

JUL 13 2006

ORDERED PUBLISHED

**HAROLD S. MARENUS, CLERK
U.S. BKCY. APP. PANEL
OF THE NINTH CIRCUIT**

**UNITED STATES BANKRUPTCY APPELLATE PANEL
OF THE NINTH CIRCUIT**

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28

In re:)	BAP No.	AZ-05-1440-MoSA
)		
JOHN M. COSTAS and RACHELLE M. COSTAS,)	Bk. No.	02-19423-RTB
)		
Debtors.)	Adv. No.	04-01228-RTB
)		
<hr/>			
MAUREEN GAUGHAN, Chapter 7 Trustee,)		
)		
Appellant,)		
)		
v.)	O P I N I O N	
)		
THE EDWARD DITTLOF REVOCABLE TRUST; RACHELLE M. COSTAS; UNITED STATES TRUSTEE,)		
)		
Appellees.)		
)		
<hr/>			

Argued and Submitted on June 22, 2006
at Phoenix, Arizona

Filed - July 13, 2006

Appeal from the United States Bankruptcy Court
for the District of Arizona

Hon. Redfield T. Baum, Sr., Chief Bankruptcy Judge, Presiding.

Before: MONTALI, SMITH and AHART,¹ Bankruptcy Judges.

¹Hon. Alan M. Ahart, Bankruptcy Judge for the Central District of California, sitting by designation.

1 MONTALI, Bankruptcy Judge:

2

3 A chapter 7² trustee sought to avoid as a fraudulent
4 conveyance a disclaimer by the debtor of her interests in a trust.
5 The court entered an order granting the debtor's summary judgment
6 motion and denying the relief sought by the trustee. The trustee
7 appealed and we AFFIRM.

8

**I.
FACTS**

9

10 The facts in this case are undisputed. Debtor Rachelle M.
11 Costas ("Debtor") was the beneficiary of a trust created by her
12 father, Edward P. Dittlof ("Decedent"); within thirty days prior
13 to filing bankruptcy, Debtor disclaimed her interests in that
14 trust, the Edward Dittlof Revocable Trust ("Trust"). The Trust
15 included real property located in Milwaukee, Wisconsin (the
16 "Property"). Pursuant to the terms of the Trust, the following
17 distributions would occur upon the Decedent's death:

18 "[The Property] to benefit in equal shares to: my
19 daughter [Debtor], my son Eric Dittlof, and my daughter
20 Renee Dittlof, equally who survive me . . . I leave all
21 the rest and remainder of the trust property to these
22 same 3 beneficiaries: [Debtor], Eric Dittlof, and Renee
23 Dittlof to be divided equally."

24 The Trust provided that any beneficiary could disclaim his or
25 her interest in the Trust. The Trust further provided that in the
26 event a beneficiary died before complete distribution of the

27

28 ²Unless otherwise indicated, all chapter, section and rule
references are to the Bankruptcy Code, 11 U.S.C. §§ 101-1330, and
to the Federal Rules of Bankruptcy Procedure, Rules 1001-9036, as
enacted and promulgated prior to the effective date of The
Bankruptcy Abuse Prevention and Consumer Protection Act of 2005,
Pub. L. 109-8, Apr. 20, 2005, 119 Stat. 23.

1 Trust's assets, the beneficiary's children would receive the
2 beneficiary's share. Arizona law governs issues relating to the
3 Trust.

4 Decedent died on February 25, 2002. On November 7, 2002,
5 Debtor disclaimed her interest in the Trust (the "Disclaimer").
6 Prior to the Disclaimer, the value of Debtor's interest in the
7 Trust was no less than \$34,800.00.

8 On December 3, 2002, Debtor and her spouse filed a voluntary
9 chapter 7 petition. Appellant Maureen Gaughan was appointed as
10 the chapter 7 trustee ("Trustee"). Trustee filed a complaint
11 against Debtor and the Trust to avoid the Disclaimer as a
12 fraudulent transfer. Debtor and the Trust (collectively,
13 "Appellees") filed a motion for summary judgment seeking a
14 determination that the Disclaimer could not be avoided as a
15 fraudulent transfer.

16 Trustee filed a cross-motion for a summary judgment avoiding
17 the Disclaimer for the benefit of the chapter 7 estate. After
18 taking the motions under advisement, the bankruptcy court entered
19 a "minute entry/order" holding that the Disclaimer was not a
20 transfer of property subject to avoidance and distinguishing Drye
21 v. United States, 528 U.S. 49 (1999). On October 24, 2005, the
22 bankruptcy court entered an order granting Appellees' motion for
23 summary judgment and denying Trustee's motion for summary
24 judgment.³ Trustee filed a timely notice of appeal.

25 _____
26 ³The court did not enter a separate summary judgment.
27 Ordinarily there should be a separate document embodying a final
28 judgment that is distinct from and in addition to an order
granting a motion for summary judgment. See Fed. R. Bankr. P.
(continued...)

1 an inheritance is not avoidable as a fraudulent transfer under
2 section 548?⁵

3 Trustee concedes that the Disclaimer was effective under
4 Arizona law. Trustee, however, contends that Drye limits the
5 application of state law under which a disclaimer "relates back"
6 to the date of the death of testator and the property passes as
7 though the debtor/beneficiary had predeceased the testator.
8 Arizona law governing this case contains such a "relation-back"
9 provision: Arizona Revised Statutes section 14-2801(G) provided
10 that a "disclaimer relates back for all purposes to the date of
11 death of the decedent" and "the disclaimed interest devolves as if
12 the disclaimant had predeceased the decedent." Az. Rev. St. § 14-
13 2801 (effective through 2005).⁶

14 Applying similar state law, courts have repeatedly held that
15 the debtor/beneficiary never held a property interest which could

16
17 ⁴(...continued)
18 Robert H. Feldman, Misconceptions About Estate Planning, 36 Ariz.
Att'y 30, 31 (Aug./Sept. 1999).

19 ⁵Section 548 empowers Trustee to "avoid any transfer of an
20 interest of [Debtor] in property" made within one year of the
petition date if the debtor made the transfer with "actual intent
21 to hinder, delay, or defraud" his creditors or, under certain
circumstances, if the debtor "received less than a reasonably
22 equivalent value in exchange for such transfer." Here, the
bankruptcy court concluded that the disclaimer did not operate as
23 a "transfer of an interest of the debtor in property" during the
one-year period prior to filing.

24 ⁶In 2005, Arizona repealed and replaced section 14-2801(G),
25 but it is still governing law in this case because the disclaimer
occurred in 2002 and the chapter 7 petition was filed in 2002.
26 The new Arizona law contains similar provisions: section 14-
10006(A)(1) provides that the disclaimer "takes effect . . . as of
27 the time of the intestate's death" and section 14-10006(A)(3)
provides that unless otherwise provided in the will or operative
28 instrument, "the disclaimed interest passes as if the disclaimant
had died immediately before the time of distribution."

1 be "fraudulently transferred." Wood v. Bright (In re Bright), 241
2 B.R. 664, 672 (9th Cir. BAP 1999) (applying the "relation-back"
3 provisions of Washington law, the panel found that the debtor "had
4 no interest in property to transfer and thus the [d]isclaimer does
5 not satisfy the fraudulent conveyance provisions of § 548"); see
6 also Jones v. Atchison (In re Atchison), 925 F.2d 209, 212 (7th
7 Cir. 1991) (applying the relation-back principles of Illinois law,
8 the Seventh Circuit held "that the disclaimer does not constitute
9 a transfer of an interest in property which the trustee may avoid
10 under [s]ection 548(a) of the Bankruptcy Code"); Simpson v. Penner
11 (In re Simpson), 36 F.3d 450, 453 (5th Cir. 1994) ("under Texas
12 law a disclaimer is not a fraudulent transfer under 11 U.S.C.
13 § 548"). Absent a change in the law, we are bound by our
14 precedent in Bright. Ball v. Payco-General Am. Credits, Inc. (In
15 re Ball), 185 B.R. 595, 597 (9th Cir. BAP 1995).

16 The foregoing case law was decided before the Supreme Court
17 issued its decision in Drye. In Drye, the Supreme Court concluded
18 that a disclaimer of an inheritance cannot remove the disclaimed
19 property from the reach of a federal tax lien. Drye, 528 U.S. at
20 59. In particular, the Court held that 26 U.S.C. §§ 6321 and 6331
21 limit the application of state law in determining what property is
22 subject to federal tax liens, noting specifically that state
23 exemption laws are inapplicable to federal tax liens and
24 collection efforts. Id. at 55-56. "Just as 'exempt status under
25 state law does not bind the federal collector,' so federal tax law
26 'is not struck blind by a disclaimer.'" Id. at 59 (internal
27 citations omitted). The Court enumerated examples of where it had
28 held that the Internal Revenue Service had superior rights to

1 other creditors and noted that the language of the tax code "is
2 broad and reveals on its face that Congress meant to reach every
3 interest in property that a taxpayer might have." Id. at 56
4 (quoting U.S. v. National Bank of Commerce, 472 U.S. 713, 719-20
5 (1985)). The Court stated that while state law may be helpful in
6 initially determining "what rights the taxpayer has in the
7 property the Government seeks to reach," federal law determines
8 "whether the taxpayer's state-delineated rights qualify as
9 'property' or 'rights to property' within the compass of the
10 federal tax lien legislation." Id. at 58. The Supreme Court then
11 held that the taxpayer's right to exercise the disclaimer ("th[e]
12 power to channel the estate's assets") constituted "property" or a
13 "right to property" under 26 U.S.C. § 6331 subject to federal tax
14 liens. Id. at 61.

15 Trustee argues that under Drye, federal bankruptcy law (like
16 federal tax law) should preempt state disclaimer law with respect
17 to the definition of property interests. In other words, Trustee
18 contends that to the extent the disclaimer operates to "channel
19 property" within an decedent's estate, the right to exercise that
20 disclaimer is itself a "property interest" and the actual exercise
21 of that disclaimer thus constitutes the transfer of property of
22 the estate. One bankruptcy court agrees with Trustee's analysis,
23 while two others have held that Drye is inapplicable in section
24 548 cases. We believe the latter cases are more persuasive
25 primarily because, as noted by the Supreme Court, "Congress has
26 generally left the determination of property rights in the assets
27 of a bankrupt's estate to state law." Butner v. U.S., 440 U.S.
28 48, 54 (1979).

1 Trustee relies primarily on In re Kloubec, 247 B.R. 246
2 (Bankr. N.D. Iowa 2000), aff'd on other grounds, 268 B.R. 173
3 (N.D. Iowa 2001), in arguing that Drye overrules this panel's
4 decision in Bright that under state law "relation-back" statutes,
5 a disclaimer does not operate as a fraudulent transfer of a
6 debtor's property. In Kloubec, a debtor disclaimed his
7 inheritance the day prior to filing his chapter 12 petition; the
8 trustee sought to invalidate the disclaimer as a fraudulent
9 transfer under section 548. The bankruptcy court concluded that
10 "even though Drye was a tax lien case, the issue decided was
11 identical to the issue presented here, that is, whether the state
12 doctrine of relationship-back can modify rights created under
13 Federal statutes. The U.S. Supreme Court held unambiguously that
14 this artificially-created state doctrine cannot modify a
15 substantive Federal statute." Kloubec, 247 B.R. at 256.⁷
16 Concluding that state law relation-back statutes are inapplicable
17 in defining property rights for the purposes of section 548, the
18 Kloubec court held that exercise of the disclaimer "channeled
19 property" away from the bankruptcy estate and was thus a

21 ⁷Six years before Drye was decided, the bankruptcy court that
22 decided Kloubec issued a decision under section 727(a)(2)(A)
23 holding that state relation-back law should not be considered in
24 determining whether a transfer of property occurred: "It is the
25 finding of this Court that the doctrine of relation-back, for
26 Bankruptcy law purposes, should be construed as a transfer under
27 § 101(58). . . . [A] Federal Court is not bound to give effect to
28 the doctrine of relation-back in the same manner as it is to the
definition of 'property', particularly when the admitted effect of
thwarting creditors is completely contrary to the spirit and
philosophy of the Bankruptcy Code." Agristor Leasing v. Dinsdale
(In re Dinsdale), 1993 WL 1112064 (Bankr. N.D. Iowa 1993), aff'd,
1995 WL 1312673 (N.D. Iowa 1995). The Dinsdale holding is
inconsistent with this panel's decision in Bright, which would
govern but for the question raised about Drye's applicability.

1 fraudulent transfer. Id. Finding that the Kloubec debtors had
2 acted fraudulently, the bankruptcy converted their case to chapter
3 7.⁸

4 Trustee urges us to apply the reasoning of Kloubec here. We
5 decline because we agree with the reasoning of two other post-Drye
6 bankruptcy decisions. In Michael A. Grassmueck, Inc. v. Nistler
7 (In re Nistler), 259 B.R. 723 (Bankr. D. Or. 2001) and Garrett v.
8 Bank of Oklahoma (In re Faulk), 281 B.R. 15 (Bankr. W.D. Okla
9 2002), the bankruptcy courts concluded that Drye does not apply to
10 bankruptcy cases arising under section 548 and that the pre-Drye
11 law of Bright and Atchison was still effective law.

12 In Nistler, the debtor disclaimed his inheritance
13 prepetition. The trustee in his chapter 7 estate, citing Drye and
14 Kloubec, sought to avoid the disclaimer as a fraudulent transfer
15 under section 548. Nistler, 259 B.R. at 726. The court expressly
16 disagreed with the Kloubec decision to apply Drye in defining
17 property interests for the purposes of section 548, stating:

18 In Drye, the Supreme Court specifically relied on the
19 language of § 6321 of the Internal Revenue Code. All of
20 the cases cited by the Drye Court involved tax liens.
21 There are many instances where the IRS has superior
22 rights over other creditors, for example, state
23 exemption statutes are not enforceable against the IRS.
(Citation omitted). In addition, the result in Kloubec
would have been the same without looking to Drye because
the rule in Iowa since 1993 has been that a "disclaimer
of an inheritance can form the basis of a fraudulent
transfer." [Kloubec, 247 B.R.] at 253.

24 In Bright, however, the Ninth Circuit BAP looked to

25 ⁸While the district court ultimately affirmed the bankruptcy
26 court's decision to convert the Kloubec case, it specifically
27 refused to address the issue of whether Drye applied in the
"federal bankruptcy fraud context," stating that it "need not make
28 that determination in this litigation." Kloubec, 268 B.R. at 177.
Instead, the district court held that, under state law, the debtor
had waived his right to disclaim his inheritance. Id.

1 state law and specifically determined that because the
2 debtor's disclaimer related back, such that the debtor
3 was treated as never having possessed any interest in
4 the inheritance, the disclaimer could not be a transfer
of an interest of the debtor in property. In re Bright,
241 B.R. at 672.

5 Nistler, 259 B.R. at 726-27.

6 The Nistler court is correct in observing that the Drye
7 decision rests on tax statutes and law which ignore state law
8 exemptions, while the Bankruptcy Code in general observes and
9 respects state law exemptions. In essence, the Drye decision is
10 based largely on Congressional mandates that the federal
11 government be able to exercise its extensive abilities to impose
12 liens in order to collect delinquent taxes; the Supreme Court set
13 forth a litany of examples of where the IRS primes other
14 creditors. In contrast, the Supreme Court and Congress have
15 traditionally referred to state law in determining what is
16 property of the estate for the purposes of the Bankruptcy Code.
17 Butner, 440 U.S. at 54. "In the absence of any controlling
18 federal law, 'property' and 'interests in property' are creatures
19 of state law." Barnhill v. Johnson, 503 U.S. 393, 398 (1992).
20 Unlike federal tax law governing tax liens, section 548 contains
21 no provision that trumps state law definitions of "property."
22 Absent a Congressional mandate like that in the Internal Revenue
23 Code, bankruptcy courts should not preempt areas of traditional
24 state law in defining property interests.

25 The court in Faulk similarly distinguished Drye, noting that
26 "the fact that Drye was a tax case cannot be minimized. The
27 [C]ourt's decision was based on its construction of the specific
28 language of Section 6321 of the Internal Revenue Code. In support

1 of its ruling, it cited only cases involving tax liens." Faulk,
2 281 B.R. at 20. The Faulk court further distinguished Drye
3 factually:

4 [I]n Drye, the tax lien had been filed and had already
5 attached to the subject property before the disclaimer
6 disclaimer, where the subject property had become
7 property of the estate before the filing of the
8 disclaimer, and not a prepetition disclaimer, as is
9 before the court. Generally, postpetition disclaimers
10 have not been upheld in bankruptcy. In re Betz, 84 B.R.
11 470 (Bankr. N.D. Ohio 1987). See S. Alan Medlin, An
12 Examination of Disclaimers under UPS 2-801, 55 Alb. L.
13 Rev. 1233, 1265-1266 (1992). Prepetition disclaimers,
14 on the other hand, have been held by most courts as
15 being effective and are not generally construed as
16 transfers for fraudulent transfer purposes, as the cases
17 cited herein indicate.

18 Faulk, 281 B.R. at 20.

19 The Faulk court correctly analogized the disclaimer in Drye
20 to a postpetition disclaimer. Yet, the distinction between Drye
21 and the situation presented here and in Faulk is even more
22 fundamental. The focus should be on the rights of the parties
23 between themselves. In Drye, the Internal Revenue Service
24 assessed its lien before the disclaimer occurred. In essence, the
25 Supreme Court held that the lien could not be defeated by a
26 subsequent disclaimer. Here (as in Faulk and Nistler), no other
27 parties' rights had affixed in Debtor's interests before she
28 disclaimed them.

29 We find that the courts in Nistler and Faulk correctly
30 rejected efforts to apply Drye in the context of a section 548
31 fraudulent transfer action. We therefore conclude that the well-
32 reasoned decision in Bright is still binding on us. Consequently,
33 we hold that, under Bright and Arizona law, Debtor's Disclaimer
34 was not a fraudulent transfer of property. The bankruptcy court

1 did not err in entering summary judgment in favor of Appellees.

2 **V.**
3 **CONCLUSION**

4 For the foregoing reasons, we AFFIRM.
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28