UNITED STATES BANKRUPTCY COURT
DISTRICT OF MINNESOTA

In re:

ADRIANE JOY BASTYR,
Debtor.

BKY 4-88-1868

JULIA CHRISTIANS, as Trustee for the Bankruptcy Estate of Adriane Joy Bastyr,
Plaintiff,
-v.-
LARKIN, HOFFMAN, DALY & LINDGREN, LTD.,
Defendant.

ADV 4-90-15

and

JULIA CHRISTIANS, as Trustee for the Bankruptcy Estate of Adriane Joy Bastyr,
Plaintiff,
-v.-
BELL, ARCAND, FLORIN & TENNANT,
Defendant.

ADV 4-90-16

and

JULIA CHRISTIANS, as Trustee for the Bankruptcy Estate of Adriane Joy Bastyr,
Plaintiff,
-v.-
SCHWARTZ & ASSOCIATES,
Defendant.

ADV 4-90-17

MEMORANDUM ORDER GRANTING DEFENDANT SUMMARY JUDGMENT IN ADV 4-90-16

At Minneapolis, Minnesota, July 31, 1990.

The above-entitled matter came on for hearing before the undersigned on the 28th day of June, 1990 on motions by plaintiff Julia Christians (the "Trustee") and defendants Bell, Arcand, Florin & Tennant and Schwartz & Associates for summary judgment. The appearances were as follows: Richard McGee for the Trustee; Michael LeBaron for Larkin, Hoffman, Daly & Lindgren, Ltd. ("Larkin"); Thomas Johnson for Bell, Arcand, Florin & Tennant ("Bell"); and Frank Farrell, Jr. for Schwartz & Associates ("Schwartz") (collectively, the "Law Firms"). This Court has jurisdiction over the parties to and the subject matter of this adversary proceeding pursuant to 28 U.S.C. Sections 157 and 1334, and Local Rule 103. Moreover, this Court may hear and finally adjudicate these motions because their subject matter renders such adjudication a "core" proceeding pursuant to 28 U.S.C. Section 157(b)(2)(K).

UNDISPUTED FACTS

In January of 1983, Debtor retained Bell to commence a medical malpractice and product liability lawsuit to recover for injuries suffered by the Debtor as a result of breast implant surgery she

underwent in 1979. In late August of 1986, Debtor terminated Bell and retained Schwartz to pursue the litigation. Debtor subsequently retained Larkin as co-counsel.

Schwartz and Larkin negotiated a settlement of the lawsuit. A check dated April 28, 1988 in the amount of $190,000 (the "Check") was delivered to Schwartz in consideration of Debtor's dismissal of her lawsuit. As is customary, the Check was made jointly payable to the Debtor, Bell, Schwartz and James Miley, who was then a partner in Larkin. Schwartz deposited the Check in its trust account and did not withdraw any of the proceeds thereof (the "Proceeds") prior to Debtor's filing for bankruptcy.

Bell held an attorney lien on the Proceeds by virtue of a financing statement Bell filed on September 2, 1986. Bell's retainer agreement with the Debtor also provided that Bell was entitled to receive a portion of any recovery had by the Debtor:

> I further agree that from the proceeds of any such recovery, whether by settlement, judgment, or otherwise, you may deduct the attorney's fees to which you are entitled, together with all costs and expenses which remain unpaid . . ..

In a Memorandum Order entered July 13, 1990, I determined that the Trustee was not entitled to avoid Bell's lien because of a minor error in reporting the Debtor's name in the financing statement.(1)

Footnote 1
In the Memorandum Order, I also denied the Trustee's motion for summary judgment on the same issue.
End Footnote

In the state court that had jurisdiction over Debtor's lawsuit, Schwartz and Larkin moved "for an order determining fees to be paid to [Bell] out of the settlement proceeds" pursuant to Bell's attorney lien. On May 6, 1990, the state court entered an Order decreeing that the Law Firms were entitled to receive from the Proceeds $63,333.00 in aggregate legal fees, of which Bell was entitled to $16,000 and Schwartz and Larkin together were entitled to $47,333.00, plus their documented costs.

On May 9, 1988, Schwartz filed on behalf of the Debtor a voluntary petition for relief under Chapter 7 of the Bankruptcy Code. After Debtor filed for bankruptcy, Schwartz made disbursements of the Proceeds from its trust account to Bell, Larkin and itself (the "Transferred Proceeds") for legal fees in the amounts established by the state court order, plus $9,716.31 in documented costs, and paid the balance of $111,950.69 to the Debtor. For legal fees, Bell received $16,000 and Schwartz and Larkin each received $23,666.50. None of the Law Firms sought approval from this Court prior to disbursement of the Transferred Proceeds from Schwartz's trust account.(2)

Footnote 2
Neither Schwartz nor Larkin informed Bell that Debtor had filed bankruptcy, and thus Bell was not aware that it might need to move for approval of this Court in order to make proper its receipt of its share of the Transferred Proceeds.
End Footnote

In her schedules, Debtor claimed the Proceeds exempt, to which the Trustee timely objected. The Trustee and Debtor have settled their dispute regarding said claim of exemption. Pursuant to the "Settlement Agreement" between the Trustee and the Debtor, the

Trustee withdrew her objection to exemption for most of the Proceeds received by the Debtor, and Debtor relinquished her claim of exemption for the balance of the Proceeds, including the Transferred Proceeds:

> Upon approval [by this Court], Trustee agrees to withdraw her objection to $110,000 of the Personal Injury Action actually received by Debtor. The remaining portion of the Personal Injury Action shall be retained by the Bankruptcy Estate of Joy Adriane Bastyr.

This Court approved said agreement by Order entered October 15, 1989. Bell submitted an affidavit alleging that it did not receive notice of the motion for approval of the settlement, but the mailing matrix lists Bell, and notice of said motion was sent to all creditors on said matrix.

The Trustee commenced the instant adversary proceedings to avoid the postpetition disbursements of the Transferred Proceeds to the Law Firms pursuant to 11 U.S.C. Section 549 and to compel the Law Firms to turn over said funds.(3) In its answer, Bell sought a declaration that the Trustee is not entitled to avoid its attorney lien pursuant to 11 U.S.C. Section 544(a). The Trustee, Bell and Schwartz have moved for summary judgment on a number of legal issues. This Memorandum Order will address the issue of whether the Transferred Proceeds constituted property of the estate.

Footnote 3
ERROR
but its prayers for turnover therein were sufficient to give notice to the Law Firms that the Trustee is seeking to recover the Transferred Proceeds from them pursuant to section 550(a) if the transfers thereof were avoided. The parties, however, have not briefed whether they are entitled to summary judgment on recovery under section 550(a).
End Footnote

DISCUSSION

The task before me is to determine what interest, if any, Debtor had in the Transferred Proceeds at the time she filed for bankruptcy, for whatever interest Debtor had in said funds would constitute property of the estate:

> The commencement of a case under section 301, 302, or 303 of this title creates an estate. Such estate is comprised of all the following property, wherever located and by whomever held:
>
> > (1) [A]ll legal or equitable interests of the debtor in property as of commencement of the case.

11 U.S.C. Section 541(a)(1) (emphasis added). As the statute makes clear, it is irrelevant that Schwartz possessed the Transferred Proceeds in its trust account at the time Debtor filed for bankruptcy, since property of the estate extends to the Debtor's property "wherever located and by whomever held." The issue here is who owned the Transferred Proceeds, regardless of where and by whom they were held, at the time Debtor filed for bankruptcy:

> It is "necessary to look to nonbankruptcy law, usually state law, to determine whether the debtor has any legal or equitable interest in any particular item."

In re MacDonald, 114 B.R. 326, 329 (D. Mass. 1990) (quoting(4) 4 Collier on Bankruptcy 541.02[1], at 541-13 (L. King 15th ed. 1989)). In the instant case, the nonbankruptcy law potentially relevant to determining ownership interests includes the Minnesota

Rules of Professional Conduct and the common law of contracts.

Footnote 4
I will use the verbs "belong" or "own" to signify that a party either legally owned a particular portion of the Proceeds or had a beneficial interest in Schwartz's trust account for the amount of said portion following deposit of the Check.
End Footnote

There are two mutually exclusive possibilities for the ownership status of the Transferred Proceeds, both of which are reasonably plausible. The Law Firms will prevail if the Transferred Proceeds did not constitute property of the estate because the Law Firms had ownership interests in said funds exclusive of the Debtor at the time Debtor filed for bankruptcy.(1)

Footnote 1

If, on the other hand, the Proceeds belonged entirely to the Debtor at the time she filed for bankruptcy, and the Law Firms merely had secured or unsecured claims for legal fees and expenses based on their respective retainer agreements with the Debtor, the Transferred Proceeds constituted property of the estate.

The deposit of the Check in Schwartz's trust account did not cause the Law Firms to have ownership interests in the Transferred Proceeds. An attorney is required to deposit in his or her trust account any funds that might belong in part to himself or herself and in part to the client:

> All funds of clients paid to a lawyer or law firm shall be deposited in one or more identifiable interest bearing trust accounts as set forth in paragraphs (c) through (f). No funds belonging to the lawyer or the law firm shall be deposited therein except a follows:
>
> . . .
>
> (2) funds belonging in part to a client and in part presently or potentially to the lawyer or law firm must be deposited therein, but the portion belonging to the lawyer or law firm may be withdrawn when due unless the right of the lawyer or law firm to receive it is disputed by the client, in which event the disputed portion shall not be withdrawn until the dispute is finally resolved.

Minn. R. Professional Conduct 1.15(a) (emphasis added). But this does not mean that any funds deposited in an attorney's trust account automatically belong in part to the attorney when deposited; the funds may have belonged entirely to the client, and a portion of them may have potentially belonged to the attorney without him or her having any present ownership interest in the funds, at the time said funds were deposited.

An attorney is entitled to hold in his or her trust account any funds that may potentially belong to him or her until he or she is granted ownership. Minn. R. Professional Conduct 1.15 comment (1985). But the attorney does not own such funds until some action transfers ownership from the client to the attorney. C.f. Shalant v. State Bar, 33 Cal. 3d 485, 658 P.2d 737, 189 Cal. Rptr. 374 (1983) (holding that attorney did not violate disciplinary rule by transferring out of trust account proceeds of which client had

relinquished ownership). If the funds were owned entirely by a client when deposited in an attorney's trust account, they would continue to be entirely owned by the client while they were held in said account, unless some action transferred ownership; the mere fact that said funds were deposited in the attorney's trust account would not alter their ownership.

Nor did the entry of the state court order cause the Law Firms to have ownership interests in the Transferred Proceeds. The state court order determined the amount of legal fees and expenses that each of the Law Firms was entitled to receive from the Proceeds, but it did not declare that each firm owned a portion of the Proceeds. If the Proceeds belonged entirely to the Debtor when the Check was delivered and no prepetition action transferred ownership to the Law Firms, the effect of the state court order would have been merely to liquidate the Law Firms' respective claims against the Debtor, since even if said order constituted a judgment, none of the Law Firms took the steps necessary to garnish or attach the Proceeds in the trust account prior to Debtor's filing for bankruptcy.(5) C.f. Williams Management Enter. v. Buonauro, 489 So. 2d 160 (Fla. Ct. App. 1986) (enforcing judgment by garnishment or attachment, rather than bringing action for replevin, is proper mechanism recovering funds held in attorney's trust account). Moreover, even if the Law Firms had obtained prepetition judgment liens, the Proceeds still would have constituted property of the estate, just as any other property owned by the Debtor but subject to a lien becomes property of the estate.(6) The Law Firms would have had ownership interests in the Transferred Proceeds based on the state court order only if they had executed on garnishments or attachments prepetition, which they did not do.

Footnote 5
If the Law Firms had garnished or attached the Proceeds in Schwartz's trust account based on the state court order, said garnishment or attachment might have constituted a preference, since said order was entered three days before Debtor filed for bankruptcy.
End Footnote

Footnote 6
Similarly, the portion of the Transferred Proceeds paid to Bell would still be property of the estate, even though Bell had a perfected lien on said proceeds.
End Footnote

Consequently, Debtor owned the Proceeds entirely at the time she filed for bankruptcy, and thus said funds were entirely property of the estate, unless the Transferred Proceeds belonged to the Law Firms at the time the Check was delivered or ownership of the Transferred Proceeds was transferred to the Law Firms prepetition. The affidavits proffered by the Trustee fail to establish that the Law Firms had no ownership interest in the Transferred Proceeds, and neither Schwartz nor Larkin have provided affidavits establishing any basis for an ownership interest in the same. Bell, however, has provided an affidavit supported by a copy of its retainer agreement,(7) which contains language granting Bell an ownership interest in the Transferred Proceeds upon delivery of the Check:

> I further agree that from the proceeds of any such recovery, whether by settlement, judgment, or otherwise, you may deduct the attorney's fees to which you are

entitled, together with all costs and expenses which remain unpaid . . . (emphasis added).

Consequently, Bell is entitled to summary judgment holding that the Trustee is not entitled to avoid Bell's receipt of the Transferred Proceeds pursuant to 11 U.S.C. Section 549(a), and the Trustee's and Schwartz's motions for summary judgment must be denied. Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 248-49 (1986).

Footnote 7
None of the parties' briefs discussed whether the language of each firm's retainer agreement was important to determining whether each firm's portion of the Transferred Proceeds constituted property of the estate. Consequently, I did not question the parties regarding the existence or effect of such language at the motion hearing.
End Footnote

I will address one additional issue raised in the parties' briefs. The Law Firm assert that, in the event the Court finds the Transferred Proceeds constituted property of the estate, said funds were exempted from the estate, and therefore the postpetition transfers thereof were not transfers of property of the estate. Debtor claimed the entire amount of the Proceeds exempt. Property claimed exempt is deemed exempt unless a party in interest files a timely objection, which the Trustee did. See 11 U.S.C. Section 522(l). The Trustee filed a timely objection to said claim of exemption, and the Debtor relinquished said claim for the Transferred Proceeds. Therefore, the Transferred Proceeds were never exempted from the estate, although they were temporarily claimed as exempt.

Footnote 8
Consequently, it is irrelevant whether Bell received notice of the motion for approval of the "Settlement Agreement" wherein Debtor relinquished her claim of exemption.
End Footnote

ACCORDINGLY, IT IS HEREBY ORDERED:

1. The portion of the Trustee's motion for summary judgment not previously decided is denied;
2. Schwartz's motion for summary judgment is denied;
3. The portion of Bell's motion for summary judgment not previously decided is granted;
4. Bell shall have judgment declaring that the Trustee is not entitled to avoid, pursuant to 11 U.S.C. Section 549(a), the postpetition transfer from Schwartz's trust account to Bell of $16,000 for attorneys fees and any additional funds received therefrom by Bell as reimbursement for documented costs;
5. Pursuant to the Order for Trial entered July 25, 1990, trial will be held in ADV 4-90-15 and 4-90-17 on August 27, 1990 at 10:00 a.m.

LET JUDGMENT BE ENTERED ACCORDINGLY.

Nancy C. Dreher
United States Bankruptcy Judge