

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

IN RE:)	Chapter 7
Edith Hull)	
)	Case No. 02-10216 (MFW)
)	
)	
Debtor.)	

MEMORANDUM OPINION¹

Before the Court is the Debtor's Motion to Vacate an Order of the Court of Chancery that directed the disbursement of funds from the Debtor's former law practice. The Debtor claims those funds are property of the estate which were exempted by her in her Chapter 7 bankruptcy case. For the reasons stated below, the Motion will be granted in part.

I. BACKGROUND

On February 27, 2001, in a confidential hearing before the Supreme Court of Delaware, the Debtor was suspended from the practice of law. As a result, the Debtor's practice was closed on March 12, 2001. On June 29, 2001, Tempe Steen was appointed receiver ("the Receiver") by the New Castle County Court of Chancery. The Receiver took control of the Debtor's files and

¹ This Opinion constitutes the findings of fact and conclusions of law of the Court pursuant to Federal Rule of Bankruptcy Procedure 7052, which is applicable to contested matters pursuant to Rule 9014.

accounts (including client escrow accounts) and was granted the authority to collect and distribute funds.

The Debtor filed a petition for relief under chapter 7 on January 18, 2002. Initially the Debtor did not list on her schedules the funds and accounts held by the Receiver. However, on May 29, 2002, the Debtor amended her schedules and claimed that property as exempt.

As of May 31, 2002, the total amount of funds held by the Receiver was \$3,205.72. On August 20, 2002, the Court of Chancery entered a Final Order directing the disbursement of the funds to the Debtor's former clients and unsecured creditors of the Debtor's practice. Specifically, \$2,120 was ordered to be returned to the Debtor's former clients. The balance of the funds (\$1,085.72) was ordered to be paid to unsecured creditors and to the Receiver for expenses.

On November 12, 2002, the Debtor filed the Motion to vacate the Chancery Court's Final Order. A hearing was held on March 21, 2003. The Receiver submitted a post-hearing letter brief on May 1, 2003.

II. JURISDICTION

This Court has jurisdiction over this matter, which is a core proceeding, pursuant to 28 U.S.C. § 157(b) (2) (A), (B), (E), (G), and (O).

III. DISCUSSION

The Debtor seeks an Order vacating the Order of the Chancery Court which directed the distribution of the funds collected by the Receiver. Those funds included retainers which had been received from clients and held by the Debtor pending performance of legal services for them, as well as collection of fees owed by the clients to the Debtor for services rendered.²

To the extent that the Chancery Court Order dealt with property of the Debtor or her estate, it is void as a violation of the automatic stay which prevents any act "to enforce against property of the debtor any lien. . . [which] secures a [pre-petition] claim" and any act "to exercise control over property of the estate." 11 U.S.C. §362(a)(3) & (5). Where, by court order or otherwise, property of the estate is transferred post-petition, the transfer is void if in violation of the automatic stay. See, e.g., 40235 Washington Street Corp. v. Lusardi, 329 F.3d 1076, 1080 (9th Cir. 2003) (foreclosure sale to good faith purchaser was void as violation of automatic stay); In re Schwartz, 954 F.2d 569, 571 (9th Cir. 1992) (post-petition tax assessment and lien was void as violation of automatic stay); Maritime Electric Co., Inc. v. United Jersey Bank, 959 F.2d 1194, 1206 (3d Cir. 1991) ("automatic stay suspends any non-bankruptcy

² Some of the funds collected were received from the chapter 13 trustee representing payment of fees to the Debtor from clients in chapter 13.

court's authority to continue judicial proceedings then pending against the debtor" and "[a]bsent relief from the stay, judicial actions and proceedings against the debtor are void ab initio").

The automatic stay applies equally to stay actions taken by a receiver. See, e.g., Underwood v. Hilliard (In re Rimsat, Ltd.), 98 F.3d 956, 961 (7th Cir. 1996) (action by receiver in obtaining an order from the appointing court expanding his powers over property of the debtor violated the automatic stay). As stated by the Seventh Circuit:

Unlike a creditor's action, [the Receiver's] recourse to the [appointing] court did not threaten to deplete the estate directly. But it did imperil the orderly administration of the bankruptcy proceeding, and by doing so it posed an indirect threat to the estate. . . . The efficacy of the bankruptcy proceeding depends on the [bankruptcy] court's ability to control and marshal the assets of the debtor wherever located (see § 541(a)), which in this case required that [the Receiver] be prevented from exercising control over the debtor.

Id. at 961-62.

The Final Order of the Chancery Court was entered after the Debtor's bankruptcy petition was filed. Thus, we must determine whether the Final Order violated the automatic stay by exercising control over property of the estate. The issue is whether the funds held by the Receiver which are the subject of the Final Order, representing fees paid by clients of the Debtor for legal services, are property of the Debtor's estate and may be exempted

by the Debtor. See, e.g., Maritime Electric, 959 F.2d at 1205 (actions against non-debtor or non-debtor's property are not subject to the automatic stay).

Section 541 of the Bankruptcy Code provides that property of the bankruptcy estate includes all of a debtor's legal or equitable interest in property as of the petition date. However, subsection (d) provides that:

Property in which the debtor holds, as of the commencement of the case, only legal title and not an equitable interest. . . becomes property of the estate under subsection (a). . . of this section only to the extent of the debtor's legal title to such property, but not to the extent of any equitable interest in such property that the debtor does not hold.

11 U.S.C. § 541(d). See, e.g., Beiger v. IRS, 496 U.S. 53, 59 (1990) ("Because the debtor does not own an equitable interest in property he holds in trust for another, that interest is not 'property of the estate'").

The first inquiry is whether the Debtor held legal title to the receivership funds as of the petition date. Delaware law provides for two distinct types of receiverships: (i) special receivers of corporations and (ii) all other receiverships appointed by the Court of Chancery. Clark v. Delaware, 269 A.2d 59, 61 (Del. 1970). In this case, we are dealing not with a corporate receivership but a general receivership. Regarding general receiverships, the Clark Court explained:

We are concerned with receivers appointed pursuant to the general powers of Chancery to

take into custody all of the assets of the debtor for the purpose of conserving them for the payment of creditors. As to receivers appointed pursuant to the general powers of the Court of Chancery, it is quite clear that they do not obtain title to the assets or books and records turned over to them. . . . They have no title to [the debtor's] assets; they are appointed to conserve those assets for the benefit of his creditors.

Id. Thus, the creation of a receivership here did not transfer title of the funds from the Debtor to the Receiver under general receivership law. Nor did the Chancery Court's Order appointing the Receiver purport to convey title in the assets to the Receiver. It provided only that:

Said Receiver shall have the power and authority to assist the [Debtor's] clients as necessary or appropriate in each of their legal matters, to turn over all files and documents to such clients at their request, to assist such clients in obtaining substitute legal counsel, if necessary, to file appropriate pleadings in connection with such clients' cases presently being litigated, and to take any other such action which is necessary or appropriate to protect the interests of such clients.

(Court of Chancery Appointment Order dated June 29, 2001, ¶9.)

Therefore, the Debtor retained legal title to the receivership assets.

The Receiver asserted, however, that an equitable trust should be imposed on the funds. Under Delaware law, an equitable trust is appropriate when "one party, by virtue of fraudulent, unfair, or unconscionable conduct, is enriched at the expense of

another to whom he or she owes some duty." Hogg v. Walker, 622 A.2d 648, 652 (Del. 1993).

The equitable trust argument has merit in the former client context. The Receiver was appointed by the Chancery Court to protect the interests of the Debtor's former clients and to assure they received the legal services for which they had paid. In the Final Order, the Chancery Court has directed that some of the funds be returned to those clients. That Order is premised on a finding that the Debtor did not perform the required services or that the clients were entitled to the balance of funds after considering the value of the services that were performed. In either event, the clients retained an equitable interest in those funds and they, therefore, never became property of the Debtor's estate.³ Therefore, we conclude that the Final Order of the Chancery Court directing the return of \$2,120 to the Debtor's clients is not void, because it did not implicate property of the Debtor's estate and, therefore, was not entered in violation of the automatic stay. See, e.g., Maritime Electric, 959 F.2d at 1205.

However, neither the Appointment Order nor the Final Order provide any basis for concluding that the unsecured creditors or Receiver held any equitable interest in the Debtor's assets. The Receiver failed to establish the Debtor had a fiduciary duty to

³ The Debtor conceded this at the hearing.

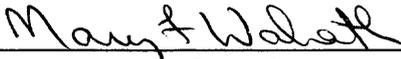
her general creditors. In fact, both at the hearing and in the Receiver's post-hearing letter brief, the Receiver was unable to present any case law or support for imposing an equitable trust on the remaining general funds of the Debtor in favor of the general creditors.⁴ As a result, we conclude that the remaining funds (\$1,085.72) are property of the Debtor's bankruptcy estate. The Chancery Court's Order which purported to exercise dominion over that property of the estate is, therefore, void. See, e.g., 40235 Washington Street Corp. v. Lusardi, 329 F.3d at 1080; Underwood v. Hilliard, 98 F.3d at 961; In re Schwartz, 954 F.2d at 571; Maritime Electric Co., 959 F.2d at 1206-07.

The Debtor is entitled to claim \$5,000 as exempt property. 11 U.S.C. § 522; Del. Code Ann., tit. 10 §4914. Accordingly, the Debtor is entitled to claim as exempt the \$1,085.72 held by the Receiver after repayment of the Debtor's former clients.

An appropriate order is attached.

BY THE COURT:

Dated: August 19, 2003



Mary F. Walrath
United States Bankruptcy Judge

⁴ In her post-hearing letter brief, the Receiver conceded this outcome and advised that the Receiver's firm had agreed to absorb the costs of administrating the receivership.