate. See Paragraphs Eighteen and Nineteen of Will.

⁷ Ex. A, pp. 5-7 attached to Bank's Motion to Distribute Funds.

therefrom until such emergency fund or tax fund is created. Such emergency fund shall not exceed 25% of the total income of such trust for the first five years subsequent to its creation.

The trustee shall have the sole and exclusive selection as to the tenant occupying such land

The trustee is authorized and directed to lease and let the real estate for exploration of oil, gas or other minerals upon contracts as are reasonable . . . That delay rentals, lease money and income from production, if any, shall be considered current income and distributed as income.

Income from such trust shall be distributed quarterly to beneficiary and at such other times as is to the trustee reasonable and convenient. . . .

When Bertha died, certain land was settled on the First National Bank of Dighton, Kansas, to be held in trust for debtor during her life. Income from the land was to be paid quarterly to debtor and at other times in the discretion of the trustee. Upon the debtor's death, the income payments were to continue to her children until the youngest surviving child reaches the age of 21 years, at which time the land itself would pass to debtor's children.

The testamentary trust provision contains no restriction on the alienation of debtor's beneficial interest nor any indication that the trust was established for debtor's welfare or maintenance. Debtor was one of several nieces and nephews to whom a devise or bequest was made. In the case of two devises to nephews, the testators restricted the ability of the devisees to encumber and convey the real property devised for a period of 21 years.⁸

On December 31, 1985, Bertha Ware died, causing the trust provision to take effect. According to the pleadings filed in the case, the First National Bank of Dighton declined to serve as trustee and Security State Bank was therefore appointed trustee.

Debtor filed this chapter 7 bankruptcy case with her husband on September 13, 2001 and J.

⁸ Cf. Paragraphs Eighteen and Nineteen of Will.

Michael Morris was appointed trustee.⁹ In Schedule C, debtor claimed the trust income exempt under KAN. STAT. ANN. § 60-2310 (2001 Supp.), the wage garnishment exemption statute. The debtor's first meeting of creditors pursuant to 11 U.S.C. § 341, was scheduled and held October 16, 2001. Under Fed. R. Bankr. P. 4003(b), the deadline for objecting to exemptions was thirty days later. No objection was filed to any of the claimed exemptions.

On January 18, 2002, the United States Trustee issued a notice of late discovered assets in the amount of \$1,417.42.¹⁰ An order establishing a new bar date of May 20, 2002 was subsequently issued.¹¹ On February 15, 2002, the debtors received their discharge.¹²

On April 9, 2002, the Security State Bank filed a Motion seeking an order from the Court determining to whom the quarterly trust income distributions were to be made.¹³ Then, on June 18, 2002, the Bank filed its Motion to Distribute Funds.¹⁴ In this motion, the Bank set forth that the Trustee had demanded that all post-petition distributions under the trust be made to him for the benefit of creditors. The Bank further alleged that on January 14, 2002, the Bank had distributed \$1,147.42 by a joint payee money order to the Trustee and debtor, and that the Trustee had negotiated the money order, without the debtor's endorsement. The Bank further alleged that it made a second distribution to the Trustee and debtor on March 5, 2002 in the amount of \$962.25, this time forwarding the money

⁹ The bankruptcy case was originally noticed as a "no-asset" case. *See* Dkt. 2.

¹⁰ *See* Dkt. 10. The late-discovered assets appear to be a reference to the trust income distribution made to debtor on January 14, 2002.

¹¹ *See* Dkt. 11 and 14. An amended order re-noticing the claims bar date was issued February 8, 2002.

¹² Dkt. 16.

¹³ Dkt. 17. However, the Bank never properly noticed its Motion. *See* Dkt. 18.

¹⁴ Dkt. 22.

order to debtor's counsel who returned it with a request that the check be made payable to debtor only.

On June 20, 2002, the Trustee filed his Motion to Determine Rights in Trust wherein he asserted that the debtor's assets included her interest in the trust, and that the claimed exemption of the trust income under KAN. STAT. ANN. § 60-2310 was unwarranted.¹⁵ The Trustee sought an order "determining the trust not exempt."

On July 2, 2002, the debtor filed objections to the Bank's and the Trustee's motion, contending that the failure of any party to object to the exemption of the trust income resulted in a waiver of the same and further, that the trust was a spendthrift trust and, as such, is not property of the estate under 11 U.S.C. § 541(c)(2).

Pursuant to a pretrial scheduling conference, the debtor and Trustee were directed to submit briefs on the legal issues. The debtor filed her brief on November 27, 2002 and the Trustee filed his brief on December 17, 2002.¹⁶

Jurisdiction

The Court has jurisdiction of this case and of contested matters within it.¹⁷ This contested matter is a core proceeding under 28 U.S.C. § 157(b)(2)(A), (B) and (E).

¹⁵ Dkt. 24.

¹⁶ Dkt. 36 and 37.

¹⁷ 28 U.S.C. § 1334.

Analysis

The first question the Court will address is whether, as a matter of Kansas law, the testamentary trust created by paragraph twenty of the Will is a spendthrift trust. This determination is necessary because under 11 U.S.C. § 541(c)(2), property subject to a spendthrift trust¹⁸ is excluded from property of the estate.¹⁹

The determination of whether the trust is a spendthrift trust is a property law issue that is determined under state, rather than federal law.²⁰ This requires the Court to construe the language of the Will creating the trust.²¹ Here, neither party contends that the language creating the trust is ambiguous and the Court likewise concludes that the Will provision in question is unambiguous.²²

Kansas law has long recognized that incorporation of certain restrictions into a trust can result in the trust assets and income being protected from the claims of a beneficiary's creditors. This principle was recognized in the early Kansas case of *Sherman v. Havens*.²³ The Kansas Supreme Court adopted the American Rule that a spendthrift trust may be created by express language or by necessary implication from the whole body of the instrument.

¹⁸ A spendthrift trust is a trust created to provide a fund for the maintenance of a beneficiary *and at the same time* secure the fund against the beneficiary's improvidence or incapacity. Provisions against alienation of the the trust fund are the usual incidents of a spendthrift trust. *In re Estate of Sowers*, 1 Kan. App. 2d 675, 680, 574 P.2d 224 (1977).

¹⁹ See *In re Hayes*, 168 B.R. 717, 723-24 (Bankr. D. Kan. 1994).

²⁰ *Butner v. United States*, 440 U.S. 48, 54-55, 99 S.Ct. 914, 59 L.Ed 2d 136 (1979).

²¹ Where the trust is created by a will, the principles applicable to construction of a will are invoked. The intent of the testator as expressed in the entire will is paramount. *In re Estate of Sowers*, 1 Kan. App. 2d 675, 680, 574 P.2d 224 (1977).

²² In the absence of ambiguity, extrinsic evidence of the testator's intention is inadmissible. *In re Estate Sowers*, 1 Kan. App. 2d 675, 680, 574 P. 2d 224 (1977).

²³ 94 Kan. 654, 146 Pac. 1030 (1915).

The rule was further refined in *In re Estate of Sowers*²⁴, where the Court of Appeals held that a spendthrift trust is created when “the trustor clearly manifest[s] the intention not only to create a trust, but to create it with the spendthrift effect.”²⁵ An inference of intent to create the spendthrift effect must be made with reasonable certainty and may not be based upon “loose and vague declarations” contained in the instrument.²⁶

The testators here included no express spendthrift language in the section establishing the trust and the debtor concedes as much. There is no language which restricts or nullifies a transfer of the debtor’s beneficial interest to third parties. Nor is there language suggesting that the trust is established for the support or maintenance of the debtor. It is clear the testators intended to create a trust, but unclear as to why. Given the fact that some other devises to heirs under the Will did include restrictions on alienation of those heirs’ interests, the testators clearly knew how to expressly restrict alienation of a beneficiary’s interest and so provided in some instances. In short, a fair reading of the whole Will while employing the principles enunciated in *In re Estate of Sowers* leads the Court to conclude that no spendthrift effect was intended. Because the trust in question is not a spendthrift trust, the debtor’s beneficial interest in the testamentary trust is property of the estate.

Having reached this conclusion, the Court now turns to the issue of whether the trust income was properly exempted by the debtor under KAN.STAT.ANN. § 60-2310. However, before exploring the exemption issue, the Court must first consider the extent to which the trust property and income would be in the debtor’s bankruptcy estate in the absence of a valid exemption. The testators devised

²⁴ 1 Kan. App. 2d 675, 574 P.2d 224 (1977).

²⁵ *Id.* at 680, *citing* 76 Am. Jur. 2d, Trusts, § 150.

²⁶ *Id.* at 680.

to the Bank, as trustee, certain real estate in Lane County, Kansas for the use of debtor during her life. Income from the real estate was to be paid to debtor quarterly and at such other times governed by the trustee's discretion. Upon the debtor's death, the income interest was redirected to her children until the youngest of them reached 21 years of age, at which time, the trust terminates and the real estate is distributed to the children. The Court does not see that the remainder interests of the children would be property of the estate; however it does appear that absent a valid exemption, the debtor's life income interest in the trust would be property of the estate.

Debtor claimed the trust income exempt under KAN. STAT. ANN. §60-2310. This is the Kansas wage garnishment exemption statute. It applies specifically to "earnings" which are defined as "compensation paid or payable for personal services."²⁷ There is no indication from the record that the trust income to debtor is in any fashion compensation for personal services. As such, there is no valid basis for exempting the trust income under this statute.

This conclusion, however, does not resolve the exemption issue because the Trustee failed to timely object to the debtor's claimed exemption.²⁸ 11 U.S.C. § 522(1) clearly states that unless a party objects to a claim of exemption, the property claimed is exempt. In *Taylor v. Freeland & Kronz*²⁹, the United States Supreme Court held that the failure of a trustee to timely object to an exemption claiming more than the permitted dollar amount of a debtor's interest in a lawsuit results in the allowance of the claimed exemption, even though the exemption went well beyond that allowed by the

²⁷ KAN. STAT. ANN. § 60-2310(a)(1)(2001 Supp.).

²⁸ See Fed. R. Bankr. P. 4003(b). Nor did the Trustee seek an extension of the objection deadline.

²⁹ 503 U.S. 638, 112 S. Ct. 1644, 118 L.Ed. 2d 280 (1992).

applicable law.³⁰ The Trustee does not address in his brief his failure to object to the claimed exemption, stating only that he should be entitled to an evidentiary hearing on the claim of exemption. The Court, however, deems it unnecessary to conduct such a hearing.

In *Taylor*, the Supreme Court rejected the Trustee's assertion that a late objection to an exemption lacking a good faith basis could be sustained. As Justice Thomas stated:

Deadlines may lead to unwelcome results, but they prompt parties to act and they produce finality. In this case, . . . [trustee] did not object to the claimed objection . . . [and] cannot now seek to deprive [the debtor] of the exemption.³¹

In short, the Supreme Court has held that §522(l) is clear and unambiguous and is to be interpreted literally.

There is little here to distinguish this case from *Taylor*. As in that case, the debtor clearly disclosed the nature of the property and her intention to exempt it. The debtor recited in her schedules that she held the “Judy Ann Ware Semmel Trust consisting of continuous income from Real Estate . . .”³² An identical reference to the trust income is set forth in debtor's Schedule C pertaining to exemptions. The trust was further identified as a source of income in debtor's statement of financial affairs. From the record before the Court, it cannot be said that the existence or nature of the trust was in any way concealed from the Trustee. Indeed, the Trustee was apparently on notice of the existence of the property because he laid claim to it in correspondence with the Bank, albeit after the exemption objection deadline had passed. Accordingly, § 522(l) applies and the trust income is exempt, even though debtor's attempt to exempt trust income under the wage garnishment statute would have been

³⁰ *Id.* at 642. In *Taylor*, the exemption was claimed under 11 U.S.C. §522(d)(11). *See also, Kwiecinski v. Community First Nat'l Bank of Powell (In re Kwiecinski)*, 245 B.R. 672 (10th Cir. BAP 2000).

³¹ 503 U.S. at 644.

³² Dkt. 1, Schedule B.

rejected by this Court out of hand had there been a timely objection. While the Trustee may have other remedies in this situation³³, resort to an untimely exemption objection is not among them.

Conclusion

The Trustee's Motion to Determine Rights in Trust is denied. The Trustee is directed, within 20 days from the date of this Order, to turnover to the debtor the funds received by him by virtue of the January 14, 2002 money order (\$1,147.42) as well as any interest accrued on that amount up to the date of turnover. The debtor may proceed to cash the money order issued by the Bank on March 5, 2002. Future income distributions from the trust shall be paid to the debtor without regard to her bankruptcy estate.

IT IS SO ORDERED.

Dated this 27th day of February, 2003.

ROBERT E. NUGENT,
CHIEF BANKRUPTCY JUDGE
UNITED STATES BANKRUPTCY COURT
DISTRICT OF KANSAS

CERTIFICATE OF SERVICE

The undersigned certifies that copies of the **Memorandum Opinion And Order** were deposited in the United States mail, postage prepaid on this 27th day of February, 2003, to the

³³ The Court notes that while bankruptcy schedules need not be signed by counsel (*see* Fed. R. Bankr. P. 9011(a)), presentation of them to the Court represents the attorney's certification that they are not presented for an improper purpose and that legal contentions contained in them are warranted by existing law or an extension or modification thereof. *See* Fed. R. Bankr. P. 9011(b)(1) and (2). Nothing in *this* record places in question debtor's counsel's good faith in this connection and, thus, Rule 9011 matters are not presently before the Court.

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