

In the United States Bankruptcy Court

for the Northern District of Iowa

Western Division

BECKETT BELL JR. and
NAYDEEN RAE BELL

Bankruptcy No. 98-01587S

Debtor(s).

Chapter 7

ORDER RE: TRUSTEE'S MOTION FOR TURNOVER

The matter before the court is the Chapter 7 trustee's motion to require the debtor, Naydeen Rae Bell, to turn over a Gateway stock option certificate. Hearing was held May 16, 2000 in Sioux City. Appearing were Wil Forker, trustee, and Richard Kallsen for the debtor. This is a core proceeding under 28 U.S.C. § 157(b)(2)(E).

Findings of Fact

Naydeen Rae Bell filed a Chapter 7 petition on May 27, 1998. She has been employed for several years by Gateway 2000. On September 22, 1997, Gateway granted her an option to buy 235 shares of the company's common stock at \$32.63 per share. Exhibit 1. The option is exercisable "to the extent that it is vested and has not expired." *Id.*, ¶ 2. The option vests in increments of 25 percent of the option shares on each anniversary of the date the option was granted. *Id.*, ¶ 3.1. Vesting will occur only if the optionee continues employment with the company. *Id.*, ¶ 3.2. An employee has 90 days to exercise any vested portion of the option if there has been an "Allowed Termination;" otherwise, the option expires immediately. *Id.*, ¶ 4.2. The option expires by its terms on September 21, 2007. *Id.*, ¶ 4.1.

Bell has worked for Gateway continuously since the date the stock option was granted. On September 21, 1998, the stock option vested for 25 percent of the shares, or 59 shares. On September 21, 1999, the option vested for an additional 59 shares. If Bell continues to be employed by Gateway, the option will vest for the remaining 59 and 58 shares on September 21, 2000 and September 21, 2001, respectively.

A Gateway employee exercises a stock option by delivering the stock option certificate to a designated broker. The broker advances the funds to purchase the stock, which is then sold. The employee receives the difference between the option price and the market price, less the broker's commission and withholding taxes. This procedure enables the employee to exercise the option without any cash outlay.

Discussion

Persons in possession or control of property of the estate that the trustee may use or sell are required to turn the property or its value over to the trustee. 11 U.S.C. § 542(a). The trustee states that he needs to have possession of the original Gateway stock option certificate in order to liquidate the asset for the benefit of the estate. He moves for an order requiring Bell to turn over the certificate.

Bell contends that, because she was not vested in any portion of the stock option on the date of filing, the option had no value. She argues that the present value of the option was created by post-petition earnings, so that the stock option is not property of her estate and not subject to turnover. Bell has not scheduled her interest in the stock option and has not claimed it exempt. The sole issue before the court is the extent to which the asset is property of the bankruptcy estate.

The commencement of a bankruptcy case creates an estate--

comprised of all the following property, wherever located and by whomever held:

(1) ... all legal or equitable interests of the debtor in property as of the commencement of the case.

...

(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.

11 U.S.C. § 541(a)(1), (6).

The scope of 11 U.S.C. § 541(a) is very broad. United States v. Whiting Pools, Inc., 103 S.Ct. 2309, 2313 & nn.8, 9 (1983). The terms "property" and "interest in property" as used in § 541(a) "should be construed extremely broadly, encompassing virtually every right that a debtor has at the time of filing." Allen v. Levey (In re Allen), 226 B.R. 857, 862 (Bankr. N.D. Ill. 1998). The value of the debtor's interest in property is irrelevant to whether the interest becomes property of the estate in the first instance. The trustee may abandon property that is later determined to be burdensome to the estate or of inconsequential value. 11 U.S.C. § 554(a). Nevertheless, all of the debtor's property first comes in to the bankruptcy estate. Then it is the prerogative of the trustee and creditors to decide whether the property has value for the estate. In re Winebrenner, 170 B.R. 878, 883 (Bankr. E.D. Va. 1994); see also Matter of Tobiason, 185 B.R. 59, 63 (Bankr. D. Neb. 1995) (rejecting Chapter 13 debtor's argument that interest in option agreement had no value for the estate because of restraints on alienation).

Bell's interest in the Gateway stock option is a contract right. In re Allen, 226 B.R. at 862; In re Taronji, 174 B.R. 964, 969 (Bankr. N.D. Ill. 1994). On the bankruptcy filing date, her interest was contingent. She would become vested in a portion of the stock option only upon reaching the anniversary of the date she received the grant certificate, a condition that was not certain to occur. See Black's Law Dictionary 816 (7th ed. 1999) (contingent interest is an "interest that the holder may enjoy only upon the occurrence of a condition precedent").

Numerous cases have found contingent property interests to be property of a bankruptcy estate. See, e.g., Rau v. Ryerson (In re Ryerson), 739 F.2d 1423 (9th Cir. 1984) (rights in contract contingent upon termination of employment, which occurred several months postpetition); In re Allen, 226 B.R. at 863-64 (stock option contract conditioned on continuous employment, and discussing cases

involving other contingent interests); In re Taronji, 174 B.R. at 971 (contingency of continued employment did not prevent rights in stock option plan from becoming property of estate). The breadth of § 541(a) indicates an "intention to include all legally recognizable interests although they may be contingent and not subject to possession until some future time." Rau v. Ryerson, 739 F.2d at 1425. Even under the Bankruptcy Act's less expansive view of property of the estate, contingent property could be included in the estate. Id. (contingent interests assignable or subject to execution, seizure or sequestration included in estate under Act); Potter v. Drewes (In re Potter), 228 B.R. 422, 423 (B.A.P. 8th Cir. 1999) ("property" under the Act "has been construed most generously and an interest is not outside its reach because it is novel or contingent or because enjoyment must be postponed") (quoting Segal v. Rochelle, 86 S.Ct. 511 (1966)).

A debtor's rights in a contingent contract existing on the date of bankruptcy filing are property of the estate. When the contingency occurs postpetition, the proceeds of the contract rights become property of the estate as well, pursuant to § 541(a)(6). Rau v. Ryerson, 739 F.2d at 1425-26; In re Allen, 226 B.R. at 867; In re Taronji, 174 B.R. at 970; see also In re Potter, 228 B.R. at 424 (death of life beneficiary brings trust corpus into estate of debtor with contingent remainder on date of filing). Although § 541(a)(6) expands the estate by including proceeds of property of the estate, such proceeds do not include "earnings from services performed by an individual debtor after the commencement of the case." 11 U.S.C. § 541(a)(6).

The "earnings exception" of § 541(a)(6) has been applied to a variety of rights to payment. Postpetition wages and salaries are thus excluded from the estate. In re Powell, 187 B.R. 642, 646 (Bankr. D. Minn. 1995); see also Larson v. Cameron (In re Larson), 147 B.R. 39, 42 (Bankr. D. N.D. 1992) (stock options given expressly in lieu of director's compensation). "Earnings" in forms other than wages and salaries are likewise excepted by § 541(a)(6). In Rau v. Ryerson, the debtor had at filing an interest in an employment agreement. The contract provided that he would receive payments upon termination, based on commission history and years of service. The debtor was terminated nearly nine months later. The Ninth Circuit held that the payment under the agreement was excluded from the estate to the extent of any portion "related to services performed" postpetition. Rau v. Ryerson, 739 F.2d at 1426. In Towers v. Wu (In re Wu), 173 B.R. 411, 414 (B.A.P. 9th Cir. 1994), the issue was whether renewal commissions paid postpetition on insurance policies sold prepetition were property of the estate. The court determined that such income is attributable to "earnings" within the meaning of § 541(a)(6) if the debtor's postpetition services are necessary to obtain the payments. The court remanded for findings on whether Wu's employment agreement required her to remain employed with the firm, to service existing policies, or perform other services in order to receive the commissions. In In re Allen, the debtor had received four stock options that vested one or two years from the date of grant. Because the option contracts were conditioned on continued employment, their subsequently realized value was attributable in part to debtors' postpetition services, and was excluded from the debtor's estate to that extent. In re Allen, 226 B.R. at 867. See also In re Taronji, 174 B.R. at 972 (stock option plan required four years' continuous employment for stock ownership to vest, "in effect a supplemental compensation arrangement"); In re Carlson, 211 B.R. 275, 279-80 (Bankr. N.D. Ill. 1997) (value of attorney-debtor's postpetition services under prepetition contingent fee agreement excluded on quantum meruit basis); cf. Andrews v. Riggs National Bank (In re Andrews), 80 F.3d 906, 909-10 (4th Cir. 1996) ("earnings from services performed" does not include payments for refraining from doing something; debtor's payments under prepetition non-compete agreement were property of the estate).

Section 541 creates a potential conflict when the debtor has a property interest on the date of filing that generates postpetition proceeds attributable to the debtor's earnings. The property interest comes

into the estate under the broad reach of § 541(a)(1), but postpetition earnings must be excluded under § 541(a)(6). Courts in several cases have rejected an "all or nothing" resolution of this conflict; they have instead made a proportional division of the asset into pre- and postpetition components. In In re Wu, the Bankruptcy Appellate Panel for the Ninth Circuit stated that the court must "first determine whether any postpetition services are necessary to obtaining the payments at issue." The debtor's property interest will be excluded from the estate to the extent attributable to postpetition services. In re Wu, 173 B.R. at 414-15 (following Rau v. Ryerson, 739 F.2d 1423 (9th Cir. 1984)). See also In re Allen, 226 B.R. at 867 (realized value of stock options was property of estate only to extent required vesting days had passed prepetition); In re Carlson, 211 B.R. at 279-80 (proceeds of attorney-debtor's contingent fee agreement divisible on quantum meruit basis); In re Taronji, 174 B.R. at 970 (proceeds of stock option contract excluded from estate insofar as they arise from debtor's postpetition services); In re Larson, 147 B.R. at 44 (debtor had received stock options in lieu of compensation; shares came into estate in same proportion as fraction of fiscal year that had passed prepetition).

This court concludes that Bell's interest in the Gateway stock option should be divided proportionally, using a method similar to that used in In re Allen. See 226 B.R. at 867-68. On the date of her bankruptcy filing, Bell's contract rights in the Gateway stock option became property of her estate. Her rights are conditioned on continued employment from the September 22, 1997 grant date to anniversaries of that date. Each day of employment is necessary for vesting. On her bankruptcy petition date, Bell had been employed for 247 days of the first year of the option contract. Her continued employment postpetition was required for any portion of the option to vest. Therefore, the proceeds of her rights in the contract arise both from estate assets and from Bell's postpetition services. The trustee should receive a proportional share of the contract proceeds. In re Taronji, 174 B.R. at 970.

Each 25 percent portion of the option contract requires a different length of employment for vesting. The first portion vested 365 days from the grant date of the contract, and the second in 730 days. The third group will vest in 1,096 days from the grant date, and the fourth in 1,461 days. Bell was employed 247 days from the date of the stock option grant to the date of her bankruptcy filing. The proportion that 247 bears to the number of days required for each group of shares to vest is the proportion of the value, as to each group of shares, of Bell's rights under the stock option contract that is property of the estate. The estate's share of the value of each portion of the stock option is, respectively, 68 percent, 34 percent, 23 percent and 17 percent. The trustee is entitled to turnover of the stock option certificate in order to realize the estate's share.

IT IS ORDERED that the Trustee's motion to turn over is granted.

SO ORDERED THIS 23rd DAY OF JUNE 2000.

William L. Edmonds
U.S. Bankruptcy Judge