

**United States Bankruptcy Court
Northern District of Illinois
Eastern Division**

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Bankruptcy Caption: In re Michael Hughes

Bankruptcy No.: 18 B 11700

Date of Issuance: December 16, 2020

Judge: A. Benjamin Goldgar

Appearances of Counsel:

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**UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION**

In re:) Chapter 7
)
MICHAEL HUGHES,) No. 18 B 11700
)
Debtor.) Judge Goldgar

MEMORANDUM OPINION

In 2007, Carrie Ann Hughes, wife of debtor Michael Hughes, settled the Carrie Ann Hughes 2007 Living Trust. The Carrie Trust is a revocable trust with a spendthrift provision, and Michael is a beneficiary. Three years later, Carrie and Michael as tenants by the entirety conveyed to the Trust their interest in the family home. Almost a decade after that, Michael filed a chapter 7 bankruptcy case. On his Schedule C, he claimed his interest in the Carrie Trust as exempt. Two creditors, CR Adventures LLC, d/b/a CR Farms, and JCR Produce Co., have objected to the exemption. They contend the Carrie Trust is not subject to the Illinois statute that protects property held in trust for judgment debtors.

As discussed below, CR Farms and JCR are mistaken. Their objections will be overruled.

1. Jurisdiction

The court has subject matter jurisdiction under 28 U.S.C. § 1334(a) and the district court's Internal Operating Procedure 15(a). This is a core proceeding. *See* 28 U.S.C. § 157(b)(2)(A); *Pension Benefit Guar. Corp. v. Continental Airlines, Inc. (In re Continental Airlines)*, 138 B.R. 442, 445 (D. Del. 1992); *Knopfler v. Schraiber (In re Schraiber)*, 97 B.R. 937, 939-40 (Bankr. N.D. Ill. 1989).

2. Facts

The facts come mostly from the parties' briefs and exhibits (including the affidavits of Carrie and Michael) and are uncontested. Some background facts, also uncontested, come from summary judgment papers in adversary proceedings that CR Farms and JCR brought against Michael.^{1/}

a. The Wadsworth Home and the Carrie Trust

Michael and Carrie have a home in Wadsworth, Illinois. (Resp. ¶ 17). They bought the property in 2001, taking title as tenants by the entirety. (*Id.* ¶ 18).

Six years later, Carrie settled the Carrie Ann Hughes 2007 Living Trust. (Resp. Ex. 3 at 1, 30). The Trust declaration named Carrie as trustee (*id.* at 1) and Michael, Carrie, and their children as beneficiaries (Resp. ¶ 14). In October 2010, Michael and Carrie as tenants by the entirety conveyed title to the Wadsworth property to the Carrie Trust. (*Id.* ¶ 19).

b. Terms of the Carrie Trust

The Carrie Trust declaration makes the Trust revocable during Carrie's life and irrevocable on her death. During her life, she has the sole right to revoke and terminate the Trust. (Resp. Ex. 3 at 1).

The Trust declaration empowers Carrie alone to distribute the principal and income of the Trust as she sees fit. (*Id.*). The beneficiaries have no "voice in [her] exercise" of that discretion and no right to compel a distribution. (*Id.* at 13). The declaration also has this spendthrift clause shielding Trust assets from creditors:

^{1/} See *CR Adventures LLC v. Hughes*, No. 18 A 257 (Bankr. N.D. Ill.); *JCR Produce Co. v. Hughes*, No. 18 A 258 (Bankr. N.D. Ill.).

10.7 Spendthrift Provision. Present or future interests in income and/or principal shall not be subject to claims for alimony or support, claims of any creditor or others, or to legal process, and may not be voluntarily or involuntarily alienated or encumbered. This Section shall not limit the exercise of any power of appointment or the effectiveness of any disclaimer or release.

(Id.).

The Carrie Trust's only asset is title to the Wadsworth property. (Resp. ¶ 20). The Trust declaration allows Michael to live there "on the condition that [he be] responsible for all real estate and/or income taxes and interest payments on any mortgage with respect to such real estate." (Resp. Ex. 3 at 18).

Illinois law governs the interpretation of the Trust declaration. (*Id.* at 29).

c. Mortgage Refinancing

In 2017, the Hugheses sought to refinance their mortgage on the Wadsworth property. (Resp. ¶ 20). The prospective lender, though, was unwilling to lend if the Carrie Trust held title to the property. (*Id.*). So to allow the refinancing, in June 2017 Carrie had the Trust convey title to Michael and Carrie as tenants by the entirety. (*Id.* ¶ 21). The loan went through, and the Hugheses recorded the new mortgage the same day. (*Id.* ¶ 22). In August, Michael and Carrie as tenants by the entirety then reconveyed title to the property to the Carrie Trust. (*Id.* ¶ 23). The Trust has held title since then. (*See id.* ¶ 68).

d. Michael's Debts to CR Farms and JCR

In 2012, about five years after Carrie settled the Carrie Trust, Michael began working at National Produce Sales, Inc., a Chicago fruit and vegetable wholesaler that his father, David El-Aboudi, owned. (*Id.* ¶ 25). Michael eventually bought his father's shares and became the

company's sole owner. (*Id.* ¶ 26).

National Produce had many vendors. These included CR Farms, an Idaho company, and JCR, based in Florida. From 2012 on, CR Farms sold and shipped potatoes and onions to National Produce. (*See id.* ¶ 28). JCR Produce sold and shipped tomatoes to National Produce from at least 2016. (*See id.* ¶ 29).

At some point, National Produce ran into financial problems and stopped paying vendors. In February 2018, JCR sued National Produce, Michael, and his father in the district court for more than \$224,000. *See JCR Produce Co. v. National Produce Sales, Inc.*, No. 18 C 1151 (N.D. Ill.). JCR asserted claims under the Perishable Agricultural Commodities Act, 7 U.S.C. §§ 499a-499s, and sought to enforce a statutory trust that PACA imposes on sales proceeds. CR Farms intervened in the action as a plaintiff and asserted similar claims to recover more than \$450,000.

e. The Bankruptcy Case

Faced with the CR Farms/JCR action, Michael filed a chapter 7 bankruptcy case.^{2/} On his amended Schedule A/B in the bankruptcy, Michael listed as an asset his interest in the Carrie Trust. On his amended Schedule C, he claimed the interest as exempt under 735 ILCS 5/2-1403 (2018), an Illinois statute that shields property held in a valid spendthrift trust from the beneficiary's creditors.^{3/}

^{2/} National Produce also filed a chapter 7 bankruptcy case. El-Aboudi did not, and the district court entered default judgments against him. (Dist. Ct. Dkt. Nos. 31, 38).

^{3/} Michael's initial Schedule A/B listed an interest in the Wadsworth property and said the property was "owned by" the Carrie Trust and another trust, the Michael Hughes 2007 Living Trust. His initial Schedule C claimed exemptions in both trusts. The amended Schedule A/B deleted the Wadsworth property, and the amended Schedule C claimed an exemption only

CR Farms and JCR objected to Michael’s claim of exemption under section 522 of the Bankruptcy Code, 11 U.S.C. § 522. The objection is fully briefed and ready for ruling.

3. Discussion

The objections to the claim of exemption will be overruled – not because Michael’s interest in the Carrie Trust is exempt, but because it is not property of his bankruptcy estate in the first place.

a. Nature of the Dispute

Although the parties have presented this as a dispute over Michael’s attempt to exempt his interest in the Carrie Trust, it is not an exemption dispute.

The filing of a bankruptcy petition creates an estate consisting of the debtor’s property. 11 U.S.C. § 541(a). The Code’s definition of estate property is “broad,” *United States v. Whiting Pools, Inc.*, 462 U.S. 198, 205 (1983), encompassing “all legal or equitable interests of the debtor in property,” 11 U.S.C. § 541(a)(1). Despite the definition’s breadth, though, not all property is property of the estate. Some property is excluded. *See* 11 U.S.C. §§ 541(b), (c). And even when property is property of the estate, a debtor may exempt certain property. 11 U.S.C. § 522(b); *Taylor v. Freeland & Kronz*, 503 U.S. 638, 642 (1992). But before property can be exempt, it must first be property of the estate. *Owen v. Owen*, 500 U.S. 305, 308 (1991) (“No property can be exempted . . . unless it first falls *within* the bankruptcy estate.” (emphasis in original)).

in the Carrie Trust. CR Farms and JCR find something suspicious about these amendments, complaining that Michael “fails to explain them.” (Reply at 1-2). But a debtor can amend his schedules “as a matter of course at any time before the case is closed.” Fed. R. Bankr. P. 1009(a). No explanation is necessary.

The dispute here is whether Michael’s interest in the Carrie Trust, a trust with a spendthrift provision, is property of his bankruptcy estate. Section 541(c)(1)(A) says that property enters the estate on the petition date “notwithstanding a provision . . . that restricts or conditions transfer of such interest by the debtor.” 11 U.S.C. § 541(c)(1)(A). Section 541(c)(2) then provides an exception: “A restriction on the transfer of a beneficial interest of the debtor in a trust” is enforceable in bankruptcy if it is “enforceable under applicable nonbankruptcy law.” 11 U.S.C. § 541(c)(2); *see Patterson v. Shumate*, 504 U.S. 753, 758 (1992) *Carroll v. Takada*, 864 F.3d 512, 514 (7th Cir. 2017).

The applicable nonbankruptcy law in this case is section 2-1403 of the Illinois Code of Civil Procedure, which bars creditors from satisfying a judgment from property held in trust for the judgment debtor under certain conditions. 735 ILCS 5/2-1403 (2018). The parties disagree about whether those conditions have been met. Michael says they have; CR Farms and JCR say they have not. But the underlying issue, the issue that section 2-1403 determines, is whether Michael’s interest in the Carrie Trust is property of his bankruptcy estate. His claim of exemption is irrelevant.

b. Procedural Questions

Because this is an estate property dispute, not an exemption dispute, two preliminary procedural questions must be addressed.

The first is whether the court can decide the dispute when the objections of CR Farms and JCR to Michael’s exemption missed the mark procedurally. The answer is yes. In *Carroll*, the debtors claimed an exemption under section 2-1403, the trustee objected, and the bankruptcy court sustained the objection. *Carroll*, 864 F.3d at 514. The debtors then argued on appeal that it

was “procedurally improper for the bankruptcy court to decide the section 2-1403 issue by sustaining the trustee’s objection” rather than addressing it through an adversary proceeding. *Id.* at 515. The court of appeals dismissed the argument, finding that “the trustee’s objection and the bankruptcy court’s ruling simply responded to the [debtors’] own § 522 exemption claim” and the objection “was properly sustained.” *Id.*; see also *Lunkes v. Gecker*, 427 B.R. 425, 428 n. 1 (N.D. Ill. 2010) (noting “for the sake of clarity” the difference between an exemption dispute and an estate property dispute and adding that “the end result would be the same”).

The second question is whether CR Farms and JCR are the right parties to litigate the section 2-1403 issue here. Usually, the answer is no. Because the Code gives the chapter 7 trustee the duty to “collect and reduce to money the property of the estate,” 11 U.S.C. § 704(a)(1), the trustee is the only party with the right collect the debtor’s assets, *In re Perkins*, 902 F.2d 1254, 1257 (7th Cir. 1990); see also *Black v. U.S. Postal Serv. (In re Heath)*, 115 F.3d 521, 523 (7th Cir. 1997) (noting the trustee’s “exclusive right to sue on behalf of the debtor’s estate”). Creditors “may not exercise that power on behalf of the estate.” *Access Lending, Inc. v. Scott (In re Scott)*, Nos. 05 B 16227, 05 A 1677, 05 A 1715, 2006 WL 126757, at *4 (Bankr. N.D. Ill. Jan. 18, 2006).^{4/}

But whether a creditor can sue on the estate’s behalf is a matter of who is the real party in interest to pursue the claim, or perhaps who has “statutory standing” to do so, *Spaine v. Community Contacts, Inc.*, 756 F.3d 542, 546 (7th Cir. 2014) (observing that courts have invoked both concepts in this context), and neither doctrine is jurisdictional, *Knopick v. Jayco*,

^{4/} The answer is usually rather than always no because in “narrow circumstances” a creditor can bring a claim for the estate. *Perkins*, 902 F.2d at 1258. Whether those circumstances are present here is unclear.

Inc., 895 F.3d 525, 529 (7th Cir. 2018) (real party interest) *Ameritech Benefit Plan Comm. v. Communication Workers of Am.*, 220 F.3d 814, 819 (7th Cir. 2000) (statutory standing).

Because the point is not a jurisdictional one, parties who fail to raise it forfeit the point. *RK Co. v. See*, 622 F.3d 846, 850-51 (7th Cir. 2010). Neither Michael nor the trustee has suggested that CR Farms and JCR are the wrong parties to pursue their objections. They have forfeited the point.

And so to the real issue: whether Michael's interest in the Carrie Trust is property of his bankruptcy estate. It is not. The Trust's spendthrift provision, valid and enforceable in Illinois, satisfies section 2-1403 and so is a "restriction on the transfer of a beneficial interest of the debtor in a trust" enforceable in bankruptcy. 11 U.S.C. § 541(c)(2).

c. Spendthrift Trusts

Illinois law has long recognized spendthrift trusts. *See Geiger v. Geer*, 395 Ill. 367, 375-76, 69 N.E.2d 848, 853 (1946). A spendthrift trust is one that provides for the beneficiary while protecting the trust *res* "from the beneficiary's incapacity or imprudence." *Lunkes*, 427 B.R. at 429; *see also Firestone v. Metropolitan Life Ins. Co. (In re Di Piazza)*, 29 B.R. 916, 918-19 (Bankr. N.D. Ill. 1983). To determine whether a trust qualifies as a spendthrift trust, courts consider several factors: "(1) whether the trust restricts the beneficiary's ability to alienate and the beneficiary's creditors' ability to attach the trust corpus; (2) whether the beneficiary settled and retained the right to revoke the trust[;] and (3) whether the beneficiary has exclusive and effective dominion and control over the trust corpus, distribution of the trust corpus[,], and termination of the trust." *Perkins*, 902 F.2d at 1258 n.2; *see also Lunkes*, 427 B.R. at 429.

The Carrie Trust has each of these features. Carrie settled the Trust and has the sole right

to revoke it. Carrie also has exclusive control over Trust assets and the power to distribute principal and income. Michael, a beneficiary, has no control over the assets and no right to compel their distribution. The declaration's spendthrift provision restricts the ability of creditors to reach the Trust corpus, stating that the assets "shall not be subject to . . . claims of any creditors." The Carrie Trust appears to be a fairly standard trust with a fairly standard spendthrift provision. CR Farms and JCR do not claim otherwise.

d. Section 2-1403

The Illinois Code of Civil Procedure enforces spendthrift trusts by insulating trust assets from the demands of a beneficiary's creditors. Section 2-1403 provides: "No court . . . shall order the satisfaction of a judgment out of any property held in trust for the judgment debtor if such trust has, in good faith, been created by, or the fund so held in trust has proceeded from, a person other than the judgment debtor." 735 ILCS 5/2-1403 (2018).

For this section to apply, three conditions must be met. First, the trust must have been created "in good faith." *Id.* A trust is created in good faith if it was not created specifically to avoid judgment creditors. *Hickory Point Bank & Trust FSB v. Natural Concepts, Inc.*, No. 3-16-0260, 2017 WL 1392860, at *3 (Ill. App. Ct. 3d Dist. Apr. 11, 2017). Good faith is typically present when the trust predates the judgment creditor's debt. *Id.*

Second, someone "other than the judgment debtor" must have created the trust. 735 ILCS 5/2-1403. If the judgment debtor created the trust and named himself as a beneficiary, the trust is "self-settled" and void as to his existing and future creditors. *Rush Univ. Med. Ctr. v. Sessions*, 980 N.E.2d 45, 52 (Ill. 2012). The reason is plain: "[a] settlor can insulate a gift in trust to beneficiaries by using a spendthrift clause, but cannot insulate assets for herself." Helene

S. Shapo, George Gleason Bogert & George Taylor Bogert, *Bogert's Law of Trusts and Trustees*, § 223 at 469 (3d ed. 2007); *Barash v. Morris (In re Morris)*, 144 B.R. 401, 404 (Bankr. C.D. Ill. 1992) (“The law does not permit one to create a spendthrift trust with his own property for his own benefit.”).

Third, the trust assets must have “proceeded from” someone “other than the judgment debtor.” 735 ILCS 5/2-1403. Section 2-1403 does not define “proceeded,” but the ordinary meaning is “to come forth from a source.” *Hickory Point*, 2017 WL 1392860, at *3 (quoting *Webster's Third New International Dictionary 1807* (1976)). So trust assets that came from someone other than the judgment debtor are protected; trust assets that came from the judgment debtor are not and are fair game for creditors. *Id.* at *3-4; *Wachowski v. Wachowski*, No. 2-16-0416, 2017 WL 1049618, at *5 (Ill. App. Ct. 2d Dist. Mar. 17, 2017).

The Carrie Trust meets each of these conditions. Nothing in the record suggests the Carrie Trust was created other than in good faith. The Trust dates from 2007, roughly a decade before the oldest unpaid invoices to CR Farms and JCR and five years before Michael even began working at National Produce. CR Farms and JCR do not challenge the Trust's good-faith creation.

CR Farms and JCR do claim the Carrie Trust is self-settled, but they are mistaken. The settlor was Carrie, not Michael. True, the Trust is self-settled as to Carrie: she was both the settlor and a beneficiary. If Carrie were the judgment debtor, then, CR Farms and JCR would have a point: the spendthrift provision would be invalid as to her. But the judgment debtor here is Michael. The rule that a spendthrift trust cannot be created for the benefit of the settlor “does not invalidate a spendthrift restraint with respect to the interests of others.” Restatement (Third) of the Law of Trusts § 58 cmt. e (2003); *Sessions*, 980 N.E.2d at 55 (distinguishing the settlor's

interest in a “self-settled trust” from “an interest that creditors may not reach: where assets contributed by the settlor are irrevocably deeded to the trust for the benefit of other beneficiaries”).^{5/}

CR Farms and JCR also claim that the sole asset of the Carrie Trust, title to the Wadsworth property, at least “proceeded from” Michael, but again they are mistaken. Michael and Carrie held title, not as tenants in common or as joint tenants, but as tenants by the entirety. A tenancy by the entirety is a statutory estate established under the Joint Tenancy Act, 765 ILCS 1005/0.01-5 (2018). The estate is limited to homestead property, and only spouses can hold the estate. 765 ILCS 1005/1c (2018); *Premier Prop. Mgmt., Inc. v. Chavez*, 191 Ill. 2d 101, 105, 728 N.E.2d 476, 479 (2000). As tenants by the entirety, each spouse owns the entire property. Because they do, neither spouse can dispose of the property or encumber it without the other’s consent, and the property cannot be sold to satisfy the individual debts of either spouse. *Marquette Bank v. Heartland Bank & Trust Co.*, 41 N.E.3d 1007, 1010 (Ill. App. Ct. 1st Dist. 2015); *see also In re Jaffe*, 932 F.3d 602, 609 (7th Cir. 2019).

A tenancy by the entirety “operates under the fictional assumption that a husband and wife are one for legal purposes – it conveys the property to them as one person.” *Marquette Bank*, 41 N.E.3d at 1010. Once conveyed, “all interest in the property is vested in the marital unity.” *Erdmann v. Charter One Bank (In re Erdmann)*, 446 B.R. 861, 868-69 (Bankr. N.D. Ill. 2011). Put simply, spouses who own property as tenants by the entirety own it, not as individuals, but “as a single legal entity.” *Loventhal v. Edelson*, 844 F.3d 662, 663 (7th Cir.

^{5/} In fairness, the “self-settled trust” argument may date from before Michael amended his Schedule A/B to show title to the Wadsworth property only in the Carrie Trust rather than both the Carrie and Michael Trusts. The argument makes more sense (and the issue becomes more difficult) if the Michael Trust also holds title.

2016). When Carrie and Michael conveyed the Wadsworth property title to the Carrie Trust, then, they did so as a single legal entity. Title “proceeded from” that entity, not from Michael himself.^{6/}

In sum, the Carrie Trust is an enforceable spendthrift trust that Carrie created in good faith for the benefit of Michael (among others), and Carrie and Michael as tenants by the entirety conveyed to the Trust title to the Wadsworth property. Section 2-1403 therefore shields the property from Michael’s creditors, and under section 541(c)(2) of the Code, the bankruptcy estate excludes his interest in the Trust.

CR Farms and JCR make one last argument seemingly directed at the Carrie Trust’s spendthrift provision. They suggest that Michael may have used his wages from National Produce to pay the mortgage on the Wadsworth property, wages generated from produce sales and subject to the PACA trust. If he did, they say, he should not have the benefit of section 2-1403.

Their argument has two problems. The first is legal. The sole issue here is whether Michael’s interest in the Carrie Trust belongs to his bankruptcy estate. CR Farms and JCR cite no legal authority suggesting that Michael’s payment of the mortgage on the Wadsworth

^{6/} Courts differ on whether the conveyance of entireties property to a spendthrift trust severs the tenancy or renders the trust’s spendthrift provision unenforceable. *See, e.g., Edelson*, 844 F.3d at 664 (tenancy not severed under Illinois law where trust also had entireties language); *Security Pac. Bank Wash. v. Chang*, 80 F.3d 1412, 1416-17 (9th Cir. 1996) (tenancy severed and spendthrift provision unenforceable under Hawaii law); *C.I.T. Corp. v. Flint*, 333 Pa. 350, 354, 5 A.2d 126, 128 (1939) (spendthrift provision enforceable); *Bolton Roofing Co. v. Hedrick*, 701 S.W.2d 183, 184 (Mo. Ct. App. 1985) (same); *Watterson v. Edgerly*, 40 Md. App. 230, 238, 388 A.2d 934, 939 (1978) (same). The decisions tend to turn on applicable state law. No Illinois decision appears to consider the circumstances here: the conveyance of entireties property to a trust lacking entireties language. But CR Farms and JCR do not argue either that the conveyance severed the tenancy or that it made the spendthrift provision of the Carrie Trust unenforceable. So the question need not be addressed.

property with PACA trust funds could somehow affect the outcome on that question, causing section 2-1403 not to apply. The other problem is factual. Even if CR Farms and JCR had cited relevant legal authority supporting their position, they simply speculate that Michael paid the mortgage using his wages. (See CR Farms Am. Obj. at 5 (saying only that he “likely” did so). They offer no evidence that he did. In response, Michael offers his deposition and an affidavit showing that he neither cashed nor deposited any National Produce paychecks after September 20, 2017, when he first became a shareholder of the company.

4. Conclusion

The amended objections of CR Adventures, LLC, d/b/a CR Farms, and JCR Produce Co. to the exemption Michael Hughes claimed in the Carrie Ann Hughes 2007 Living Trust are overruled. A separate order will be entered consistent with this opinion.

Dated: December 16, 2020



A. Benjamin Goldgar
United States Bankruptcy Judge