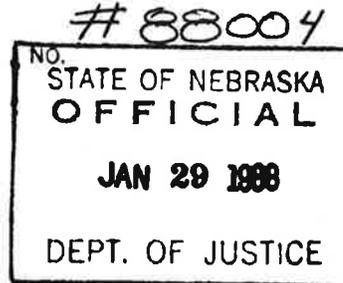


DEPARTMENT OF JUSTICE

STATE OF NEBRASKA

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DATE: January 28, 1988

SUBJECT: Whether LB 1146 adequately protects workers' compensation beneficiaries in the event of bankruptcy by a self-insured employer.

REQUESTED BY: Senator Timothy J. Hall
Nebraska State Legislature

WRITTEN BY: Robert M. Spire, Attorney General
Yvonne E. Gates, Assistant Attorney General

The issue of whether trust assets are property of the estate in the debtor's bankruptcy proceedings has been litigated considerably in various jurisdictions. To determine if the debtor has any interest in trust assets the court examines the trust document and assesses the trustor's property rights based on state statutes. The majority of those cases involve situations where the debtor is the beneficiary of the trust, as in spendthrift trusts. Those courts held the trust assets are not property of the estate. See, In the Matter of Rueben Leimer, 54 B.R. 587 (Neb. 1985). Yet, in those cases where the trustor declared bankruptcy and was also a beneficiary of the trust, as in retirement trusts, the courts have found the assets to be included in the bankruptcy estate. See In Re Shuman, 68 B.R. 290 (Nev. 1986); In Re Goff, 812 F.2d 931 (1987). Where the trustor has no legal or equitable interest in the trust, trust assets are clearly not property of the estate. George v. Kitchens by Rice Brothers, 665 F.2d 7 (1981); In the Matter of Lenk, 48 B.R. 867 (DC 1985).

The correctness of this application of the bankruptcy code is clearly established by the legislative history which indicates: "However, only the debtor's interest in such property becomes property of the estate. If the debtor holds bare legal title or holds property in trust for another, only those rights

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which the debtor would have otherwise had emanating from such interest pass to the estate under section 541." 124 Cong.Rec. H32399, (September 28, 1978) (remarks of Rep. Edwards); 124 Cong Rec. S33999, (October 5, 1978) (remarks of Senator DeConcini).

LB 1146 §2 attempts to legislate the degree of interest retained by the debtor/trustor in the event of bankruptcy, regardless of the provisions in the trust document. Yet, the determination of what property constitutes property of the debtor's estate is made exclusively by application of the Federal Bankruptcy Code. See, Elliott v. Bumb, 356 F.2d 749 (1966).

11 U.S.C. § 541(a) explicitly states "Such estate is comprised of all the following property, wherever located and by whomever held: (1) 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." Therefore, whatever rights the debtor is granted in the trust assets by the trust agreement will become property of the bankruptcy estate. In those situations where the trustor retains any interest in the trust assets and becomes insolvent, LB 1146 § 2 does not totally protect workers' compensation beneficiaries. The trust document controls to what extent and how adequately beneficiaries are protected.

However, there are exceptions to what property enters the debtor's estate. 11 U.S.C. § 541 (c)(1) directs

(c)(1) Except as provided in paragraph (2) of this subsection, an interest of the debtor in property becomes property of the estate under subsection (a)(1), (a)(2), or (a)(5) of this section notwithstanding any provision in an agreement, transfer instrument, or applicable nonbankruptcy law--

(A) that restricts or conditions transfer of such interest by the debtor; or

(B) that is conditioned on the insolvency or financial condition of the debtor, on the commencement of a case under this title, or on the appointment of or taking possession by a trustee in a case under this title or a custodian before such commencement, and that effects or gives an option to effect a forfeiture, modification, or termination of the debtor's interest in property.

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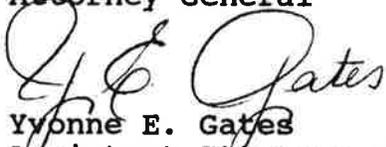
(2) A restriction on the transfer of a beneficial interest of the debtor in a trust that is enforceable under applicable nonbankruptcy law is enforceable in a case under this title. (Underscoring added.)

Paragraph 2 has been used as the justification for the rulings in the spendthrift trust cases. Since this is a question of first impression, we cannot say with any degree of certainty that the language of LB 1146 §2, would qualify for the exception permitted by paragraph 2. Because LB 1146 §2 is conditioned on the debtor's insolvency and attempts to exclude the trust assets from the debtor's estate (which is not enforceable under nonbankruptcy law) we believe it is unenforceable.

An alternative would be for the statute to require that any security, indemnity, trust agreement or bond under this section must include provisions restricting beneficial interest to those of the employees of the self insurer, regardless of the solvency or insolvency of the employer. Such language is more likely to qualify for a paragraph 2 exception and adequately protect the workers' compensation beneficiaries to the same extent as spendthrift trust beneficiaries.

Sincerely,

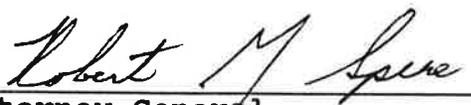
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cc: Patrick J. O'Donnell
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APPROVED BY:



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