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Ruminations on Property of the Estate—Does Anyone Know Why a Debtor's Postpetition Earnings, Generated by Her Own Earning Capacity, Are Not Property of the Bankruptcy Estate?

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Presently, the bankruptcy world is awash in waves of proffered reform and revision, made necessary by either rampant abuse by debtors or unbridled lending to non-qualified borrowers by the credit community, depending upon who has the podium. There is afoot the cyclical suggestion that bankruptcy judges be made Article III lifetime appointees, which is supported by the bulk of the bankruptcy judiciary, but only if it is somehow grandparented in from its present (and lowly) roost. Creditors, debtors, lawyers, and business turnaround "artists," it seems, have vast stakes in tremorous modifications of existing law, and all, it seems, have withering criticisms of all others' perspective. Certainly, this is truly fertile ground upon which ruminants might graze, if the ruminants are, how do we say, groovy, and in touch with the multifaceted, self-interested pushes for change.

Because these ruminants are not (either groovy or in such touch), but are slow enough to have trouble making certain that they understand the way the present Bankruptcy Code is put together and what the statutes mean, and are perpetually befuddled by how many who are supposed to understand but who do not, we have taken a different approach. We want to explore a fundamental bankruptcy notion and the working together of a very few Bankruptcy Code articles. We think that there is plenty of food for thought presented by the present pastures, and, though we risk being seen as out-of-step or behind-the-curve, have determined that there is worth in simply trying to figure out what certain portions of the Code say, and, thereafter, how they work in particular circumstances.

I. INTRODUCTION

One of the basic precepts, affixed deep in the grain of the bankruptcy practitioner, or thinker, is the fundamental notion that a debtor's earnings generated by her personal earning capacity subsequent to the filing of the bankruptcy case are not property of the debtor's bankruptcy estate.¹ Clearly,

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1. This general statement is not all-encompassing, and for now we exclude from our discussion earnings by a debtor who has filed a Chapter 13 petition under 11 U.S.C. §§ 1301-1330 as at least

this makes sense, for otherwise, nothing else would. For example, what good would a discharge be if creditors, whose claims had been discharged, could look to the trustee to continue collecting a debtor's wages in payment of their claims against "the estate"? How could this action coexist with the prohibition against involuntary servitude espoused by the Thirteenth Amendment? All right, so it makes sense, and everyone knows it to be so. Is there another question? Well, yes. We are dealing with a Code (Title 11, U.S.C.), which is the law. If such a fundamental proposition as here articulated is in the law, shouldn't it be in the Bankruptcy Code? Finally, if it is in the Code, where is it?

There is a vast expanse of judicial opinion interpreting the scope of the "earnings exception."² The near-uniform assumption underlying discussions of the earnings exception, which has been perpetuated into a mind-numbing monolith (by courts at the circuit, district, and bankruptcy levels), is that the earnings exception was codified by and through Section 541(a)(6) of the Bankruptcy Code,³ which reads as follows:

(a) The commencement of a case under . . . this title creates an estate. Such estate is comprised of all the following property, wherever located and by whomever held:

. . . .
 (6) Proceeds, product, offspring, rents, or profits *of or from property of the estate*, except *such* as are earnings from services performed by an individual debtor after the commencement of the case.⁴

Interestingly (and we take a deep breath here, in view of our disagreement with about 678 judges), though Section 541(a)(6) does mention "individual debtor," "earnings," and "services. . . after the commencement of the case," this section of the Bankruptcy Code is *not* the source of the earnings exception; but given the hundreds of cases which incorrectly posit it there, it stands as a monument (perhaps a small one) to the need for a close reading of the statute, lest wrong interpretation get out of hand and take a life of its own.

II. FIRST, EVIDENCE OF THE SCOPE OF THE MISINTERPRETATION

So, we have said it. Hundreds are wrong, and we are right. This, of course, might be subject to dispute (if anyone (i) reads this stuff and (ii) cares). What is not subject to dispute is the extent to which courts have almost universally

some portion of that debtor's postpetition earnings *are* property of the bankruptcy estate under Section 1306(a)(2).

2. "Earnings exception" will be used as a short form reference for the exclusion of an individual debtor's postpetition earnings from the bankruptcy estate.

3. 11 U.S.C. § 541(a)(6) (1994).

4. 11 U.S.C. § 541(a)(6) (1994) (emphasis added).

regarded Section 541(a)(6) as the source of the earnings exception, to be kneaded, probed, interpreted, and given shape, as facts require.

These opinions articulate the general proposition that Section 541(a)(6) is the source of the earnings exception.⁵ As well, in dealing with particular questions, these courts have relied upon Section 541(a)(6) to determine whether payments

5. *See, e.g.*, In re Norris, 203 B.R. 463, 465 (Bankr. D. Nev. 1996) (pursuant to Section 541(a)(6), postpetition earnings are not property of the estate of a Chapter 7 debtor, but earnings from services performed prior to bankruptcy but paid postpetition are property of the estate because such earnings do not arise from postpetition services of the debtor); In re Bemish, 200 B.R. 408 (Bankr. M.D. Fla. 1995) (because the Chapter 7 debtor's postpetition earnings were excluded from property of the estate pursuant to Section 541(a)(6), the debtor did not need to claim her postpetition earnings as exempt); In re DeSoto, 181 B.R. 704 (Bankr. D. Conn. 1995) (pursuant to Section 541(a)(6), a trustee may not retain for the benefit of a Chapter 7 bankruptcy estate property which has been created postpetition through the postpetition efforts and earnings of the debtor); In re Raper, 177 B.R. 107 (Bankr. N.D. Fla. 1994) (pursuant to Section 541(a)(6), postpetition wages are not part of the Chapter 7 estate, and therefore credit union violated the automatic stay by continuing postpetition to accept voluntary payroll deductions initiated prepetition in the good faith belief that the Chapter 7 debtor was voluntarily continuing payments and by applying those payments to the debt); In re Michaels, 157 B.R. 190 (Bankr. D. Mass. 1993) (pursuant to Section 541(a)(6), Chapter 7 debtor's earnings from services performed postpetition were not property of the estate); In re Passmore, 156 B.R. 595 (Bankr. E.D. Wis. 1993) (pursuant to Section 541(a)(6), postpetition income of Chapter 7 debtor is not property of the estate); In re Anders, 151 B.R. 543 (Bankr. D. Nev. 1993) (postpetition spousal support payments owing to Chapter 7 debtor-wife did not constitute "earnings," within the meaning of Section 541(a)(6), as payments were not derived from postpetition services performed by the debtor, and therefore were not excluded from property of the estate pursuant to Section 541(a)(6)); In re Zrubek, 149 B.R. 631 (Bankr. D. Mont. 1993) (military pension benefits were not "wages" under the Federal Uniform Services Former Spouses Protection Act, and therefore were not excluded from property of the Chapter 7 debtor's estate pursuant to Section 541(a)(6)); In re Becker, 136 B.R. 113, 115 (Bankr. D.N.J. 1992) (pursuant to Section 541(a)(6), postpetition earnings from services performed by the Chapter 7 debtor are not property of the estate, and therefore, proceedings to collect alimony, maintenance or support from such earnings are not subject to the automatic stay); In re Martin, 117 B.R. 243, 248 (Bankr. N.D. Tex. 1990) (money due to Chapter 7 debtor-business consultant for postpetition services were excluded from property of the estate pursuant to Section 541(a)(6)); In re Daugherty, 117 B.R. 515 (Bankr. D. Neb. 1990) (pursuant to Section 541(a)(6), earnings from postpetition services of Chapter 7 debtor are not property of the estate, and therefore the debtor's postpetition wages may be garnished to enforce claims for alimony, maintenance, or support without obtaining relief from the automatic stay); In re Calder, 94 B.R. 200 (Bankr. D. Utah 1988) (pursuant to Section 541(a)(6), postpetition wages and earnings of the Chapter 7 debtor are excluded from property of the estate, but wages earned prepetition and paid postpetition are not excluded); In re Meade, 84 B.R. 106 (Bankr. S.D. Ohio 1988) (pursuant to Section 541(a)(6), postpetition wages of the Chapter 7 debtor are excluded from property of the estate, but wages earned prepetition and paid postpetition are not excluded); In re Palmer, 57 B.R. 332 (Bankr. W.D. Va. 1986) (postpetition year-end bonus paid by Chapter 7 debtor's employer was not property of the estate under Section 541(a)(6), because debtor's receipt of the bonus was conditioned in part on his employment on a date almost six months postpetition, on debtor's satisfactory job performance postpetition and on a determination by the chief executive officer of the employer that debtor was entitled to receive the bonus); In re Whisenton, 40 B.R. 468 (Bankr. D.C. 1984) (postpetition earnings of Chapter 7 debtor are excluded from the property of the estate pursuant to Section 541(a)(6), and therefore debtor's postpetition transfers of wages pursuant to voluntary wage-allotment agreement could not be avoided by the Chapter 7 trustee or the debtor).

made to the Chapter 7 debtor pursuant to an anti-competition agreement constitute property of the estate;⁶ whether commissions paid postpetition to the Chapter 7 debtor constitute property of the estate;⁷ whether postpetition

6. See, e.g., *Andrews v. Riggs Nat'l Bank (In re Andrews)*, 80 F.3d 906 (4th Cir. 1996) (postpetition payments to Chapter 7 debtor pursuant to prepetition noncompetition agreement were not "earnings from services performed" within the meaning of Section 541(a)(6), and therefore were not excluded from property of the estate, even if the noncompetition agreement was an executory agreement, because the payments were "rooted in" and "gr[e]w out of" the debtor's prepetition sale of his share in a ready-mix concrete business); *Johnson v. Taxel (In re Johnson)*, 178 B.R. 216 (B.A.P. 9th Cir. 1995) (anti-competition payments that the Chapter 7 debtor received postpetition were not excluded from the bankruptcy estate pursuant to Section 541(a)(6), because the debtor's nonparticipation in any competing activity did not qualify as performance of services by the debtor, in that the debtor's estate would have been entitled to the anti-competition payments if he had died, and the refraining from performances is not "services performed," within the meaning of Section 541(a)(6)); *In re Bluman*, 125 B.R. 359 (Bankr. E.D. N.Y. 1991) (consideration paid by the purchaser of the Chapter 7 debtor's business in exchange for the debtor's covenant not to compete did not constitute earnings from postpetition services and therefore was not excluded from property of the estate pursuant to Section 541(a)(6)).

7. See, e.g., *Tully v. Taxel (In re Tully)*, 202 B.R. 481 (B.A.P. 9th Cir. 1996) (Chapter 7 debtor's real estate commission pending in escrow at the time the debtor filed his petition was not excluded from the estate pursuant to Section 541(a)(6), even though the commission was payable at closing which occurred three weeks postpetition and the debtor assisted the purchaser in obtaining financing postpetition, where the debtor was not required by contract to assist the purchaser with financing in order to receive the commission, the sales contract and authorization agreement were signed prepetition, and the debtor found a willing and able purchaser prepetition); *Towers v. Wu (In re Wu)*, 173 B.R. 411 (B.A.P. 9th Cir. 1994) (whether and to what extent renewal commissions for insurance policies sold prepetition are excluded from the bankruptcy estate pursuant to Section 541(a)(6) depends upon whether the Chapter 7 debtor's postpetition services are prerequisite to the debtor's right to the renewal commissions, and if so, the extent to which the commissions are attributable to postpetition services rather than prepetition services; remand to the bankruptcy court to make this determination); *Williams v. Tomer (In re Tomer)*, 147 B.R. 461 (S.D. Ill. 1992) (insurance commissions paid postpetition to the Chapter 7 debtor were not excluded from property of the estate pursuant to Section 541(a)(6), because the commissions did not result from postpetition personal services rendered by the debtor, in that entitlement to the commissions was not contingent upon performance of any particular postpetition services of the debtor but instead were to be paid even if the debtor died or terminated the contract); *In re Palmer*, 167 B.R. 579 (Bankr. D. Ariz. 1994) (renewal commissions on life insurance policies sold prepetition by a Chapter 7 debtor were not excluded from the bankruptcy estate pursuant to Section 541(a)(6), because the debtor could receive renewal commissions even if he did not attend to or service the policies); *In re Hodgson*, 54 B.R. 688 (Bankr. W.D. Wis. 1985) (renewal commissions Chapter 7 debtor had received postpetition were excluded from property of the estate under Section 541(a)(6), because commissions were the result of postpetition work); *In re Kervin*, 19 B.R. 190 (Bankr. S.D. Ala. 1982) (renewal insurance commissions which accrued postpetition were excluded from property of the estate of Chapter 7 debtor under Section 541(a)(6), because debtor was still employed by insurance company postpetition, was still selling insurance postpetition, and was servicing old policies postpetition, and his right to the renewal premiums was contingent upon his generation of new business and his providing the policyholders services); *In re Sloan*, 32 B.R. 607 (Bankr. E.D. N.Y. 1983) (Chapter 7 debtor's share of finder's fee in the event that stock offered to the public was not excluded from property of the estate pursuant to Section 541(a)(6), even though the fee was paid to the debtor postpetition, because the debtor had actually fulfilled all his obligations, pursuant to an oral contract governing the finder's fee, prepetition).

payments made to the Chapter 7 debtor pursuant to an employment contract constitute property of the estate;⁸ and whether postpetition payments to the Chapter 7 debtor representing lost future wages in settlement of a lawsuit⁹

8. See, e.g., *Turner v. Avery*, 947 F.2d 772 (5th Cir. 1991), *aff'd on remand*, 198 B.R. 192 (E.D. La. 1996) (payments under a prepetition fee-splitting agreement between a Chapter 7 debtor-attorney and his law firm partner were not excluded from property of the estate under Section 541(a)(6), where the agreement assigned some cases for the partner to work on exclusively, and the debtor did not perform "personal services" on those cases; the debtor's share of advanced costs on partnership cases and share of liquidated partnership accounts were not excluded from property of the estate under Section 541(a)(6), because the residual partnership funds were distributed as a result of dissolution and did not result from the debtor's postpetition "personal services"); *Clark v. First City Bank* (In re Clark), 891 F.2d 111 (5th Cir. 1989) (postpetition payments pursuant to professional football player's employment contract constituted postpetition earnings, because the player had to play to earn the money, and therefore the earnings were not property of the player's Chapter 7 bankruptcy estate under Section 541(a)(6)); *Laughlin v. Nickless*, 190 B.R. 719 (D. Mass. 1996) (postpetition payments made to Chapter 7 debtor under a settlement agreement with his former employer arising out of an employment dispute were not excluded from property of the estate under Section 541(a)(6) merely because the debtor was obligated to provide up to five hours of consulting services per month under the agreement at the employer's request, where the overarching purpose of the agreement was to settle the lawsuit and the debtor's obligation to provide consulting services was not the "essence" of the settlement agreement and was not the sole event upon which payment was conditioned); In re Carlson, 211 B.R. 275 (Bankr. N.D. Ill. 1997) (postpetition earnings are excluded from property of the estate pursuant to Section 541(a)(6), but postpetition payments for Chapter 7 debtor-attorney's prepetition work pursuant to contingency fee arrangements were part of the estate pursuant to Section 541(a)(1), since the debtor had a legal or equitable interest in them as of the commencement of the case); In re Taronji, 174 B.R. 964 (Bankr. N.D. Ill. 1994) (stock that the Chapter 7 debtor-employee received prepetition, but in which he had only limited rights which were subject to forfeiture until he completed four years of service with his employer, was excluded from property of the estate, pursuant to Section 541(a)(6), but only to the extent that the restrictions on the debtor's ownership were removed as a result of the employee's postpetition completion of the required four years of service, thereby making the stock postpetition earnings excluded from property of the estate under Section 541(a)(6)); In re McDaniel, 141 B.R. 438 (Bankr. N.D. Fla. 1992) (monthly payments to Chapter 7 debtor from his former accounting firm under a profit-sharing agreement triggered when the debtor sold his stock in the firm were not excluded from property of the estate pursuant to Section 541(a)(6), even though the debtor would forfeit the right to payments if he competed with the firm, because the covenant not to compete was a penalty separate from the main objective of the transaction, which was to sell the debtor's stock in the firm, and earnings for services *not* performed are not excluded from property of the estate under Section 541(a)(6)).

9. See, e.g., In re Coltellaro, 204 B.R. 640 (Bankr. S.D. Fla. 1997) (pursuant to Section 541(a)(6), lost future wages that a state court would award to the Chapter 7 debtor-seaman, in his pending suit against his employer for injuries suffered while working aboard a cruise ship, would not be property of the estate, because if the debtor had not been injured but had filed for relief under Chapter 7, such future wages would have been earned postpetition and therefore would have been excluded from property of the estate pursuant to Section 541(a)(6)); In re Goins, 181 B.R. 45 (Bankr. S.D. Ohio 1994) (the value of the debtor's claim for reinstatement was not excepted from property of the estate pursuant to Section 541(a)(6), because the proceeds of the proposed settlement of the debtor's claim were not conditioned upon actual performance of postpetition services by the debtor, despite the debtor's contention that reinstatement would necessarily involve postpetition services); In re Lerocque, 164 B.R. 4 (Bankr. D.N.H. 1994) (portion of settlement on a prepetition cause of action that was attributable to compensation for lost future earnings was not excluded from the Chapter 7 debtor's estate pursuant to Section 541(a)(6), because "earnings from services performed"

constitute property of the estate. In so doing, these courts have enshrined Section 541(a)(6) as the "earnings exception" upon which they can hang their hat when determining whether *any* postpetition earnings of the debtor constitute property of the estate.

So, there are a few cases out there. If they are wrong, what is right? Mindful of the directive of the Supreme Court that "the plain meaning of legislation should be conclusive, except in the 'rare cases [in which] the literal application of a statute will produce a result demonstrably at odds with the intentions of its drafters,'"¹⁰ and mindful of the title of this issue of the *Louisiana Law Review*—"Ruminations"—we stroll back, first, to the old discussions of the earnings exception, from and through which we can meander forward, trying to find it in today's law.

III. POSTPETITION EARNINGS UNDER THE BANKRUPTCY ACT

The Supreme Court has stated that although "the starting point in every case involving construction of a statute is the language itself,"¹¹ the "[Bankruptcy] Act of 1898 informs our understanding of the language of the Code."¹² As early as 1934, in *Local Loan Co. v. Hunt*,¹³ the Supreme Court rejected the notion that a bankrupt could assign his future wages in payment for a debt that had been discharged, thus suggesting that the bankrupt's future earnings were not property of the estate under the Bankruptcy Act:

When a person assigns future wages, he, in effect, pledges his future earning power. The power of the individual to earn a living for himself and those dependent upon him is in the nature of a personal liberty quite as much if not more than it is a property right. To preserve its free exercise is of the utmost importance, not only because it is a

means that the debtor must *actually* have performed such services postpetition, not merely that the debtor receive compensation for lost future earnings); *In re Carson*, 82 B.R. 847 (Bankr. S.D. Ohio 1987) (portion of tort settlement which constituted claim for future lost wages was property of the Chapter 7 bankruptcy estate, because the earnings exception, Section 541(a)(6), requires that the debtor actually perform services postpetition).

10. See *U.S. v. Ron Pair Enters., Inc.*, 489 U.S. 235, 242, 109 S. Ct. 1026, 1031 (1989) (quoting *Griffin v. Oceanic Contractors, Inc.*, 458 U.S. 564, 571, 102 S. Ct. 3245, 3250 (1982)). See also *BFP v. Resolution Trust Corp.*, 511 U.S. 531, 570, 114 S. Ct. 1757, 1778 (1994) (Souter, J., dissenting) ("[Absent any] indication that doing so would frustrate Congress's clear intention or yield patent absurdity, our obligation is to apply the statute as Congress wrote it.").

11. *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 756, 95 S. Ct. 1917, 1935 (1975) (Powell, J., concurring).

12. See *Kelly v. Robinson*, 479 U.S. 36, 44, 107 S. Ct. 353, 358 (1986); *Midlantic Nat'l Bank v. New Jersey Dept. of Env'tl. Protection*, 474 U.S. 494, 501, 106 S. Ct. 755, 759 (1986) ("The normal rule of statutory construction is that if Congress intends for legislation to change the interpretation of a judicially created concept, it makes that intent specific. *Edmonds v. Compagnie Generale Transatlantique*, 443 U.S. 256, 266-67, 99 S. Ct. 2753, 2759-60 (1979). The Court has followed this rule with particular care in construing the scope of bankruptcy codifications.").

13. 292 U.S. 234, 54 S. Ct. 695 (1934).

fundamental private necessity, but because it is a matter of great public concern. From the viewpoint of the wage-earner there is little difference between not earning at all and earning wholly for a creditor. Pauperism may be the necessary result of either. . . . The new opportunity in life and the clear field for future effort, which it is the purpose of the [B]ankruptcy [A]ct to afford the emancipated debtor, would be of little value to the wage-earner if he were obliged to face the necessity of devoting the whole or a considerable portion of his earnings for an indefinite time in the future to the payment of indebtedness incurred prior to his bankruptcy. . . . [W]e reject the Illinois decisions as to the effect of an assignment of wages earned after bankruptcy as being destructive of the purpose and spirit of the [B]ankruptcy [A]ct.¹⁴

In *Segal v. Rochelle*,¹⁵ the Court continued this line of reasoning by holding that the "future wages" (i.e., postpetition earnings) of the bankrupt were not property, within the meaning of Section 70a(5) of the Bankruptcy Act,¹⁶ which provided that the trustee was vested by operation of law, as of the commencement of the case, with the bankrupt's title in "property . . . which prior to the filing of the petition [the debtor] could by any means have transferred or which might have been levied upon and sold under judicial process against him, or otherwise seized, impounded, or sequestered." The Court acknowledged that "[t]he main thrust of [section] 70a(5) is to secure for creditors everything of value the bankrupt may possess in alienable or leviable form when he files his petition,"¹⁷ but excepted from the reach of Section 70a(5) are the "future wages" of the bankrupt, because "one purpose [of the Act] which is highly prominent . . . is to leave the bankrupt free after the date of his petition to accumulate new wealth in the future."¹⁸ The Court added, however, that any sums received postpetition by the bankrupt that were "sufficiently rooted in the pre-bankruptcy past and so little entangled with the bankrupts' ability to make an unencumbered fresh start . . . should be regarded as 'property' under section 70a(5)."¹⁹

14. *Id.* at 245, 54 S. Ct. at 699 (emphasis added).

15. 382 U.S. 375, 379, 86 S. Ct. 511, 515 (1966). In *Segal v. Rochelle*, the issue before the Court was whether the loss-carryback tax refunds arising out of business losses immediately prior to bankruptcy but not collected until after the bankruptcy petition had been filed were "property" under Section 70a(5) of the Bankruptcy Act. The Court concluded that the tax refund claim was "sufficiently rooted in the pre-bankruptcy past and so little entangled with the bankrupts' ability to make an unencumbered fresh start that it should be regarded as 'property' under Section 70a(5)." *Id.* at 380, 86 S. Ct. at 515.

16. 11 U.S.C. § 110(a)(5) (1898, repealed 1978).

17. *Segal*, 382 U.S. at 379, 86 S. Ct. at 515.

18. *Id.*

19. *Id.* at 380, 86 S. Ct. at 515.

In *Lines v. Frederick*,²⁰ the Court expanded upon its holding in *Segal v. Rochelle*, by excepting a bankrupt wageearner's vacation pay, which had accrued prepetition but which was paid postpetition, from the definition of "property" under Section 70a(5), because such earnings, although "sufficiently rooted in the pre-bankruptcy past," were nevertheless necessary to provide the bankrupt with "an unencumbered fresh start."²¹

Local Loan Co. v. Hunt, *Segal v. Rochelle*, and *Lines v. Frederick* thus established the general rule, under the Bankruptcy Act of 1898, that the future (i.e., postpetition) earnings of the individual bankrupt (now "debtor") did not constitute "property," within the meaning of Section 70a(5) of the Bankruptcy Act, with *Lines v. Frederick* expanding the earnings exception to apply to earnings that accrued prepetition but were necessary to effectuation of the debtor's fresh start.

IV. POSTPETITION EARNINGS UNDER THE BANKRUPTCY CODE

A. Property of the Estate—The Statute

1. General Contextual Overview

We begin our exploration of Section 541(a)(6) of the Bankruptcy Code with a general overview of Section 541(a), by which a bankruptcy "estate" is created as of the commencement of the case. The estate is composed of "property,"²² and Section 541(a) divides property of the estate into two components, namely, property of the debtor as of the commencement of the case (i.e., property acquired or existing prepetition),²³ and certain property or rights the debtor acquires after commencement of the case or that is generated or acquired by the estate after commencement of the case (i.e., property acquired postpetition).²⁴ The Code broadly defines property of the estate acquired or existing prepetition as "all legal or equitable interests of the debtor in property as of the commence-

20. 400 U.S. 18, 91 S. Ct. 113 (1970).

21. *Lines v. Frederick*, 400 U.S. 18, 20, 91 S. Ct. 113, 114 (1970). Justice Harlan dissented on the ground that the bankrupt became entitled to a little over three days' pay, which would have accrued to a person starting work on the date of bankruptcy with no debts or assets, and therefore that the bankrupt not only got a fresh start, but a "head start," to the extent of one-half a day's pay. *Id.* at 21, 91 S. Ct. at 115.

22. In the absence of a conflict with federal policies underlying bankruptcy law, state law governs the issue of whether a debtor possesses an interest in property, see *Butner v. United States*, 440 U.S. 48, 99 S. Ct. 914 (1979), but once it is determined that the debtor does possess an interest in property recognized under state law, bankruptcy law or applicable non-bankruptcy law controls as to whether such interest becomes property of the estate. See *Patterson v. Shumate*, 504 U.S. 753, 112 S. Ct. 2242 (1992).

23. See 11 U.S.C. § 541(a)(1), (a)(2) (1994).

24. See 11 U.S.C. § 541(a)(3)-(a)(7) (1994).

ment of the case"²⁵ and "[a]ll interests of the debtor and the debtor's spouse in [certain] community property."²⁶ This broad definition of property of the estate, which pursuant to Section 103(a) of the Code applies to all cases under Chapters 7, 11, 12 or 13 of the Code, effectively overrules *Lockwood v. Exchange Bank*,²⁷ because under Section 541(a)(1), all legal or equitable interests of the debtor in property as of the commencement of the case, including exempt property,²⁸ become property of the estate.²⁹ Section 541(a)(1) of the Code, however, did not overrule the Supreme Court's ruling in *Segal v. Rochelle*³⁰ that future (i.e., postpetition) earnings are not property of the estate under Section 70a(5) of the Bankruptcy Act.³¹

Property of the estate acquired postpetition includes any interest in property that the trustee recovers pursuant to certain avoidance actions;³² certain interests

25. See 11 U.S.C. § 541(a)(1) (1994).

26. See 11 U.S.C. § 541(a)(2) (1994).

27. 190 U.S. 294, 23 S. Ct. 47 (1903). In *Lockwood*, the issue before the Court was: "Has the bankruptcy court jurisdiction to protect or enforce against the bankrupt's exemption the rights of creditors not having a judgment or other lien, whose promissory notes or other like obligations to pay contain a written waiver of the homestead and exemption authorized and prescribed by the [C]onstitution of the State [of Georgia], or are such creditors to be remitted to the state courts for such relief as may be there obtained?" *Id.* at 298, 23 S. Ct. at 753. Finding that "it is made as clear as anything can be, that such exempted property constitutes no part of the assets in bankruptcy," *id.* at 299, 23 S. Ct. at 753, the Court held that the Bankruptcy Act "afford[ed] no just ground for holding that the court of bankruptcy must administer and distribute, as included in the assets of the estate, the very property which the act in unambiguous language declares shall not pass from the bankrupt or become part of the bankruptcy assets." *Id.* at 299-300, 23 S. Ct. at 753.

28. See *Taylor v. Freeland & Kronz*, 503 U.S. 638, 112 S. Ct. 1644, 1647 (1992). Under Section 522(f) of the Code and Rule 4003 of the Federal Rules of Bankruptcy Procedure, it then becomes the debtor's responsibility to file a list of property that the debtor claims as exempt under Section 522(b) of the Code. See *Hardage v. Herring Nat'l Bank*, 837 F.2d 1319, 1322 (5th Cir. 1988). Unless a party in interest objects, the property claimed as exempt on such a list is exempt. Interestingly, the majority of courts have held that a postpetition transformation in the character of property claimed as exempt will not change the status of that property. These courts have relied on the principles that once property is exempt, it will always be exempt, notwithstanding any occurrences postpetition, and because the property deemed exempt has been withdrawn from the bankruptcy estate. See *Owen v. Owen*, 500 U.S. 305, 308, 111 S. Ct. 1833, 1835 (1991) (an "exemption is an interest withdrawn from the estate (and hence its creditors) for the benefit of the debtor"). Any proceeds from the postpetition disposition of that property do not become property of the estate under Section 541(a)(6) of the Code, even when, absent bankruptcy, such proceeds would have ceased to be exempt. See, e.g., *Armstrong v. Peterson (In re Peterson)*, 897 F.2d 935, 937 (8th Cir. 1990); *Payne v. Wood*, 775 F.2d 202, 204 (7th Cir. 1985); *Lowe v. Yochem (In re Reed)*, 184 B.R. 733 (Bankr. W.D. Tex. 1995); *Lasich v. Estate of A. N. Wickstrom (Matter of Wickstrom)*, 113 B.R. 339, 343-44 (Bankr. W.D. Mich. 1990); *In re Whitman*, 106 B.R. 654, 656-57 (Bankr. S.D. Cal. 1989); *In re Harlan*, 32 B.R. 91, 92-93 (Bankr. W.D. Tex. 1983).

29. See 11 U.S.C. § 541(b) (1994) with regard to property that is not included in property of the estate.

30. 382 U.S. 375, 86 S. Ct. 511 (1966).

31. See *supra* text accompanying notes 15-19.

32. See 11 U.S.C. § 541(a)(3) (1994). It is not the avoidance power, or avoidance section, that is property of the estate, but only the recovery therefrom, if any.

in property preserved for the benefit of or ordered transferred to the estate;³³ certain interests in property that would have been property of the estate if such interest had been an interest of the debtor on the petition date and that the debtor acquires or becomes entitled to acquire within 180 days thereafter;³⁴ certain proceeds, product, offspring, rents, and/or profits of or from property of the estate;³⁵ and any interest in property that the estate acquires after the commencement of the case.³⁶ Section 541 is comprised of other provisions as well, none of which are relevant at this moment.

2. Section 541(a)(6)—What Does It Say? What Does It Mean? Could It Mean What It Says?

So, roughly broken in two, Section 541(a) categorizes the estate into: (1) the property existing as of the petition date; and (2) property acquired thereafter. Section 541(a)(6) is found within the second main category, apparently designed to reflect statutorily the practical fact that property itself generates value, and if so, that value so generated becomes estate property. For example, one day there will be an individual Chapter 7 debtor who files a case with money in the bank—it is at least conceivable that) interest earned upon that money, if deposited into an estate bank account, belongs to the estate. But let us now turn to working through the words of Section 541(a)(6), the purported repository of the earnings exception.

We first observe that Section 541(a)(6) seems to be comprised of two main clauses, the first of which is “[p]roceeds, product, offspring, rents, or profits of or from property of the estate,” and the second of which is “except such as are earnings from services performed by an individual debtor after the commencement of the case.”

What does the first clause of Section 541(a)(6) mean? We initially note that “[p]roceeds, product, offspring, rents, or profits” are grouped together, suggesting their similar nature, and that “of or from property of the estate” follows this group. However, “of or from property of the estate” also follows the perhaps broken-out “or profits.” Does “of or from property of the estate” modify “profits” only, or does it modify “[p]roceeds, product, offspring, rents or profits” as well? In answering this question, we observe that there appears to be no principled distinction between “[p]roceeds, product, offspring, rents” and “profits,” such that the latter word must be “of or from property of the estate,” while each item in the former category need not be. Given the similar nature of “[p]roceeds, product, offspring, rents, or profits,” and the fact that the statute groups them together with the joinder “or,” it follows logically that “of or from

33. See 11 U.S.C. § 541(a)(4) (1994).

34. See 11 U.S.C. § 541(a)(5) (1994).

35. See 11 U.S.C. § 541(a)(6) (1994).

36. See 11 U.S.C. § 541(a)(7) (1994).

property of the estate" modifies each word in this entire *group*, rather than modifying "profits" only. Moreover, it also makes sense that the "[p]roceeds, product, offspring, [and] rent," as well as the "profits," of Subsection (a)(6) should be "of or from property of the estate," because the clause in which they are contained includes them as being within the "estate" itself, as set forth in Section 541(a). Why would each item in the group be included in the "estate" pursuant to section 541(a), if each item was not "of or from property of the estate"? If "[p]roceeds, products, offspring, [and] rent" are not "of or from property of the estate," in the same way that "profits" are "of or from property of the estate," then including the former within the estate pursuant to Section 541(a) would constitute an unbridled acquisitive power, absorbing (like a black hole) into the estate any and all proceeds, product, offspring and rents from . . . well, either anywhere or anyone, or from the debtor for all time.

We therefore conclude that the plain meaning of the first clause of Section 541(a)(6) of the Code includes in property of the estate *only* those proceeds, product, offspring, rents, and/or profits that are "of or from property of the estate." If such items are not "of or from property of the estate," then they do not comprise property of the estate under the first clause of Section 541(a)(6).

What is the plain meaning of the second clause of Section 541(a)(6)—"except such as are earnings from services performed by an individual debtor after the commencement of the case"? Does "except such" refer to "[p]roceeds, product, offspring, rents or profits" only; to "[p]roceeds, products, offspring, rents or profits *of or from property of the estate*" (emphasis added); or merely to "profits of or from property of the estate"? We can conjure no basis for carving up the first clause for the purpose of limiting this "except such" limitation. To do so would set up the absurdity that certain categories of estate property *can* include earnings for services performed by an individual debtor after commencement of the case. Not even the courts³⁷ that have misread the Code by finding a general earnings exception in Section 541(a)(6) could disagree with us on this point, for to do so would constitute the championing of a further diminution of the earnings exception. The plain meaning of the second clause of Section 541(a)(6), therefore, appears to be that *only* those "earnings for services performed by an individual debtor after the commencement of the case" that also constitute "[p]roceeds, product, offspring, rents or profits *of or from property of the estate*," are excepted from the first clause of Section 541(a)(6) and thereby excluded from the estate, because if such earnings are not *also* proceeds, etc. "of or from property of the estate," then they do not fall within the scope of the exception set forth in the second clause of Section 541(a)(6), as they are not "such."³⁸

37. See *supra* notes 5-9.

38. Only two courts, as far as we can tell, have concluded similarly. See, e.g., *In re Harp*, 166 B.R. 740, 755 (Bankr. N.D. Ala. 1993); *In re Herberman*, 122 B.R. 273, 278 (Bankr. W.D. Tex. 1990). These cases arise within the Chapter 11 context and will be dealt with in the second installment. It suffices here to say that although these opinions concur with this much of our analysis, they end up at a different place.

We conclude, therefore, that the plain meaning of the whole of Section 541(a)(6) is that *only* those postpetition earnings of the individual debtor that are proceeds, etc. "of or from property of the estate" are excepted or excluded, by Section 541(a)(6), from property of the estate. Any other earnings of the individual debtor (i.e., those that do not constitute "proceeds, product, offspring, rents, or profits of or from property of the estate," such as a debtor's postpetition earnings generally) would not be excluded or excepted from property of the estate under Section 541(a)(6), because Section 541(a)(6) is not applicable to them. Section 541(a)(6), then, by its own terms (if read), does not create the earnings exception that the cases mentioned herein³⁹ think they are dealing with when they try to determine whether the monies at issue (in these cases) arise from "services rendered by the individual debtor after the commencement of the case."⁴⁰ They simply do not realize that the earnings from services rendered after commencement of the case *must* also be proceeds, product, offspring, rents, or profits of or from property of the estate for Section 541(a)(6) to be applicable.

Can this be? Well, it looks so. Could this be what Congress intended (even if we could further inquire, given the plainness of the language or the absence of ambiguity in the words of the statute)? Surely, the aforementioned reams of case law⁴¹ must have hooked onto Congress' actual intent and simply looked beyond its lack of linguistic ability. Is there, then, any legislative history with which to hammer the authors? Let's look.

In actuality, our analysis is backed up by the legislative history of Section 541(a)(6). The Report of the Committee on the Judiciary, House of Representatives,⁴² accompanying proposed Section 541(a)(6), provided as follows:

The estate also includes . . . proceeds, product, offspring, rents, and profits of or from property of the estate, except such as are earnings from services performed by an individual debtor after the commencement of the case. See proposed 11 U.S.C. [Section] 503(b)(1). . . .

Postpetition payments to an individual debtor for services rendered to the estate are administrative expenses, and are not property of the estate when received by the debtor. This situation would most likely arise when the individual was a sole proprietor and was employed by the estate to run the business after the commencement of the case. An individual debtor in possession would be so employed, for example. See *Local Loan v. Hunt*, 292 U.S. 234, 243 (1943).⁴³

39. See *supra* notes 5-9.

40. See 11 U.S.C. § 541(a)(6) (1994).

41. See *supra* notes 5-9.

42. See Report of the Committee on the Judiciary, House of Representatives, to Accompany H.R. 8200, H.R. Rep. No. 95-595 (1977).

43. See Report of the Committee on the Judiciary, House of Representatives, to Accompany H.R. 8200, H.R. Rep. No. 95-595, at 355, 368 (1977).

The Report of the Committee on the Judiciary, United States Senate,⁴⁴ regarding Section 541(a)(6), is virtually identical, as follows:

Postpetition payments to an individual debtor for services rendered to the estate are administrative expenses, and are not property of the estate when received by the debtor. This situation would most likely arise when the individual was a sole proprietor and was employed by the estate to run the business after the commencement of the case. An individual debtor in possession would be so employed, for example. See *Local Loan v. Hunt*, 292 U.S. 234, 243 (1943).⁴⁵

Both the House and the Senate Reports, and *Local Loan Co. v. Hunt*,⁴⁶ set up the meaning of Section 541(a)(6) in the context of an individual debtor employed by the estate to run her business postpetition, and contemplate *shielding the debtor's postpetition salary*, paid by the estate as an administrative expense under Section 503(b)(1), from the reach of property of the estate.⁴⁷ In other words, the legislative history of Section 541(a)(6) contemplates an "earnings exception" that is narrowly tailored to fit the situation where the debtor's earnings, generated from the proceeds, product, offspring, rent or profits of estate property and paid, perhaps, under Section 503(b)(1), are excluded from property of the estate. Section 503(b)(1) is the perfect vehicle for implementing Section 541(a)(6), as it allows the court to determine the extent to which wages, salaries, and earnings have been accruing to preserve or benefit the estate.⁴⁸ The plain meaning of Section 541(a)(6) accords with this interpretation.⁴⁹

There is a slight interpretive problem raised by our analysis that needs mentioning. For example, what if an individual debtor is working for the estate and/or performing services for, upon, or in connection with property of the estate, and though wages have accrued (i.e., been earned), there is not enough estate property to pay them and all other non-debtor administrative expense claimants? Section 726(b) of the Code provides that all claimants similarly situated (within the discrete levels of priorities) share pro rata if there is not

44. See Report of the Committee on the Judiciary, United States Senate, to accompany S. 2266, S. Rep. No. 95-989 (1978).

45. See Report of the Committee on the Judiciary, United States Senate, to accompany S. 2266, S. Rep. No. 95-989, at 66 (1978).

46. See *supra* text accompanying notes 13-14.

47. The operative provision of 11 U.S.C. § 503(b)(1)(A), as it reads provides: "After notice and a hearing, there shall be allowed administrative expenses . . . including . . . the actual, necessary costs and expenses of preserving the estate, including wages, salaries, or commissions for services rendered after the commencement of the case."

48. Section 726(a)(1) of the Code provides that property of the estate shall be distributed first, in payment of the kind specified in, and in the order specified in, Section 507 of the Code. 11 U.S.C. § 726(a)(1) (1994). Section 507(a) provides that administrative expenses allowed under Section 503(b) of the Code have first priority in being paid. 11 U.S.C. § 507(a)(1) (1994).

49. See *supra* text accompanying notes 22-40.

enough to go around.⁵⁰ Does Section 541(a)(6) somehow modify Section 726(b) by distinguishing the earnings of the individual debtor who works for the estate from the other, non-debtor persons enjoying claims for administrative status? This seems possible, though unlikely. A more reasonable view, we think, is to focus upon the reference in the legislative committee reports to *Local Loan Co. v. Hunt*.⁵¹ Recall that at issue was whether a lien upon a debtor's future wages survived discharge by passing through the bankruptcy case unaffected. To this question the Supreme Court answered "No." Hunt was not working for the bankruptcy estate, and the case has already been cited as one of the steps to developing the earnings exception—which we say is not found in Section 541(a)(6). Suppose the wage assignee in *Hunt* was asserting a postpetition expectation of the wage assignment lien in, to, and upon wages which are also property of the estate? Couldn't the assignee argue that *Local Loan Co. v. Hunt*⁵² is inapplicable because the lien, attaching to estate property, primes the right of the debtor to the wages/estate property as a floating, previously-perfected lien? To pretermitt this argument, and to insure that prepetition creditors could not claim priming rights to estate property used to pay debtors, Section 541(a)(6) of the Code, as pointed out by the legislative history,⁵³ simply excludes *such* earnings from the estate. Of course, the flip side of the *Local Loan Co. v. Hunt* concern is that the debtor not be allowed to shield such earnings from postpetition creditors or creditors whose claims are not discharged, by claiming automatic stay protection.⁵⁴

But if Section 541(a)(6) is not a general "earnings exception," where is the earnings exception? By process of elimination, we first note that such earnings are not mentioned within any of the specific exceptions to the definition of property of the estate that are set forth in Section 541(b) of the Code.⁵⁵ The earnings do not constitute "any power that the debtor may exercise solely for the benefit of an entity other than the debtor";⁵⁶ are not an interest of a debtor as a lessee under a lease of nonresidential real property that by its terms has expired prepetition;⁵⁷ do not involve the eligibility of a debtor to participate in certain educational programs or any accreditation status or state licensure of a debtor;⁵⁸ do not involve any interest of a debtor in liquid or gaseous hydrocarbons transferred by means of a farmout agreement that could be brought into the estate through Sections 365 or 544(a);⁵⁹ and do not constitute an interest in cash or

50. Section 726(b) of the Code provides that payment on administrative claims "shall be made pro rata among claims of the kind specified." 11 U.S.C. § 726(b) (1994).

51. 292 U.S. 234, 234, 54 S. Ct. 696, 695 (1934).

52. *Id.*

53. See *supra* text accompanying notes 42-45.

54. See *Chunn v. Chunn, III* (In re *Chunn*), 106 F.3d 1239 (5th Cir. 1997).

55. See 11 U.S.C. § 541(b) (1994).

56. See 11 U.S.C. § 541(b)(1) (1994).

57. See 11 U.S.C. § 541(b)(2) (1994).

58. See 11 U.S.C. § 541(b)(3) (1994).

59. See 11 U.S.C. § 541(b)(4) (1994).

cash equivalents that constitute proceeds of a sale by the debtor of a money order.⁶⁰ Also, postpetition earnings do not fall within the exclusion, within Section 541(d), of property to which the debtor holds only legal title but no equitable interest, such as is required of entities servicing pools of mortgages sold to the secondary market.⁶¹ In other words, Congress has carved out specific exceptions to that which constitutes property of the estate, none of which include postpetition earnings.

Are the postpetition earnings of the individual debtor, therefore, not excepted from property of the estate under any provision of the Code? Did we make up this earnings exception? Well, no. Consider Section 541(a)(1). By providing that property of the estate includes all legal or equitable interests of the debtor in property *as of the commencement of the case*, Section 541(a) clearly does *not* overrule *Segal v. Rochelle*,⁶² which held that the bankrupt's future wages were not "property" within the meaning of Section 70a(5) of the Bankruptcy Act.⁶³ It appears, therefore, that postpetition earnings of the individual Chapter 7 debtor would be excluded from property of the estate under Section 541(a)(1), because the debtor would not have legal or equitable title or interest *as of the commencement of the case* to earnings not yet earned.⁶⁴ The individual who wakes up and goes to work at the plant simply has no legal or equitable interest in property such as earnings, unless the job has been performed. If anything, there can be

60. See 11 U.S.C. § 541(b)(5) (1994).

61. See 11 U.S.C. § 541(d) (1994).

62. 382 U.S. 375, 379, 86 S. Ct. 511, 515 (1966).

63. See *supra* text accompanying notes 15-19.

64. See *In re Froid*, 109 B.R. 481, 483 (Bankr. M.D. Fla. 1989) (with regard to whether renewal commissions which are not conditioned on future services to purchaser of life insurance policies would be deemed property of the Chapter 7 debtor's estate, court noted that the "threshold question is whether the renewal commissions are property of the estate" pursuant to Section 541(a)(1); the renewal commissions were property of the estate pursuant to Section 541(a)(1), because they were not conditioned on the debtor's future services, but instead would be paid even if the debtor terminated his relationship with the life insurance company, and because there was no evidence that any policyholder would actually cancel his policy if the debtor ceased servicing the policy and another agent took over); *In re Parker*, 9 B.R. 447, 449 (Bankr. M.D. Ga. 1981) (pursuant to Section 541(a)(1), renewal commissions due to a Chapter 7 debtor, a former sales representative of an insurance company, were property of the estate, because as of the commencement of the case, the debtor was entitled to receive the renewal commissions, and the right to receive these commissions was in no way conditioned upon future services to the insurance company); *In re Haynes*, 9 B.R. 418 (Bankr. N.D. Ind. 1981) (Chapter 7 debtor's naval retirement benefits were akin to future wages, and therefore were not property of the estate pursuant to Section 541(a)(1), for the debtor had no legal or equitable interest in such benefits as of the commencement of the case); *In re Malloy*, 2 B.R. 674 (Bankr. M.D. Fla. 1980) (under Section 70a(5) of the Bankruptcy Act, unpaid renewal commissions owed to Chapter 7 debtor-insurance salesman were transferable prepetition, so the right to the renewal commissions became property of the estate to the extent that they represented payment for past services); *Mutual Trust Life Ins. Co. v. Wemyss*, 309 F. Supp. 1221 (D. Me. 1970) (under Section 70a(5) of the Bankruptcy Act, unpaid renewal commissions due the Chapter 7 debtor-insurance salesman were property of the estate because the debtor's contractual right to future renewal commissions was a nonexempt transferable property right as of the commencement of the case).

a legal or equitable interest only in the job itself (i.e., some type of employment contract).

Questions facing a bankruptcy trustee, then, are: (1) has the debtor a right to earnings not yet paid; and (2) has the debtor a vested contract right that will give the trustee the ability to "become" the debtor for purposes of exercising the debtor's rights and performing the debtor's obligations under the contract, for the benefit of the estate? Regarding the plant worker, two alternative analytical avenues are presented.

First, the plant worker has no vested title or interest in, to, or upon her job. She can quit at any time, and, as long as the reason is not prohibitive (e.g., discrimination, etc.), she can be terminated at any time.

Second, the plant worker does have some vested interest in her job such that the trustee could conceivably claim entitlement to step into the debtor's shoes. The title or interest would only be, for example, as a contracting party. The trustee would, therefore, have to become the debtor in all respects (e.g., be a pipe fitter, union member (if applicable), have a lunch box, spit appropriately at coffee break, etc.). To do this, though, the trustee would have to be able to assume the debtor's position as a contracting party, and be able to bind the other party to perform the contract and to accept performance by the trustee, as debtor.

It is this second alternative prospect that reveals the symmetry of the Bankruptcy Code. The trustee's problem in trying to obtain hold over the debtor's job pursuant to Section 541(a)(1), by means of establishing and then enforcing some contractual right to the job, shows a couple of things. First, even if the trustee is successful, the estate still will not be entitled to this *debtor's* postpetition earnings at some *other* job, as it will be the trustee, or the estate, that takes the earnings only under the contract assumed under Section 365(a).⁶⁵ Therefore, the question of the debtor's postpetition earnings being property of the estate can never arise—certainly the debtor has no vested right or interest in some other job (made necessary by being ousted by the trustee) that did not exist as of the petition date, although the earnings from the contract assumed under Section 365(a) will be the trustee's (by performance of the debtor's job through a subcontractor).

Wait a minute. Might not the question of whether the debtor's postpetition earnings are property of the estate, in fact, arise? Well, yes, we have talked ourselves into the perfect Section 541(a)(6) situation. Debtor has contractual interest in plant job; trustee assumes contract; trustee hires *the debtor* to perform the contract; debtor has earnings because they are proceeds, product, etc. of or from property of the estate—the contract, are excluded from property of the

65. 11 U.S.C. § 365(a) (1994):

Except as provided in sections 765 and 766 of this title and in subsections (b), (c), and (d) of this section, the trustee, subject to the court's approval, may assume or reject any executory contract or unexpired lease of the debtor.

estate pursuant to Section 541(a)(6), because they represent such proceeds as are earnings from services rendered by the debtor postpetition.

Thankfully, the Bankruptcy Code, maybe by accident, maybe not, has designed a way around this apparent absurdity. (Debtor has job; trustee takes job; trustee gives debtor job.) Very simply, the trustee cannot assume those contracts that require the personal services of the debtor, so that for purposes of Section 541(a)(1), the debtor has no legal or equitable title or interest in this type of contract as of the petition date that is cognizable as a property interest that becomes property of the estate.

Section 365(c)(1)(A) prohibits the trustee from assuming contracts if the non-debtor party can refuse to accept performance from anyone other than the debtor (or a debtor as debtor-in-possession).⁶⁶ This prohibition clearly extends (though not exclusively) to contracts for personal services.⁶⁷ There is some dispute within the scholarly writing and jurisprudence over whether an assumable contract either never becomes part of the estate unless assumed or is jettisoned from the estate upon rejection.⁶⁸ However, there is no doubt that a contract which, pursuant to the provision of the Code setting forth the right of assumption, expressly cannot be assumed, can never become property of the estate. It cannot.

Returning to our trustee and the plant worker, we see that the Code has a built-in safety net, designed to insure that a debtor can pursue, postpetition, her occupation/job, even if a trustee could argue that the debtor had, as of the petition date, a vested contractual right in, to and upon the employment. Therefore, the only scenario we can conjure up that would implicate Section 541(a)(6) as something like a general earnings exception—debtor has job; trustee gets job; trustee gives job to debtor—in fact, supports our interpretation of Section 541(a)(6) and, second, gives us a glimpse into proper analysis. First of all, the situation would not suggest a general earnings exception because the earnings from services rendered postpetition would be earnings that were proceeds of or from estate property. Second, it cannot happen, because even if the trustee could point to some contractual right enforceable by the debtor, assumption is prohibited by Section 365(c)(1)(A).

66. 11 U.S.C. § 365(c)(1)(A), in its strangled entirety, reads:

[A]pplicable law excuses a party, other than the debtor, to such contract or lease from accepting performance from or rendering performance to an entity other than the debtor or the debtor in possession whether or not such contract or lease prohibits or restricts assignment of rights or delegation of duties

67. See, e.g., *In re Clark*, 891 F.2d 111 (5th Cir. 1989).

68. See Michael T. Andrew, *Executory Contracts Revisited: A Reply to Professor Westbrook*, 62 U. Colo. L. Rev. 1 (1991); Michael T. Andrew, *Executory Contracts in Bankruptcy: Understanding "Rejection"*, 59 U. Colo. L. Rev. 845 (1988); Jay Lawrence Westbrook, *A Functional Analysis of Executory Contracts*, 74 Minn. L. Rev. 227 (1989); Jay Lawrence Westbrook, *A Fresh Statute for Bankruptcy Contracts*, Bankruptcy Update 1990, 64th Annual Meeting of the National Conference of Bankruptcy Judges; see *Turner v. Avery*, 947 F.2d 772 (5th Cir. 1991), *aff'd on remand*, 198 B.R. 192 (E.D. La. 1996).

B. Particular Examples—Our First Test Batch

We take two examples from the Fifth Circuit, *In re Clark*⁶⁹ and *Turner v. Avery*,⁷⁰ to set out the proper analysis under our suggestion that Section 541(a)(1), as opposed to Section 541(a)(6), constitutes the repository of the earnings exception, and that Section 365(c)(1)(A) is to be seen as a supplement to Section 541(a)(1), assisting with the general carving out from the estate of a debtor's own postpetition earnings.

In *Clark*, the court reviewed the lower court's determination of whether the earnings of a Chapter 7 debtor/professional football player constituted, as far as earnings for playing postpetition, earnings for services rendered by an individual debtor after the commencement of the case.⁷¹ The Fifth Circuit goes on at great length, struggling mightily but unnecessarily with the question of whether the player's earnings, paid postpetition, were conditioned upon the debtor playing postpetition.⁷² The court courageously chewed the contractual cud, finding ultimately that the player had to play to be paid, that the earnings were for services rendered after the commencement of the case, and that the earnings were therefore excluded from the estate by Section 541(a)(6).⁷³

There was no question that Clark had a vested interest in the employment contract. There was a question as to whether Clark had already earned a year's worth of salary by passing the physical examination, as the bankruptcy court had construed the contract that way.⁷⁴ As a result of the court's reading of Section 541(a)(6), the court was forced to parse out the relationship between paying and playing, to find that though the contractual rights were vested (by being guaranteed), the earnings were related to or to be generated by postpetition services rendered, and that due to this postpetition performance of ours, the debtor was entitled to the earnings pursuant to Section 541(a)(6).⁷⁵ The court does not mention Section 365(a)(1)(A).

In *Turner v. Avery*,⁷⁶ the court was faced, *inter alia*, with a trustee's argument that the debtor-lawyer's contingency fee contracts (or at least part of them) constituted property of the estate.⁷⁷ The court, focusing upon Section 365(c)(1)(A)⁷⁸ of the Code, concluded that the contract was one for personal

69. 891 F.2d 111 (5th Cir. 1989).

70. 947 F.2d 772 (5th Cir. 1991), *aff'd on remand*, 198 B.R. 192 (E.D. La. 1996).

71. *In re Clark*, 891 F.2d at 113.

72. *Id.* at 113-15.

73. *Id.* at 115.

74. *Id.* at 113.

75. *Id.* at 115.

76. *Turner v. Avery*, 947 F.2d 772, 772 (5th Cir. 1991).

77. *Id.* at 773.

78. Section 365(c)(1)(A) of the Code provides that "[t]he trustee may not assume or assign any executory contract or unexpired lease of the debtor, whether or not such contract or lease prohibits or restricts assignment of rights or delegation of duties, if— . . . applicable law excuses a party, other than the debtor, to such contract or lease from accepting performance from or rendering performance

services that was not assumable pursuant to that provision, because the non-debtor party to the contract could not be made to accept performance by a person other than the debtor.⁷⁹ Therefore, the court concluded, the rights that might have value under the contract would not go into the estate: "Because the contracts were non-assumable as a matter of law they did not form a part of the bankruptcy estate."⁸⁰

However, the Fifth Circuit noted, this legal conclusion does not end the inquiry. Under a contingency fee contract, a lawyer can be terminated at any time. Under certain circumstances (e.g., where there is no "cause" for the termination), the lawyer retains a claim for a share of any ultimate fee generated by the contract under the theory of *quantum meruit*.⁸¹ Because the estate gets all the debtor's legal and equitable interests as of the petition date, but cannot assume the contract, the trustee stands in the shoes of the debtor-lawyer as though she (at the moment of the filing of the petition) was terminated (without cause) as of the petition date. As of the petition date, the debtor had this interest regardless of the continuing viability of the contract (as he had not been terminated for cause). The only pertinent question, therefore, is about the *value* of the *quantum meruit* claim that the estate has against the debtor (or, probably more precisely, against the contingency fee), for either a part of the particular fee upon its being ultimately earned, or in dollars that must be turned over to the estate regardless of the outcome of the particular lawsuit generating the fee agreement.⁸² The court imposes the burden upon the trustee to prove the value of the vested interest in property.⁸³ Likely, the trustee ultimately gets skunked, as far as all contracts which have not generated fees as of trial, for the debtor holds the value in hand (e.g., what if the debtor kicks the client in the shin the day after the bankruptcy case—result is probably discharge for cause, which obviates, under Louisiana jurisprudence, the right to *quantum meruit* recovery). But the important point is that the ultimate question is one of valuation, of a vested interest as of the petition date, with the estate not being able to assume the ultimate value of the contract rights.

Now, let's apply the *Turner v. Avery* analysis to *Clark*. The contract, of course, is one for personal services which is not assumable by a trustee (the professional football team would decline performance by anyone other than the player). What would happen if the football player was terminated? According

to an entity other than the debtor or the debtor in possession, whether or not such contract or lease prohibits or restricts assignment of rights or delegation of duties." 11 U.S.C. § 365(c)(1)(A) (1994).

79. *Turner*, 947 F.2d at 774.

80. *Id.*

81. *Id.* See also *Saucier v. Hayes Dairy Prods., Inc.*, 373 So. 2d 102 (La. 1979) (opinion on rehearing); *Acadian Bank v. Foret*, 602 So. 2d 1097 (La. App. 1st Cir. 1992); *Hebert v. State Farm Ins. Co.*, 588 So. 2d 1150 (La. App. 1st Cir. 1991); *Sims v. Selvage*, 499 So. 2d 325 (La. App. 1st Cir. 1986).

82. *Turner*, 947 F.2d at 774.

83. *Id.*

to the contract, the player probably had the right to be paid for the entire year, as long as the termination was at the whim of management.⁸⁴ The player, to earn the full value of the contract, had to be prepared to perform. Assuming the player was willing, but management decided to replace him, he was entitled to the entirety of the contract, though terminated. Would the football player have had any *quantum meruit* claim that might be seen to pass into the estate? The court says "no."

How can we square the two cases? What is our approach, informed by our understanding of Section 541(a)(6)? Probably, each case got it half right. *Turner* is correct in looking to Section 365(c)(1)(A). *Clark* is correct in looking to whether the player had already earned his year's salary by passing his physical exam (without having to do more). *Turner* is probably incorrect in concluding that the estate has a vested interest in a *quantum meruit* claim,⁸⁵ if a *quantum meruit* claim exists in *Turner v. Avery*, then probably one should exist within *Clark* as well. *Clark* is incorrect in looking to Section 541(a)(6) as the ground for excluding the earnings to be obtained for the contract postpetition; *Turner* is correct in not mentioning Section 541(a)(6). So, these two decisions make one pretty good opinion.

Properly approached, the explanation is as follows: each debtor has a vested interest in contract rights, but is required to be ready to perform in the future. Neither, as of the petition date, could, upon the contract, make a claim for a single thin dime. Any rights that might be vested cannot really be seen as vested because the debtor must stand ready to perform in order to maintain either the *quantum meruit* claim or the year's salary. At any moment the individual debtor can cause the *quantum meruit* claim or guaranteed salary to evaporate (a kick in client's or management's shin). The only vested interest is in a contract which is of such a nature that Section 365(c)(1)(A) precludes assumption. The estate has no interest in property under Section 541(a)(1) (can the trustee keep either debtor from being terminated for cause?). Section 541(a)(6) need not be mentioned.

Section 365(c)(1)(A), then, provides the legal basis for excluding from the estate vested contract rights which, without the section, would be assumable by the estate. Section 541(a)(1) provides the legal basis for determining the value, if any, of any uncompensated prepetition performance or, put another way to fit the circumstances, the value of the debtor's prepetition vested interest in property pursuant to the contract which exists independently of any future performance under the contract. The question, therefore, is not the extent to which services are to be performed postpetition, but rather: (1) the extent to which the debtor has a legal or equitable interest in property as of the petition date; (2) the extent

84. In re *Clark*, 891 F.2d 111, 113-14 (5th Cir. 1989).

85. In the case In re *Tonry*, 724 F.2d 467, 469 (5th Cir. 1984), the court held that notwithstanding the *quantum meruit* rights, inability to assume the personal services contract precluded the estate from obtaining the *quantum meruit* claim. Judge Politz wrote both opinions. They are irreconcilable, with *Tonry* probably correct.

to which the debtor's interest in contract rights is assumable by the estate; and (3) the value of (1) and (2). This approach obviates the need to even look at Section 541(a)(6), unless the estate has an interest, and the debtor's postpetition services are reimbursed out of estate property.

For another example of a misfiring analysis, we now look at *In re Larson*.⁸⁶ Larson, who first was an individual Chapter 11 debtor, but who later had the case converted to one under Chapter 7, filed an adversary proceeding alleging that certain stock options, which were issued to him by his employer shortly before he filed for relief,⁸⁷ were earnings which were excluded from property of the estate under Section 541(a)(6).⁸⁸ The trustee contended that the options, which had increased in value postpetition, were not wages, but were contractual rights Larson had acquired postpetition, pursuant to Section 541(a)(7) of the Code.⁸⁹

The court began its analysis with Section 541(a)(6), characterizing it as the earnings exception to Section 541(a)(1) of the Code.⁹⁰ The court then focused entirely upon whether the stock options were granted to Larson: (1) because of the future services he was to render to the company, and therefore were "earnings" within the meaning of Section 541(a)(6); or (2) were merely awarded to Larson as a perk, and therefore were not earnings.⁹¹ The court found that the options were earnings because "the value of the options [we]re directly tied to Larson's efforts" and the "renumeration Larson receive[d] as a director of [the corporation were] a direct result of his services."⁹² The court, therefore, concluded that the options fell "within the [earnings] exception of section 541(a)(6),"⁹³ and, citing *In re Clark*,⁹⁴ held that the trustee's interest in the stock options was limited to a pro rata share equal to the number of days Larson served as a director prior to filing his petition, while Larson was entitled to the remainder.⁹⁵ The court also rejected the trustee's argument that the options were property of the estate because the exercise of the options would be deemed property acquired by the estate under Section 541(a)(7),⁹⁶ finding that "the legislature has specifically chosen to create an exception to the portion of section 541(a)(6) which excludes from property of the estate earnings from services

86. 147 B.R. 39 (Bankr. D.N.D. 1992).

87. *Id.* at 40.

88. *Id.*

89. *Id.* Section 541(a)(7) provides that property of the estate includes "[a]ny interest in property that the estate acquires after commencement of the case."

90. *Id.* at 41.

91. *Id.* at 41-42.

92. *Id.* at 42.

93. *Id.*

94. *In re Clark*, 891 F.2d 111 (5th Cir. 1989).

95. *Larson*, 147 B.R. at 44.

96. Section 541(a)(7) of the Code provides that property of the estate includes "[a]ny interest in property that the estate acquires after the commencement of the case." See 11 U.S.C. § 541(a)(7) (1994).

performed by a debtor after commencement of the case . . . [and therefore that] the estate's interest in what stock options Larson acquire[d] after the commencement of a case as noted in section 541(a)(7) is subject to the exception found in section 541(a)(6)."⁹⁷

We think everyone was wrong in this case: Larson was wrong in arguing that the stock options were excluded from property of the estate under Section 541(a)(6), the trustee was wrong in arguing that the options were property of the estate under Section 541(a)(7), and the court was wrong in focusing upon Section 541(a)(6) as the operative provision and in citing *Clark* (because *Clark* was wrong in focusing upon Section 541(a)(6) as well). Larson was wrong because, as we have shown,⁹⁸ Section 541(a)(6) is operative only in the narrow situation where the estate is compensating a debtor under Section 503(b)(1) and serves only to except earnings that are also property of the estate from property of the estate, if paid to the debtor as compensation. Larson's options were not awarded to him by the estate under section 503(b)(1) on the basis of his performing services for the estate (and, by implication, for the stock). Larson at all times worked for the company, which was not in bankruptcy. To obtain an interest in the options, Larson would have had to claim that his services performed for a non-debtor had the effect of increasing the value of estate property (i.e., constituted profit on the options), and that he should therefore have been compensated pursuant to Section 503(b)(1). Simply put, Section 541(a)(6) was inapplicable to the discussion as we see it.

The trustee in *Larson* was wrong because, rather than focusing on the estate exercising such options postpetition so as to bring Section 541(a)(7) into play, the trustee should have focused on the fact that as of the petition date, Larson clearly had a legal or equitable interest in the options. As such, the stock options would have been property of the estate under Section 541(a)(1), or at least the right to assume the options would have been property of the estate under Section 541(a)(1), and the trustee could have assumed the options under Section 365(a). Finally, the court was wrong in focusing upon Section 541(a)(6) rather than Section 541(a)(1) as the operative provision, and in citing *Clark*. *Clark*'s contract was clearly *not* assumable by the trustee under Section 365(c)(1)(A),⁹⁹ as the employer could not be compelled to accept performance from anyone other than the debtor. Larson's stock option contract, regardless of the expectation of any party concerning his job performance with the employer, was (according to the facts of the case) exercisable by Larson the day the options were issued, and therefore (since he had not exercised the options as of the petition date) were assumable by the trustee (in fact, couldn't Larson have quit and still retained the options, without doing a lick of work after receiving them?).

97. *Larson*, 147 B.R. at 43.

98. See *supra* text accompanying notes 42-49.

99. See *supra* text accompanying notes 71-75.

In all ways, therefore, the analysis in *Larson* was incorrect, illustrating the confusion that results from setting up Section 541(a)(6), rather than Section 541(a)(1), as the analytical foundation upon which postpetition earnings of the individual debtor may be analyzed. The only way in which Section 541(a)(6) could have become relevant in *Larson* was if the debtor's postpetition efforts had increased the value of the options (thereby to be seen as profits of the options), and therefore benefitted the estate. In such a situation, the estate could have compensated Larson under Section 503(b)(1), out of the profits, upon a request by Larson. If approved, such earnings would have been excluded from property of the estate under Section 541(a)(6). This interpretation accords with both the plain meaning and the legislative history of Section 541(a)(6). Our approach, therefore, would yield a completely different result than that reached by the *Larson* court.

V. CONCLUSION

The authors have neither the time nor the energy to perform here the same analysis on the entire range of case citations, but upon the foregoing visitations with *Clark*, *Turner v. Avery*, and *Larson*, we believe that there is enough inherent substance in the differentiation between their interpretation and the scores of misreadings of Section 541(a)(6) to warrant such. The perspective offered appears to us statutorily correct, and, at least to a certain extent, a possible corrective to erroneous analysis. What we can suggest here is that there can be little downside to knowing what the law is, while there is significant downside to perpetuating statutory misconstruction, as has been and is being done with the earnings exception and Section 541(a)(6). In a second installment, we will shift our focus to utilization of our interpretation of the appropriate interplay among Sections 541(a)(1), 541(a)(6), and 365(c)(1), to analyze critically the bulk of cases cited herein (to better test ourselves) and, also, will move out of the general arenas into the specific haunts of Chapter 11 and Chapter 13-land. Until next time.

