

**IN THE UNITED STATES BANKRUPTCY COURT  
WESTERN DISTRICT OF ARKANSAS  
HOT SPRINGS DIVISION**

**In Re: Cheryl A. Reagan, Debtor**

**No. 6:04-bk-77590  
Ch. 11**

**Regions Bank**

**Plaintiff**

**v.**

**Adv. Proc. No.: 6:08-ap-07158**

**Cheryl A. Reagan, Debtor and  
Frederick S. Wetzel, III, Trustee**

**Defendants**

**Frederick S. Wetzel, III, Trustee**

**Counter-Claimant  
Cross-Claimant**

**v.**

**Regions Bank  
Cheryl A. Reagan, Debtor**

**Counter-Defendant  
Cross Defendant**

**Cheryl A. Reagan, Debtor**

**Counter-Claimant  
Cross-Claimant**

**v.**

**Regions Bank  
Frederick S. Wetzel, III, Trustee**

**Counter-Defendant  
Cross-Defendant**

**The Estate of Ronald E. Reagan, Deceased**

**Intervenor**

**OPINION**

Before the Court are a myriad of pleadings, the substance of which relate to an interpleader action in which Regions Bank sought to deposit the net income from the corpus of a trust [Trust C] into the registry of the Court and a determination of the separate interests of the debtor and the Trustee in distributions of net income. Trust C was created by the Last Will and Testament of Ronald E. Reagan [the Will]. The Will appointed Arkansas Bank and Trust Company of Hot Springs, Arkansas [Arkansas Bank

& Trust] trustee of Trust C. Regions Bank subsequently acquired Arkansas Bank & Trust and is currently the trustee of Trust C.

On February 4, 2009, the Estate of Ronald E. Reagan [RER Estate] filed a motion to intervene.<sup>1</sup> The Court held a hearing on the interpleader complaint, counterclaims, cross-claims, answers, and motion to intervene on March 26, 2009. At the hearing, the Court allowed Regions Bank to interplead the funds into the Court's registry, granted the RER Estate's motion to intervene, and took under advisement the issue of whether the debtor or her bankruptcy estate is entitled to the present and future net income of Trust C. The Court gave the parties until April 25, 2009, to brief this issue; at the request of the Trustee, the Court extended this time to May 15, 2009. For the reasons stated below, the Court finds that the debtor's interest in net income distributions is not property of the bankruptcy estate and orders that the funds in the Court's registry be distributed to the debtor.

## History

Ronald E. Reagan, the debtor's late husband, executed his Will on March 1, 1988, as a resident and domiciliary of Garland County, Arkansas. (Ex. 1.) According to the parties' briefs, Mr. Reagan [Decedent] died February 1, 2000, and his Will was probated in the Circuit Court of Garland County, Arkansas, on February 17, 2000. The Will, *inter alia*, appointed Ms. Reagan Executrix of the Decedent's estate; created a testamentary trust, referred to as Trust C; appointed Arkansas Bank & Trust to serve as trustee of Trust C; required the Executrix to distribute the Decedent's stock in the Chem-Fab Corporation [Chem-Fab], less certain deductions, to the trustee of Trust C, to be administered under the terms of Trust C; and required that the net income of Trust C be paid to Ms. Reagan or

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<sup>1</sup> The RER Estate has a claim against the debtor as a result of an approved settlement agreement. (Ex. 13 at 2.) The settlement agreement provided that the RER Estate could not offset that claim against any future or current trust income due the debtor or her bankruptcy estate. *Id.* However, the RER Estate intervened as an assignee of a separate claim previously held by creditor 1919 M Street Associates Limited Partnership. (Ex. 15 at 2.)

applied for the benefit of Ms. Reagan, during her lifetime, commencing with the date of the Decedent's death. (Ex. 1.)

At the time of his death, the Decedent owned Chem-Fab stock. However, the Executrix, Ms. Reagan, did not fund Trust C or transfer title of the Chem-Fab stock to the named trustee of Trust C. On April 23, 2004, on ex-parte petition of Rex Ivy Reagan, one of the Decedent's sons and beneficiaries, the Circuit Court of Garland County, Arkansas [Probate Court], froze the assets of the Decedent's estate, pending further orders of the Probate Court. (Ex. 4.) On May 11, 2004, the Probate Court made such relief permanent. (Ex. 5.)

Ms. Reagan filed a voluntary chapter 11 petition on November 17, 2004. In June 2006, G. Latta Bachelor was appointed successor personal representative of the RER Estate. On April 16, 2007, the Court granted the RER Estate's motion for relief from stay to allow the RER Estate and the Probate Court to proceed with the full administration of the probate estate. On April 25, 2007, the Court appointed the Trustee in this bankruptcy case.

On January 15, 2008, the Probate Court authorized Bachelor to fund Trust C in the initial amount of \$2,400,000.00, with shares held in two real estate investment trusts and certain funds on deposit, and to transfer title of Trust C to Regions Bank. (Ex. 9.) Since that time, and current through June 30, 2009, the corpus of Trust C has generated net income in the amount of \$53,021.48, which is the net income that is the subject of this action and is currently being held in the Court's registry.

### **Findings of Fact and Conclusions of Law**

The determination of whether the debtor or the Trustee is entitled to the net income of Trust C depends on whether the debtor's interest in the net income from Trust C is property of her bankruptcy estate. Section 541 of the bankruptcy code states, in relevant part, that property of the estate includes "all legal or equitable interests of the debtor in

property as of the commencement of the case,” except as provided by subsection (c)(2). 11 U.S.C. § 541(a)(1). The Supreme Court has interpreted subsection (c)(2) to exclude certain interests from the estate if they are restricted from transfer because of a spendthrift provision enforceable under applicable non-bankruptcy law. *Patterson v. Shumate*, 504 U.S. 753, 757-58 (U.S. 1992). The parties did not contest that the applicable non-bankruptcy law pertinent to this case is the law of the state of Arkansas. Thus, this Court must determine whether the debtor had a legal or equitable interest in the net income of Trust C at the time she filed her bankruptcy petition, and, if so, whether such interest is protected by a spendthrift provision enforceable under Arkansas law.

### **Nature of the Debtor’s Interest at the Time of Her Bankruptcy Filing**

Whether the debtor’s interest in the net income is property of her bankruptcy estate is decided under federal law, but the nature and extent of the debtor’s interest in the net income is determined under applicable state law. *Marrs-Winn Co. v. Giberson Elec., Inc.* (*In re Marrs-Winn Co.*), 103 F.3d 584, 591 (7th Cir. 1996). In Arkansas, the Revised Uniform Principal and Income Act is relevant when analyzing the debtor’s interest in the net income of Trust C. Ark. Code Ann. § 28-70-605 (West, Westlaw through 2009 Reg. Sess.). It provides that:

An income beneficiary is entitled to net income from the date on which the income interest begins. *An income interest begins on the date specified in the terms of the trust* or, if no date is specified, on the date an asset becomes subject to a trust or successive income interest.

Ark. Code Ann. § 28-70-301(a)(West, Westlaw through 2009 Reg. Sess.)(emphasis added). The Will, which provides the terms of Trust C, states that, “[c]ommencing with the date of [the Decedent's] death, [the trustee of Trust C] shall pay to or apply for the benefit of my said wife during her lifetime all the net income from Trust C in convenient installments but no less frequently than quarter-annually.” (Ex. 1 at 4.) Therefore, the debtor’s right to receive the net income produced by Trust C began on the date of the Decedent’s death, February 1, 2000. When the debtor filed her bankruptcy petition on November 17, 2004, her interest in the net income of Trust C had been vested for several years, despite the fact that no actual net income was generated until the trust was funded

in 2008. Although the payments of income were and are contingent on Trust C producing income, contingent interests of the debtor at the time of filing are property of the estate. *Law v. Stover (In re Law)*, 336 B.R. 780, 782 (B.A.P. 8th Cir. 2006) (“Property of the estate includes contingent interests in future payments.”); *Yorke v. Bank One Wis. Trust Co. (In re Smith)*, 189 B.R. 8, 10 (N.D. Ill. 1995) (“A beneficial interest in a trust is an equitable interest under § 541(a)(1) despite the fact that at the time of filing a bankruptcy petition the debtor's interest is unvested and contingent.”).

At the time she filed her bankruptcy petition, the debtor’s interest was the right to receive the net income or the right to have the net income applied on her behalf in, at a minimum, quarterly distributions during her lifetime [the Interest].<sup>2</sup> Because the Interest was a legally cognizable interest that the debtor held at the time she filed her bankruptcy petition, it became property of her bankruptcy estate under § 541--*except as provided under subsection (c)(2)*. 11 U.S.C. § 541(a)(1). Subsection (c)(2) “provides [an] exclusion from the otherwise broad definition of ‘property of the estate contained in § 541(a)(1) of the Code.’” *Patterson*, 504 U.S. at 757. Subsection (c)(2) states that “[a] restriction on the transfer of a beneficial interest of the debtor in a trust that is enforceable under applicable non-bankruptcy law is enforceable in a case under this title.” Such restriction is more commonly referred to as a spendthrift provision.

The exclusion of interests protected by spendthrift provisions from the bankruptcy estate is significant in this case because the Will does contain a spendthrift provision. If the spendthrift provision restricts the transfer of the Interest and is enforceable under Arkansas law, the Interest is not property of the debtor’s bankruptcy estate even though it was a legal interest of the debtor at the time she filed her petition. *Patterson*, 504 U.S. at 758.

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<sup>2</sup> The debtor held other interests as a beneficiary of the Will, such as the right to compel the trustee of Trust C to convert non-productive property to productive property upon written notice. (Ex. 1 at 4.) However, the issue before the Court only concerns the debtor’s right to current and future net income of Trust C.

### **Whether the Debtor's Interest is Protected by the Spendthrift Provision**

The Will's spendthrift provision states:

Except as otherwise provided herein, all payments of principal and income payable, or to become payable, to the beneficiary of any trust created hereunder shall not be subject to anticipation, assignment, pledge, sale or transfer in any manner, nor shall any said beneficiary have the power to anticipate or encumber such interest, nor shall such interest, while in possession of my Executor or Trustee, be liable for, or subject to, the debts, contracts, obligations, liabilities or torts of any beneficiary.

(Ex. 1 at 10-11.) This provision includes payments of income to the debtor (a beneficiary under Trust C) that are payable, including those that will become payable, among the payments that may not be assigned, pledged, sold, or transferred; anticipated or encumbered by any beneficiary; and, that cannot be subject to any beneficiaries' debts, contracts, obligations, liabilities, or torts while in the possession of the Executor or Trustee. Therefore, the spendthrift provision addresses and restricts the transfer of the Interest.

The Arkansas Trust Code, enacted in 2005, is pertinent to analyzing whether and to what extent this spendthrift provision is enforceable under Arkansas law and applies to trusts created before its enactment, with exceptions not relevant here. Ark. Code Ann. § 28-73-1106(a)(West, Westlaw through 2009 Reg. Sess.). The Arkansas Trust Code recognizes that spendthrift provisions protect beneficiaries' interests from the reach of creditors. Ark. Code Ann. § 28-73-501 (West, Westlaw through 2009 Reg. Sess.). A spendthrift provisions is valid if "it restrains both voluntary and involuntary transfer of a beneficiary's interest." Ark. Code Ann. § 28-73-502(a)(West, Westlaw through 2009 Reg. Sess.). Because the Will restrains both the voluntary and involuntary transfer of the Interest, the restriction is enforceable under Arkansas law.

However, there are two remaining considerations that affect whether and to what extent the Interest is property of the bankruptcy estate. First, to date, Regions Bank has not made a distribution of net income to the debtor. Overdue distributions are addressed under Arkansas law:

Whether or not a trust contains a spendthrift provision, a creditor or assignee of a beneficiary may reach a mandatory distribution of income or principal, including a distribution upon termination of the trust, if the trustee has not made the distribution to the beneficiary within a reasonable time after the designated distribution date.

Ark. Code Ann. § 28-73-506 (West, Westlaw through 2009 Reg. Sess.). The import of this section is that mandatory distributions of income that were not made to the beneficiary within a reasonable time after the designation date are not protected by the spendthrift provisions under Arkansas law, and, therefore, would not be excluded from property of the estate under § 541(c)(2). In this case, the Will provided that Ms. Reagan was to receive distributions of net income no less frequently than quarter-annually.<sup>3</sup>

What constitutes a “reasonable time” after a designated distribution date is neither addressed in the statute or generally defined in the trust code. However, “reasonable time” is discussed elsewhere in the trust code in the context of a statute requiring the trustee of a trust to review trust assets. Ark. Code Ann. § 28-73-904, Unif. Law Cmt. (West, Westlaw through 2009 Reg. Sess.). This statute states:

Within a reasonable time after accepting a trusteeship or receiving trust assets, a trustee shall review the trust assets and make and implement decisions concerning the retention and disposition of assets, in order to bring the trust portfolio into compliance with the purposes, terms, distribution requirements, and other circumstances of the trust, and with the requirements of this subchapter.

Ark. Code Ann. § 28-73-904. The language in the Uniform Law Comment to this section

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<sup>3</sup> Presuming quarterly distributions of any net income to the debtor from 2008, when the trust was first funded, through the date of this Order, the distributions would have occurred on: March 15, 2008; June 15, 2008; September 15, 2008; December 15, 2008; March 15, 2009; and June 15, 2009.

is informative, and states in relevant part:

Section 4, requiring the trustee to dispose of unsuitable assets within a reasonable time, is old law, codified in Restatement of Trusts 3d: Prudent Investor Rule § 229 (1992), lightly revising Restatement of Trusts 2d § 230 (1959). . . . The question of what period of time is reasonable turns on the totality of factors affecting the asset and the trust.

Ark. Code. Ann. § 28-73-904, Unif. Law Cmt. Because the statute does not limit the time period that constitutes a “reasonable time,” such query is determined by looking to the totality of the factors surrounding the assets and the trust.

Bachelor received permission of the Probate Court to fund the trust with specific assets of the RER Estate on January 15, 2008.<sup>4</sup> (Ex. 9.) On January 23, 2008, Bachelor began transferring title of these assets to the RER Estate. (Exs. at 10, 12.) According to a letter received into evidence, Regions Bank was still preparing documents necessary to transfer some stock certificates from the RER Estate and into the Regions Marital Trust on September 8, 2008.<sup>5</sup> (C.A.R. Ex. 1.) Regions Bank filed the complaint that is the subject of this Order on September 23, 2008. In its complaint, Regions Bank stated that it held net income for two quarters. (Compl. ¶ 7.)

Under the circumstances of this case, the Court cannot find that because Regions Bank has not yet made a distribution to the debtor, that distributions have been withheld for an unreasonable time after the designated distribution dates. Between January and September, Regions Bank acquired title to some or all of the four assets enumerated in the Probate Court order authorizing Bachelor to fund the Trust. Given the complex history and litigious nature of this case, it is not unreasonable that Regions Bank took months to

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<sup>4</sup> To the extent any party argued that the Trustee is entitled to the net income that *would have been generated if* Trust C had been funded sometime before 2008, this amount is indeterminable. Ms. Reagan was only entitled to all of the net income Trust C produced. If Trust C produced no net income--and it did not for eight years--then Ms. Reagan was not entitled to any as a beneficiary.

<sup>5</sup> The letter was written to Ms. Reagan and requested that she complete two Affidavits of Lost Stock Certificates.



assess the assets and determine how to comply with the distribution provisions in the light of the debtor's bankruptcy case. The bankruptcy case has now been pending for almost five years and there are over one thousand entries on the docket. Throughout her case, the debtor has been represented by no less than four different bankruptcy attorneys, though she is currently pro se. Other than the fact that it took Regions Bank nine months to initiate an adversary proceeding to determine how the net income should be distributed, there are no additional facts presented to show that Regions Bank is currently outside a reasonable time to make such distributions under these circumstances. Although the parties have argued that net income distributions are overdue, no party has come forward with any additional argument or factual evidence to show *why* they are *unreasonably* overdue. The fact that it took Regions Bank nine months to file the adversary proceeding is not so egregious by itself to find that an unreasonable amount of time has passed after the distribution date.

The distributions of net income are also not a part of the debtor's estate after they are distributed to the debtor. Property of the estate in this case is controlled by § 541.<sup>6</sup> The scope of § 541 is broad and does include some interests acquired post-petition, such as certain property interests acquired within 180 days after the petition was filed and proceeds, product, offspring, or profits of or from property of the estate. *See* 11 U.S.C. § 541(a)(5), (6). However, any received or applied payments of net income that this debtor has become entitled to or subsequently acquires occurred or will occur *more than* 180 days after the date the petition was filed. Further, the payments received are not proceeds, product, offspring, rents, or profits of or from property of the estate; rather the

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<sup>6</sup> Although § 1115 of the bankruptcy code could require the funds the debtor received post-petition to be included in the bankruptcy estate, § 1115, in its entirety, was part of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 [BAPCPA], and applies to cases commenced after October 17, 2005. The debtor's case was filed in 2004, before the enactment of BAPCPA.

payments result from an interest this Court has determined is not property of the estate. In sum, § 541 does not bring into the bankruptcy estate any money the debtor will receive on account of the Interest.

The Court is aware of the equitable argument that the debtor should not be able to profit as a beneficiary of the same Will under which she failed to carry out her duties as Executrix. However, the RER Estate proceeded in Probate Court with its claims against the debtor that resulted from her time as Executrix, and the parties reached a settlement agreement regarding those claims and could seek relief from the stay to proceed with any remaining claims. (Ex. 13.) Accordingly, the Court finds that the debtor's actions as Executrix do not defeat her net income interest she is entitled to as a beneficiary.

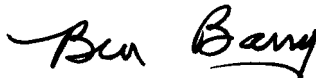
### **Conclusion**

For the reasons stated above, the Court orders that the funds in the Court's registry in the amount of \$53,020.45<sup>7</sup> be distributed to the debtor. Additionally, the Court finds that future net income resulting from Trust C is not property of the bankruptcy estate, but should be distributed by Regions Bank to the debtor in accordance with the terms of the Will.

IT IS SO ORDERED.

July 21, 2009

DATE



BEN T. BARRY

UNITED STATES BANKRUPTCY JUDGE

cc: Cheryl A. Reagan, chapter 11 debtor  
Joan Mawn

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<sup>7</sup> The amount currently on deposit with the Court is \$53,021.48. Pursuant to General Order 8, the Court is entitled to 10% of the income earned on each deposit into the registry. The net income earned on the funds deposited is \$1.03, netting the debtor \$53,020.45. These amounts are current as of June 30, 2009.

Frederick S. Wetzel, III, chapter 11 trustee  
Phyllis Jones and Roger D. Rowe, attorneys for RER Estate  
Guy Murphy, attorney for Regions Bank  
U.S. Trustee  
All creditors and interested parties